Equal Credit Opportunity (Regulation B)

Background

The Equal Credit Opportunity Act (ECOA) of 1974, which is implemented by the Board's Regulation B, applies to all creditors. The statute requires financial institutions and other firms engaged in the extension of credit to "make credit equally available to all creditworthy customers without regard to sex or marital status." Moreover, the statute makes it unlawful for "any creditor to discriminate against any applicant with respect to any aspect of a credit transaction (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract); (2) because all or part of the applicant's income derives from any public assistance program; or (3) because the applicant has in good faith exercised any right under the Consumer Credit Protection Act." In keeping with the broad reach of the prohibition, the regulation covers creditor activities before, during, and after the extension of credit.

Under the ECOA, the Federal Reserve Board is responsible for drafting and interpreting the implementing regulation. Enforcement responsibility, however, rests with a creditor's functional regulator or, for any category not so assigned, with the Federal Trade Commission. A synopsis of some of the more important points of Regulation B follows.

Prohibited Practices

Regulation B contains two basic and comprehensive prohibitions against discriminatory lending practices (section 202.4):

- A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction.
- A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage, on a prohibited basis, a reasonable person from making or pursuing an application.

Note that the regulation is concerned not only with the treatment of persons who have initiated the application process, but also with lender behavior before the application is even taken. Lending officers and employees must be careful to take no action that would, on a prohibited basis, discourage anyone from applying for a loan. For example, a bank may not advertise its credit services and practices in ways that would tend to encourage some types of borrowers and discourage others on a prohibited basis. In addition, a bank may not use prescreening tactics likely to discourage potential applicants on a prohibited basis. Instructions to loan officers or brokers to use scripts, rate quotes, or other means to discourage minority applicants from applying for credit are also prohibited.

The prohibition against discouraging applicants applies to in-person oral and telephone inquiries as well as to written applications. Lending officers must refrain from requesting prohibited information in conversations with applicants during the pre-interview phase (that is, before the application is taken) as well as when taking the written application.

To prevent discrimination in the credit-granting process, the regulation imposes a delicate balance between the creditor's need to know as much as possible about a prospective borrower and the borrower's right not to disclose information irrelevant to the credit transaction. To this end, the regulation prescribes rules for taking, evaluating, and acting on applications as well as rules for furnishing and maintaining credit information.

Rules for Taking Applications—Section 202.5

Regulation B prohibits creditors from requesting and collecting specific personal information about an applicant that has no bearing on the applicant's ability or willingness to repay the credit requested and could be used to discriminate against the applicant.

Applicant Characteristics

Creditors may not request or collect information about an applicant's race, color, religion, national origin, or sex. Exceptions to this rule generally involve situations in which the information is necessary to test for compliance with fair lending rules or is required by a state or federal regulatory agency or other government entity for a particular purpose, such as to determine eligibility for a particular program. For example, a creditor may request prohibited information

- In connection with a self-test being conducted by the creditor (provided that the self-test meets certain requirements)
- For monitoring purposes in relation to credit secured by real estate
- To determine an applicant's eligibility for special-purpose credit programs

Information about a Spouse or Former Spouse (§ 202.5(c))

A bank may not request information about an applicant's spouse or former spouse except under the following circumstances:

- The non-applicant spouse will be a user of or joint obligor on the account. (Note: The term ''user'' applies only to open-end accounts.)
- The non-applicant spouse will be contractually liable on the account.
- The applicant is relying on the spouse's income, at least in part, as a source of repayment.
- The applicant resides in a community property state, or the property upon which the applicant is relying as a basis for repayment of the credit requested is located in such a state.
- The applicant is relying on alimony, child support, or separate maintenance income as a basis for obtaining the credit.

Marital status (§§ 202.5(d)(1) and 202.5(d)(3))

Individual Credit

When an applicant applies for individual credit, the bank may not ask the applicant's marital status. There are two exceptions to this rule:

- If the credit transaction is to be secured, the bank may ask the applicant's marital status. (This information may be necessary to determine what would be required to gain access to the collateral in the event of default.)
- If the applicant either resides in a community property state or lists assets to support the debt that are located in such a state, the bank may ask the applicant's marital status. (In community property states, assets owned by a married individual may also be owned by the spouse, thus complicating the accessibility of the collateral in the event of default.)

