CHAPTER 1

The Equal Credit Opportunity Act and Regulation B

I. PREVIEW OF THE SUBJECT

A. Chapter Preview

This chapter addresses issues related to discrimination in connection with access to credit. The primary focus is on the Equal Credit Opportunity Act [ECOA; 15 USC 1691 et seq.] and its implementing regulation, the Federal Reserve Board's Regulation B. [12 CFR part 202] References to provisions of the Fair Housing Act [FHAct; 42 USC 3601 et seq.] are also included at appropriate points.

The following is a summary presentation of how this chapter is organized.

I. Preview of the Subject
II. Background, History, and Summary of ECOA and Regulation B
III. Scope of Regulation B: Applicability, Exclusions, and Exemptions
IV. Important Definitions
V. General Rule Regarding Fair Lending
VI. Compliance at Successive Phases of a Lending Transaction
VII. Other Compliance Requirements: Disclosures and Notices
VIII. Compliance Operations: Other Than Disclosures and Notices
IX. Electronic Communications
X. Enforcement and Liability
XI. Effect on State Laws and on Federal Laws and Regulations
XII. Record Retention Requirements

B. Introduction

In many respects, the Equal Credit Opportunity Act operates more as civil rights law than a consumer protection statute. The primary objective of ECOA and Regulation B is to prevent the denial of credit on the basis of characteristics or conduct that are not related to a borrower's creditworthiness. More specifically, it protects credit applicants from certain discriminatory practices in any phase of a credit transaction.

Regulation B also imposes certain requirements on creditors with respect to (i) taking and evaluating applications for credit, (ii) notifying applicants of action taken on their applications, (iii) reporting and maintaining credit histories, (iv) retaining records, and (v) providing to applicants copies of appraisal reports used in connection with credit that is secured by a lien on a dwelling. In addition, the regulation requires that creditors collect information about an applicant's race, sex, marital status, and age in connection with applications for certain loans that are related to an applicant's principal dwelling and that are secured by a lien on that dwelling. Each of these issues is addressed in this chapter.

II. Background, History, and Summary of ECOA and Regulation B

Section Preview

A. Background and History of the Law and Regulation
B. Brief Summary of Regulation B
C. Relationship of the Law and Regulation to Other Fair Lending Requirements
   1. Additional Requirements Applicable to State Nonmember Banks
   2. Additional Requirements Applicable to Savings Associations
   3. Additional Requirements Applicable to Credit Unions and FCS Institutions
D. Business Areas Within a Bank Impacted by the Law and Regulation
E. Section-by-Section Preview of Regulation B

A. Background and History of the Law and Regulation

In 1972, the National Commission on Consumer Finance held hearings that documented the difficulties faced by women attempting to obtain consumer credit. One result of those hearings was the introduction and passage of S. 2101 in the U.S. Senate the following year. That bill died in the U.S. House.

In 1974, the Equal Credit Opportunity Act was enacted into law after the House and Senate were able to reconcile their respective bills regarding credit discrimination. The stated purpose of that first version of the law was "to require that financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers *without regard to sex or marital status*." [Pub. L. 93-502, Section 502; emphasis added] The additional prohibited bases that are recognized today were added by the Equal Credit Opportunity Act Amendments of 1976. [Pub. L. 94-239, Sec. 2]

The Federal Reserve Board was given authority to write the implementing regulation. [15 USC 1691b(a)] The most recent comprehensive revision of Regulation B, which included the addition of the Official Staff Commentary and model application and notification forms, was done in 1985. [50 Fed.Reg. 48018; Nov. 20, 1985]

B. Brief Summary of Regulation B

Regulation B establishes a very basic rule: creditors shall not discriminate against an applicant in any aspect of any credit transaction on any of nine specifically

identified prohibited bases. The prohibited bases are (i) race, (ii) color, (iii) religion, (iv) national origin, (v) sex, (vi) marital status, (vii) age (provided the credit applicant has the capacity to enter into a binding contract), (viii) receipt of income from public assistance programs, and (ix) good faith exercise of any rights under the Consumer Credit Protection Act. [12 CFR 202.4(a); 12 CFR 202.2(z)]

The regulation balances the creditor's interest in learning as much as possible about a prospective borrower against the borrower's right to withhold information that is not relevant to a determination of his or her creditworthiness. It does not prevent a creditor from determining what kinds of information may be necessary to evaluate the creditworthiness of an applicant. But since 1976, it has, subject to very narrow exceptions, placed off limits any inquiries regarding the nine prohibited bases listed in the preceding paragraph.

In addition to establishing the general rule against lending discrimination, the regulation also accomplishes two further objectives. First, it provides guidance regarding how the general rule against discrimination applies in specific circumstances and various phases of a credit relationship. This includes, among other things, provisions regarding credit advertising and prescreening, the taking of credit applications, the evaluation of credit applications, and the spousal signature rules. Second, it imposes various administrative requirements that are related to such things as providing notices to applicants and borrowers, furnishing credit information, monitoring compliance with federal anti-discrimination laws, self-testing and self-correction, record retention, and enforcement.

C. Relationship of the Law and Regulation to Other Fair Lending Requirements

Readers should be aware that although ECOA and Regulation B are among the more prominent directives on the subject of fair lending, they are not the only ones. The Fair Housing Act, the Home Mortgage Disclosure Act, the Community Reinvestment Act, and the Americans with Disabilities Act each include fair lending provisions.

In addition, the FDIC, OTS, and NCUA have issued their own regulations regarding discrimination in the context of lending transactions. These are described in broad outline immediately below.

