



## Legislative Update

### September 2008

#### Federal

##### **Rulemaking by Federal Agencies**

When advocating specific details of legislation, industry lobbyists (including those in financial services) often urge lawmakers to provide as much detail and guidance as possible in the statutory language so that, if rulemaking by regulatory agencies is necessary at all, it will be highly restricted and guided by the plain language of the law. Recent rulemaking activity provides excellent examples of why this strategy is important. Unfortunately, it also provides examples of how clarity in the statute itself, even when apparently achieved, may nevertheless be diminished by ill-considered or over-reaching regulation. Finally, certain recent rulemaking illustrates the difficulty of improving the operation of poorly or complexly worded laws through implementing regulations.

Rulemaking activities by the Federal Trade Commission ("FTC") and the banking agencies ("the Agencies") are generating considerable activity and attention within financial institutions, including consumer reporting agencies ("CRAs"). Two areas of focus originate from the 2003 Fair and Accurate Credit Transactions Act ("FACT Act"); the address discrepancy processes and the risk-based pricing notice processes. These derive from the rulemaking authority provided, respectively, in Sections 315 and 311 of the FACT Act. A third proposed rulemaking, by the Board of Governors of the Federal Reserve ("the Board"), the Office of Thrift Supervision in the Department of the Treasury ("the OTS") and the National Credit Union Administration ("NCUA") promulgates new restrictions on credit card billing practices. This rulemaking derives from the authority of the Board, the OTS and the NCUA under the Federal Trade Commission Act to prohibit unfair or deceptive acts or practices ("UDAP").

Here is a brief summary of each of these rulemaking activities:

- **The Address Discrepancy Rule.** Section 315 of the 2003 FACT Act, entitled "Reconciling Addresses" requires nationwide CRAs to notify the requestor of a consumer report when the consumer's address provided by the requestor in the inquiry "substantially differs" from addresses held by the CRA in that consumer's file. Section 315 gives joint rulemaking authority to the Agencies, the NCUA and the FTC to prescribe regulations which provide guidance on reasonable policies and procedures for report recipients to follow when they receive an address discrepancy notice. Users must: 1) form a reasonable belief that they know the identity of the person to whom the consumer

report pertains, and 2) reconcile the address of the consumer with the CRA by reporting it to that CRA, if they open an account with that individual and if they furnish information to that CRA in the ordinary course of business. On November 9, 2007 the Agencies, NCUA and FTC jointly promulgated a Final Rule on this subject, effective January 1, 2008 with a mandatory compliance date of November 1, 2008.

- **The Problem:** Until recently, most practitioners in the financial services and credit reporting industries figured that the requirements of this rule were understood. The common understanding, based on the language of the statute and Final Rule, was that, if a user of a consumer report, in opening a new account for credit, received an address discrepancy flag from that credit bureau, and if the user regularly furnished account information to that credit bureau, that user must reconcile that address with the bureau (from which they received the flag) if they confirmed that new address with the consumer and if they established a continuing account relationship with that consumer. Well-established, long-standing processes are in place to meet this requirement. However, in recent weeks, federal regulators have expanded the scope of this rule to apply to *all new account information*, regardless of whether or not such information is regularly, in the ordinary course of business, provided to the bureau from which the discrepancy flag was received. This broader interpretation holds that, if the user receiving the flag provides *any account information* to that bureau, it must reconcile the address accordingly, even if it does not regularly report information to that bureau on that particular type of account. Therefore, under this recent interpretation, if a lender obtains a credit report in connection with opening a deposit account, and the report contains an address discrepancy flag, both the lender and the credit bureau may be subject to the address reconciliation requirements even though the lender does not regularly provide information on deposit accounts. Discussions are in process. Mandatory compliance date is November 1, 2008. This unexpected development has the potential to drive several, unforeseen developments in U.S. credit reporting practices. Stay tuned!
- **Risk-Based Pricing Notice (“RBPN”)**. The address discrepancy rulemaking, described above, illustrates issues that can arise in rulemaking, despite apparent clarity in the statute and in the common usage, history and expectations of all principals in the lending industry. In contrast, the Notice of Proposed Rulemaking (“NPR”) published jointly by the Board and the FTC on May 19, 2008 to implement the RBPN provisions of Section 311 of the FACT Act, illustrates a strong, commendable effort by the regulators to wring a relatively reasonable, workable rule from a very difficult, complex statutory provision. The 90-day comment period on the NPR closed on August 18. At present, given the conflicting views and complexity of the issues, promulgation of a Final Rule could extend into 2009. The *June 2008 Legislative Update* presented a detailed synopsis of the NPR. Here, we simply summarize what we see as some of the chief concerns with the NPR:
  - The NPR offers no provision for a generic, application-based RBPN, which appears to be an alternative required by the statute.
  - The NPR interprets the statute as creating a new right to a free disclosure of the individual’s credit report, for anyone receiving an RBPN—a new right that was clearly not contemplated by Congress.
  - The NPR sets the RBPN threshold at an unrealistically high point—roughly 60% of all successful applicants. To give effect to the intent of Congress, many are