Joint Credit

When a request for credit is joint (made by two or more individuals who will be primarily liable), the bank may ask the applicant's marital status, regardless of whether the credit is to be secured or unsecured, but may use only the terms ''married,'' ''unmarried,'' and ''separated.'' This requirement applies to oral as well as written requests for marital status information. ''Unmarried'' may be defined to include divorced, widowed, or never married, but the application must not be structured in such a way as to encourage the applicant to distinguish among these.

Alimony, Child Support, or Separate Maintenance Income (§ 202.5(d)(2))

A bank may ask if an applicant is receiving alimony, child support, or separate maintenance payments. However, the bank must first disclose to the applicant that such income need not be revealed unless the applicant wishes to rely on that income in the determination of creditworthiness. An appropriate notice to that effect must be given whenever the bank makes a general request concerning income and the source of that income. Therefore, a bank either must ask questions designed to solicit only information about specific income (for example, ''salary,'' ''wages,'' ''employment,'' or other specified categories of income) or must state that disclosure of alimony, child support, or separate maintenance payments is not required.

Residency and Immigration Status (§ 202.5(e))

The bank may inquire about the applicant's permanent residence and immigration status in order to determine creditworthiness.

Rules for Evaluating Applications—Section 202.6

General Rule

A creditor may consider any information in evaluating applicants, so long as the use of the information does not have the *intent* or the *effect* of discriminating against an applicant on a prohibited basis. Generally, a creditor may not

- Consider any of the prohibited bases, including age (providing the applicant is old enough, under state law, to enter into a binding contract) and the receipt of public assistance
- Use childbearing or childrearing information, assumptions, or statistics to determine whether an applicant's income may be interrupted or decreased
- Consider whether there is a telephone listing in the applicant's name (but the creditor may consider whether there is a telephone in the applicant's home)
- Discount or exclude part-time income from an applicant or the spouse of an applicant

Systems for Analyzing Credit

Regulation B neither requires nor endorses any particular method of credit analysis. Creditors may use traditional methods, such as judgmental systems that rely on a credit officer's subjective evaluation of an applicant's creditworthiness, or they may use more-objective, statistically developed techniques such as credit scoring.

Credit Scoring Systems

Section 202.2(p) of Regulation B prescribes the standards that a credit scoring system must meet to qualify as an "empirically derived, demonstrably and statistically sound, credit system." All forms of credit analysis that do not meet the standards are automatically classified as "judgmental" systems. This distinction is important because creditors that use a "demonstrably and statistically sound" system may take applicant age directly into account as a predictive variable, whereas judgmental systems may not.

Judgmental Evaluation Systems

Any system other than one that is empirically derived and demonstrably and statistically sound is a judgmental system (including any credit scoring system that does not meet the prescribed technical standards). Such a system may not take applicant age directly into account in evaluating creditworthiness. The act and the regulation do, however, permit a creditor to consider the applicant's age for the purpose of evaluating other applicant information that has a demonstrable relationship to creditworthiness.

Rules for Extensions of Credit—Section 202.7

Section 202.7 of Regulation B provides a set of rules proscribing certain discriminatory practices regarding the creation and continuation of credit accounts.

Signature Requirements

The primary purpose of the signature requirements is to permit creditworthy individuals (particularly women) to obtain credit on their own. Two general rules apply:

- A bank may not require a signature other than the applicant's or joint applicant's if under the bank's standards of creditworthiness the applicant qualifies for the amount and terms of the credit requested.
- A bank has more latitude in seeking signatures on instruments necessary to reach property used as security, or in support of the customer's creditworthiness, than it has in obtaining the signatures of persons other than the applicant on documents that establish the contractual obligation to repay.

The subsections dealing with signatures have been, for many creditors, some of the most commonly misunderstood provisions of Regulation B. For that reason, and to increase examiners' ability to facilitate lender compliance and determine whether a particular signature practice is or is not a violation of the regulation, additional guidance is provided in CA Letter 02-1, Clarifying Signature Provisions under Sec. 202.7(d) of Regulation B. Examiners should consult that CA letter when assessing the level of a bank's compliance with the signature requirements.

Special-Purpose Credit Programs—Section 202.8

The ECOA and Regulation B allow creditors to establish special-purpose credit programs for applicants who meet certain eligibility requirements. Generally, these programs target an economically disadvantaged class of individuals and are authorized by federal or state law. Some are offered by not-for-profit organizations that meet certain IRS guidelines, and some by for-profit organizations that meet specific tests outlined in section 202.8.

Experience has shown that creditors rarely seek to use section 202.8. Additionally, as stated in the commentary (supplement I to the regulation), the Federal Reserve "does not determine whether individual programs qualify for special-purpose credit status, or whether a particular program benefits an 'economically disadvantaged class of persons.' The agency or creditor administering or offering the loan program must make these decisions regarding the status of its program." Consequently, examiners are encouraged, if an issue arises regarding such a program, to consult with Board staff.

Notifications—Section 202.9

A bank must notify an applicant of action taken on the applicant's request for credit, whether favorable or adverse, within thirty days after receiving a completed application. Notice of approval may be expressly stated or implied (for example, the bank may give the applicant the credit card, money, property, or services for which the applicant applied). Notification of adverse action taken on an *existing* account must also be made within thirty days.

Under at least two circumstances, the bank need not comply with the thirty-day notification rule:

- The bank must notify an applicant of adverse action within ninety days after making a counteroffer unless the applicant accepts or uses the credit during that time.

- The bank may not have to notify an applicant of adverse action if the application was incomplete and the bank sent the applicant a notice of incompleteness that met certain requirements set forth in section 202.9(c).

Adverse Action Notice (§ 202.9(a)(2))

A notification of adverse action must be in writing and must contain certain information, including the name and address of the bank and the nature of the action that was taken. In addition, the bank must provide an ECOA notice that includes the identity of the federal agency responsible for enforcing compliance with the act for that bank. This notice is generally included on the notification of adverse action. The bank must also either provide the applicant with the specific principal reason for the action taken or disclose that the applicant has the right to request the reason(s) for denial within sixty days of receipt of the bank's notification, along with the name, address, and telephone number of the person who can provide the specific reason(s) for the adverse action. The reason may be given orally if the bank also advises the applicant of the right to obtain the reason in writing upon request.

Incomplete Applications (§ 202.9(c))

When a bank receives an incomplete application, it may send one of two alternative notifications to the applicant. One is a notice of adverse action; the other is a notice of incompleteness. The notice of incompleteness must be in writing and must specify the information the bank needs if it is to consider the application; it must also provide a reasonable period of time for the applicant to furnish the missing information.

Applications Submitted through a Third Party (§ 202.9(g))

When more than one bank is involved in a transaction and adverse action is taken with respect to the application for credit by all the banks involved, each bank that took such action must provide a notice of action taken. The notification may be given by a third party; however, the notice must disclose the identity of each bank on whose behalf the notice is given. If one of the banks approves the application, the banks that took adverse action need not provide notification.

Notification to Business Credit Applicants (§ 202.9(a)(3))

The notification requirements for business credit applicants are different from those for consumer credit applicants and are more extensive if the business had gross revenues of $1,000,000 or less in the preceding fiscal year. Extensions of trade credit, credit incident to a factoring agreement, and similar types of credit are subject to the same rules as those that apply to businesses that had gross revenues of more than $1,000,000.

Generally, a bank must comply with the same notification requirements for business credit applicants with gross revenues of $1,000,000 or less as it does for consumer credit applicants. However, the bank has more options when dealing with these business credit applicants. First, the bank may tell the business credit applicant orally of the action taken. Second, if the bank chooses to provide a notice informing the business credit applicant of the right to request the reason for action taken, it may, rather than disclose the reason itself, provide the notice at the time of application. If the bank chooses to inform the applicant of the right to request a reason, however, it must provide a disclosure with an ECOA notice that is in retainable form and that gives the applicant the same information that must be provided to consumer credit applicants when this option is used (see section 202.9(a)2)(ii)). Finally, if the application was made entirely over the phone, the bank may provide an oral statement of action taken and of the applicant's right to a statement of reasons for adverse action.

The notification requirements for business credit applicants with gross revenues of more than $1,000,000 are relatively simple. The bank must notify the applicant of the action taken within a reasonable time period. The notice may be oral or in writing; a written statement of the reasons for adverse action and the ECOA notice need be provided only if the applicant makes a written request within sixty days of the bank's notification of the action taken.