arguing that the notice should only go to the 20% to 30% of successful applicants receiving the least favorable terms.

- **Proposed UDAP Rule for Credit Cards and Deposit Accounts Overdraft Services.** As reported in the *June 2008 Legislative Update*, the NPR published on May 19 by the Board, the OTS and the NCUA offers another unique illustration of the legislative-regulatory tension always present in the rulemaking process. In the case of these UDAP rules, the agencies are acting *in advance* of Congress, without any legislative basis other than a bill<sup>1</sup> containing essentially the same provisions found in the proposed UDAP rule, and also their authority to do so as provided in the FTC Act. One view is that the regulators are using their broad powers to head off legislative action by Congress—which could effectively diminish those powers in the future. Specific provisions were highlighted in the *June 2008 Legislative Update*.

Recently, it has become clear that some resistance is developing—with opponents citing arguments that the proposed rule will have the unintended consequences of raising credit costs and reducing credit availability. One argument in particular is that so-called sub-prime credit cards can facilitate a consumer's return to the credit mainstream. TransUnion contributed data to one coalition which showed movement by many consumers out of subprime accounts into near-prime or prime accounts.<sup>2</sup> Some consumer groups counter these arguments with assertions that the targeted practices should be entirely banned, regardless of the existence of some benefit to certain consumers. Earlier in August, resistance to another aspect of the NPR—the account repricing provision (when an adverse development occurs with the consumer—a trigger event)<sup>3</sup>—arose from another quarter: Mr. John Dugan, the Comptroller of the Currency. In an August 18 letter to Fed Chairman Ben Bernanke, Mr. Dugan expressed concern over the unintended consequences of this Rule, particularly in raising costs and reducing availability of credit card services to precisely the group of consumers the NPR was intended to protect. TransUnion's trade association, the Consumer Data Industry Association, made precisely the same point in its public comment filed on July 24. There is currently no firm expectation as to when a Final Rule may be issued. However, the next Congress may consider even more restrictive measures when it convenes in 2009.

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<sup>1</sup> HR 5244, The Credit Cardholders' Bill of Rights, reported out of the Financial Services Committee on a partisan vote of 39-27 on July 31, 2008

<sup>2</sup> A coalition formed to resist the provision of the NPR concerning "subprime" credit card billing practices, Citizens for Equal Access to Credit, issued a press release on August 27 which stated, in part, "Today, Citizens for Equal Access to Credit, a diverse, multicultural nonprofit coalition, released a study that surveyed the usage of low limit cards in the United States. To illustrate the ability of consumers to re-establish their credit, TransUnion, on behalf of Citizens for Equal Access to Credit conducted an analysis of the "graduation rates" of cardholders over a 24 month period. The accuracy and methodology of the study was confirmed by the Political and Economic Research Council an independent nonprofit public policy research organization."

<sup>3</sup> This provision would restrict the ability of credit card issuers to increase interest rates on existing balances in many circumstances, denying them, for example, the ability to peg the interest rate charged on current balances to the risk currently presented by that particular account holder.

## **Credit Scoring**

Driven by the continuing “credit crunch”, and by media coverage of anecdotal stories such as a recent one in *The New York Times* concerning the treatment of student-loan inquiries by scoring models, congressional attention on credit scoring continues. On July 29, House Financial Services Oversight and Investigations Subcommittee Chairman Melvin A. Watt held a hearing entitled “What Borrowers Need to Know about Credit Scoring Models and Credit Scores.” TransUnion Group Vice President Chet Wiermanski was on the first panel of witnesses offering testimony, along with executives from Fair Isaac, Experian and Equifax. The testimony and a link to the archived webcast can be downloaded from [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/hr072908.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr072908.shtml). The hearing was also nationally broadcast on C-SPAN. A link to that archive is at [http://www.cspanarchives.org/library/index.php?main\\_page=product\\_video\\_info&products\\_id=280095-1](http://www.cspanarchives.org/library/index.php?main_page=product_video_info&products_id=280095-1).

The principle points Chet made in his 5-minute oral statement were:

- TransUnion provides our financial services customers with scoring models that help them expand the breadth of their services. We provide consumers with educational information about scores. And, for many years, we have advocated the full file reporting by utilities and telecommunications companies, believing that this practice benefits, in particular, consumers with thin files.
- Credit scoring has produced significant consumer benefits, allowing the appropriate allocation of risk at multiple levels.
- There is no such thing as a single credit score. Our generic score products, used in production by lenders and made available to consumer, can be very useful to a consumer in understanding how lenders evaluate creditworthiness.
- There are hundreds of scoring models but just three nationwide consumer reporting agencies. The single most important action a consumer can take is to exercise his or her right to a free annual disclosure by contacting us at [www.annualcreditreport.com](http://www.annualcreditreport.com)

Further activity on credit scoring is expected in the next Congress. Subcommittee Chairman Watt posed several follow-up questions to TransUnion in an August 18 letter, which we are reviewing. It is clear from the questions that consumer advocates are preparing arguments for the next Congress which support a requirement that the national credit bureaus and Fair Isaac each provide consumers with one free credit score disclosure annually. At present, however, the issue appears to be at rest for the remainder of 2008, at least with respect to further action in congressional committees.

## States

### **California Data Security / Breach Liability Bill Goes to Governor**

The issue of retailer reimbursement for data breaches continues to be a primary issue in the California legislature and is being pushed by credit union alliances. Despite a veto by Governor Schwarzenegger last year of a bill on the same subject, last week the Assembly sent back to the Governor AB 1656, which would actually have the unintended consequence of freezing evolving data security measures, while imposing onerous and unneeded data management mandates on every entity that accepts payment cards (credit and debit cards). The bill would also create new financial liabilities for small and large businesses, not-for-profit entities and government agencies. In fact, the liability created by this bill may jeopardize data security by undermining the spirit of cooperation that currently exists between members of payment networks who work together to identify data breaches immediately and prevent payment card fraud. The bill last week moved to the Governor for his signature, but it is our hope that he will veto it much like he did with AB 779 last year.