Designation of Accounts—Section 202.10(a)

A creditor that furnishes credit information to a consumer reporting agency must designate

- Any new account to reflect the participation of both spouses if the applicant's spouse is permitted to use or is contractually liable on the account
- Any existing account to reflect the participation of both spouses within ninety days after receiving a written request to do so from one of the spouses

If a creditor furnishes credit information to a consumer reporting agency, the creditor must furnish the information in the name of the spouse about whom the information was requested.

Record Retention—Section 202.12

Applications

In general, a bank must preserve all written or recorded information connected with an application for twenty-five months (twelve months for business credit) after the date on which the bank informed the applicant of action taken on an application or of incompleteness of an application.

Prohibited Information

A bank may retain information in its files that it may not use in evaluating applications. However, the information must have been obtained inadvertently or in accordance with federal or state law or regulation.

Existing Accounts

A bank must preserve any written or recorded information concerning adverse action on an existing account as well as any written statement submitted by the applicant alleging a violation of the ECOA or Regulation B. This evidence must be kept for twenty-five months (twelve months for business credit).

Prescreened Solicitations

The twenty-five-month retention rule also applies when a bank makes an offer of credit to potential customers. In such cases, the bank must retain for twenty-five months following the date of the solicitation

- The text of any prescreened solicitation,
- The list of criteria the creditor used to select potential recipients of the solicitation, and
- Any correspondence related to complaints (formal or informal) about the solicitation.

Rules for Providing Appraisal Reports—Section 202.14

Regulation B requires that banks provide a copy of the appraisal report used in connection with an application for credit to be secured by a lien on a dwelling. A bank may provide the copy either routinely (whether or not credit is granted or the application is withdrawn) or upon an applicant's written request. If the bank provides an appraisal report only upon request, it must inform the applicant in writing of the right to receive a copy of the report.

Incentives for Self-Testing and Self-Correction—Section 202.15

A self-test, as discussed in section 202.15 of Regulation B, must meet two criteria. First, it must be a program, practice, or study that a lender designs and uses specifically to determine the extent or effectiveness of its compliance with the regulation. Second, the results of the self-test must create data or factual information that is otherwise not available and cannot be derived from loan or application files or other records related to credit transactions. The findings of a self-test that is conducted voluntarily by a creditor and that meets the conditions set forth in section 202.15 are privileged against discovery or use by (1) a government agency in any examination or investigation related to the ECOA or Regulation B or (2) a government agency or an applicant in any legal proceeding involving an alleged violation of the ECOA or Regulation B. Privileged information includes the report or results of the test; data or other information created by the test; and any analysis, opinions, or conclusions regarding the results of the test. The privilege does *not* cover information about whether a test was conducted; the methodology, scope, time period, or dates covered by the test; loan or application files or other business records; and information derived from such files and records, even if aggregated, summarized, or reorganized.

Requirements for Electronic Communication—Section 202.16

Subject to the specific provisions of section 202.16 regarding disclosures, consumer consent, redelivery, electronic signatures, and exceptions, a creditor may provide by electronic communication any disclosure otherwise required by the regulation to be in writing.

Enforcement, Penalties, and Liabilities—Section 202.17

In addition to actual damages, Regulation B provides for punitive damages of up to $10,000 in individual lawsuits and up to the lesser of $500,000 or 1 percent of the bank's net worth in class action suits. Successful complainants are also entitled to an award of court costs and attorney's fees.

A bank is not liable for failure to comply with the notification requirements of section 202.9 if the failure was caused by an inadvertent error and the bank, after discovering the error, (1) corrects the error as soon as possible and (2) begins compliance with the requirements of the regulation. ''Inadvertent errors'' include mechanical, electronic, and clerical errors that the bank can show (1) were not intentional and (2) occurred despite the fact that the bank maintains procedures reasonably adapted to avoid such errors. Similarly, failure to comply with sections 202.6(b)(6), 202.10, 202.12, and 202.13 is not considered a violation if it results from an inadvertent error and the bank takes the corrective action noted above. Errors involving sections 202.12 and 202.13 may be corrected prospectively by the bank.