### **California Employment Screening Bill Passes on to Governor**

Another bill that would have an adverse affect on TransUnion business in California is AB 2918, which last week was sent to Governor Arnold Schwarzenegger for his signature. Existing federal and state law specify the procedures that a potential user of a consumer credit report in the employment context is required to follow before requesting a report and if adverse action is taken based on the report. This bill would prohibit the user of a consumer credit report, with the exception of certain financial institutions, from obtaining a consumer credit report for employment purposes unless the information is (1) substantially job related, meaning that the information in the consumer credit report relates to the position for which the person who is the subject of the report is being evaluated because the position is a highly compensated or managerial one, the position is a city, county, or both city and county position in which the employee holding the position has access to money, other assets, or confidential information, or the report is procured as part of a background check for a sworn peace officer or other law enforcement position in which there is access to cash, assets, or confidential financial information, or (2) required by law to be disclosed to or obtained by the user of the report. The bill also would extend the exemption from liability for the maintenance of reasonable procedures to ensure compliance with the provisions specified in state law to encompass the new prohibition. As it exists now, the bill looks as if it would end the automated delivery of reports for employment purposes. A broad coalition continues to oppose the bill, and we are diligently working to receive a veto from the Governor.

### **Michigan Court Rules against Insurer's Use of Credit**

After numerous years of debate and litigation surrounding the use of credit by insurers in Michigan, it is clear that the politics around the use of insurance scoring are nearly as big as the substantive debate. In a severely divided opinion issued August 21, the Michigan Court of Appeals ruled against the insurance industry and reversed a lower Circuit Court's April 2005 decision in the case of IIM et al v Commissioner, Office of Financial & Insurance Regulation. The lower court's decision had invalidated Michigan Office of Financial and Insurance Regulation's (OFIR) 2005 administrative rule banning the insurance industry's use of credit history in pricing personal lines policies. As background, in April 2004, Michigan Governor Jennifer Granholm and Insurance Commissioner Linda Watters affirmatively pronounced that the state would ban the use of insurance scoring in personal lines insurance as a rating factor

and in underwriting, which was quickly challenged by insurance industry. The Trial Court ruled that the rule as proposed by the Office of Financial and Insurance Services (OFIS) was illegal, invalid and unenforceable because the Office was attempting to rewrite the Insurance Code through administrative rulemaking. The Appellate Court (three judges) decided as follows:

- Judge One: decided to overturn the lower court, dealing with its merits.
- Judge Two: decided to overturn the lower court decision, but based the decision on the idea that a challenge in the court was premature – industry had to use insurance administrative review process and only file the suit after that was exhausted.
- Judge Three: decided to uphold the lower court decision.

Since two of the three judges agreed to overturn the lower court decision, even though there was no agreement on the decision, the lower court's ruling stands and effectively the law goes into effect. However, the insurance industry plans another appeal in the case and there is an automatic stay on the effect of the Court of Appeals decision during the time before the appeal is filed. Once the industry files suit, the stay remains pending the outcome of the appeal.

But the story does not of course end there. Michigan Republicans over the last few years have attempted to prevent OFIR from using public funds to appeal the litigation. This year, language was added to the budget bill that passed and landed on the Governor's desk that read as follows:

“The department shall not expend funds from the appropriations in part 1 for the office of financial and insurance regulation for the purpose of implementing prohibitions on the use of credit scoring in establishing insurance premiums by insurance companies until the legislature has, by statute, authorized such a prohibition.”

Granholtm recently used her powers to issue a line item veto of the above provision. In her veto letter, the governor said both sections are unenforceable as they amend "by implication" powers and duties vested in the OFIR commissioner, as well as the provisions of the Michigan Occupational Safety and Health Act.

### **New Jersey Wireless Bills**

Two wireless telephone privacy bills are currently pending in the Garden State, which presently is in recess but will take the matters up again in late September when the legislature is back in session. The senate bill is sponsored by Senator Nia H. Gill and has been referred to the Economic Growth Committee. The assembly bill was sponsored by former Assemblyman (and deputy speaker) Neil M. Cohen who recently resigned after officials confirmed he was under investigation for possessing child pornography. In the 2007-2008 session it had three times as many sponsors, but the issue does not now seem to be as contentious. The bill was amended and passed by the Assembly Telecommunications and Utilities Committee in March but has not since moved.

Under the amended bills a provider of cellular telephone service would not be able to disclose, sell or transfer individual proprietary information concerning a cellular telephone service customer in New Jersey including, but not limited to, a customer's name, home address, e-mail address or cellular telephone number, to a third party without the express

written consent of the customer. The scope of the bill is broader than the harm the bill seeks to prevent. There is a perceived fear that wireless telephone subscriber directories intrude on consumer's privacy will be costly to consumers by encouraging spammers via text messages and unsolicited calls. Joining us in opposing the bills include the New Jersey Retail Merchant's Association, National Federation of Independent Business, and major creditors and telecoms. Unless the bill can be killed, we will be seeking exemptions for the release of phone numbers for FCRA and GLBA purposes, and for fraud prevention.

### **New York ID Theft / Security Freeze Bills Enacted**

Despite our recent steps to bring the freeze online, in New York, legislators are continuing with the fine tuning of state security freeze and identity theft provisions. New York Governor David Paterson recently signed into law SB 8376, which among other things, gives authority to the state Consumer Protection Board to (1) promulgate rules "to administer the identity theft prevention and mitigation program"; and (2) act as a liaison between victims and state offices "to facilitate the victim obtaining such assistance and data as will enable the program carry out its duties to help consumers resolve the problems that have resulted from [ID] theft." The law now requires that CRAs must have a website and a dedicated toll-free number to offer information, to process requests and deliver services, requires that freezes are to be placed within one business day and confirmation must be sent within five business days of placement, and prevents the PIN from (1) being the SSN or any sequential part thereof, and (2) being used for anything else. The law adds a 15-minute lift provision and compresses from five business days to three business days the time in which a CRA must send the notice of erroneous release.

Paterson also signed into law S 5543, which provides consumers who are victims of domestic violence with a free security freeze report upon request. It establishes that no CRA shall advise a third party of the fact that a consumer requesting a security freeze is alleging to be the victim of domestic violence or identity theft without the written authorization of the consumer, and requires the abuser to reimburse CRAs for the cost of the freeze, if the victim would not have already been eligible for a free freeze.

### **AZ ID Theft Ballot Measure**

A ballot measure has been qualified in Arizona that addresses identity theft in the context of immigration. If approved, the proposition would have no direct negative impact. However, it is a reminder that twenty-four states, particularly in the west, have initiative procedures that could be harmful for TransUnion. In recent memory, for example, we saw an insurance scoring initiative defeated in Oregon and a serious privacy initiative threat in California that ultimately died out.

The Arizona measure of reference, Proposition 202, is known as the Arizona Stop Illegal Hiring Act. The measure is sponsored by former Assistant U.S. Attorney Andrew Pacheco, now in private legal practice after losing in his quest to become Maricopa County Attorney. Among other things, Proposition 202 would increase penalties on cash-based businesses that bypass current laws as well as employees who engage in identity theft to verify employment eligibility.

## Missouri Public Data Litigation

Also in the column of potential threats in the states, this year Missouri Attorney General Jay Nixon brought actions against two companies, which highlights what can happen when public officials use media stories or business practices to cast a wide net in regulating the use of public records and other information for background checks and other purposes.

Nixon brought suit against a Texas company, the Source for Public Data d/b/a [www.publicdata.com](http://www.publicdata.com) because it “recklessly provides any user with a credit card with complete access to such personal information as Social Security numbers, addresses, birthdays and physical descriptions of consumers”. This information, Nixon noted, is a “gold mine for identity thieves.” The complaint announcing the litigation notes an identity thief in Florida obtained information on Missouri residents from the defendant’s website. Also, Nixon brought suit against another Texas company, A1Peoplesearch, LLC d/b/a [www.a1peoplesearch.com](http://www.a1peoplesearch.com), with a similar complaint against which the Source for Public Data has been enjoined. These actions re-emphasize the need for TransUnion to know its customer, to have a robust credentialing and membership programs and to enforce in an impartial manner policies created for those who have access to consumer data.

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