1. Additional Requirements Applicable to State Nonmember Banks

The FDIC's Fair Housing regulation [12 CFR part 338] imposes specific obligations on state nonmember banks in connection with the advertising of residential

real estate loans. These include loans that are secured by a dwelling, as well as loans for the purpose of purchasing, constructing, improving, repairing, or maintaining a dwelling.

In advertisements for such loans, banks must prominently indicate, in a manner appropriate to the advertising medium and format utilized, that the bank makes such loans without regard to race, color, religion, national origin, sex, familial status (i.e., having one or more children under the age of 18), or handicap. [12 CFR 338.3]

In addition, banks that make these loans are required to conspicuously display the Equal Housing Lender poster in a central location within the bank where deposits are received or where the residential real estate loans are made and in a manner clearly visible to the general public entering the area where the poster is displayed. [12 CFR 338.4] Banks can choose to display either the poster that is pictured in 12 CFR 338.4(b) or the one prescribed by 24 CFR 110.25(a).

The FDIC regulation also imposes upon state nonmember banks obligations:

(i) to collect and retain certain information about certain home loan applicants' personal characteristics in accordance with Regulation B; [12 CFR 338.7] and

(ii) to maintain, update, and report a register of home loan applications in accordance with Federal Reserve Regulation C (12 CFR part 203 – Home Mortgage Disclosure). [12 FR 338.8]

2. Additional Requirements Applicable to Savings Associations

Savings associations are subject to the OTS regulation regarding Nondiscrimination Requirements. [12 CFR part 528] The topics addressed in that regulation that are relevant to this chapter include nondiscrimination in connection with lending and other services, appraisal and underwriting, applications, and advertising.

Sections 528.2 and 528.3 are of particular relevance to the subject of this chapter. Under those sections of the regulation, a savings association is generally prohibited from denying loans and other services, or discouraging or refusing to receive or consider loan applications or inquiries, on the basis of several factors. Those factors include, but are not limited to, many that are listed in ECOA and Regulation B – race, color, religion, national origin, sex, marital status, and age (provided the person has the capacity to contract). The OTS regulation also specifically prohibits discrimination on the basis of familial status (i.e., having one or more children under the age of 18) and handicap.

If a credit transaction involves a dwelling, the OTS regulation also prohibits discrimination on the basis of the age or location of the dwelling or on the race, color, religion, etc. of those who own or occupy (or will own or occupy) the dwelling for which a loan or other service is to be made *or any other dwelling in the vicinity*. [12 CFR 528.2(a)]

Savings associations are also required to display prominently, in a manner that will be readily apparent to anyone seeking a loan, one or more Equal Housing Lender posters in the lobby of each of their offices. This requirement is similar to the one observed by state nonmember banks. But whereas state nonmember banks may choose to display either of two versions of the poster, the OTS regulation prescribes the text to be used by savings associations, and also sets a minimum size (11 x 14 inches) for the posters. A Spanish language version is recommended for offices that serve areas with a substantial Spanish-speaking population. [12 CFR 528.5]

For purposes of the OTS regulation regarding nondiscrimination, the term *savings association* includes (i) federal savings associations chartered under 12 USC 1464, (ii) state chartered savings and loan associations, building and loan associations, homestead associations, and most cooperative banks, and (iii) corporations other than banks that the Federal Reserve and OTS jointly determine to be operating in substantially the same manner as a savings association. [12 USC 1813(b); 12 CFR 528.1(b)]

3. Additional Requirements Applicable to Credit Unions and FCS Institutions

Credit Unions and Farm Credit System institutions are also subject to their respective regulators' regulations regarding nondiscrimination in lending transactions. These regulations are similar to those that govern savings associations and state nonmember banks and also require the display of Equal Housing Lender posters. [Credit Unions – 12 CFR 701.31; Farm Credit System – 12 CFR part 626]

D. Business Areas Within Banks Impacted by the Law and Regulation

Each of several areas in a typical financial institution will generally need to be aware of requirements imposed by ECOA and Regulation B. The business units that deal directly with lending are obviously affected. But the scope of the law and regulation are broader than one might initially suppose, and other business units are affected as well. The broad scope of the regulation is addressed in greater detail in Section III.A of this chapter.

The following is a list of business areas within banks that are likely to be affected by the requirements and restrictions of ECOA and Regulation B. Different banks may identify these areas differently, but the functions should be clear from the names used here:

- retail, residential, and commercial lending;
- credit application processing;
- credit underwriting;
- real estate appraisal;
- credit product marketing;
- credit information reporting;
- credit operations;
- credit scoring systems; and
- customer service.

E. Section-by-Section Preview of Regulation B

The following is a general section-by-section description of Regulation B:

Section 202.1 —Authority, Scope and Purpose: This section states that the purpose of the regulation is to promote the availability of credit to all creditworthy applicants without regard to the prohibited bases (race, color, religion, etc.), prohibits creditor practices that discriminate on those bases, and briefly references additional requirements.

Section 202.2 — Definitions: This section defines key terms used in the regulation.

Section 202.3 — Limited Exceptions for Certain Classes of Transactions: This section establishes limited exceptions to some of the regulation's requirements for public utilities credit, securities credit, incidental credit, and government credit.

Section 202.4 — General Rules: This section prohibits discrimination and discouragement of applications on any prohibited basis and references disclosure and application requirements.

Section 202.5 — Rules Concerning Requests for Information: This section establishes a general rule that creditors may request any information in connection with a credit transaction, and carves out exceptions to that rule.

Section 202.6 — Rules Concerning Evaluation of Applications: This section establishes a general rule that creditors may consider any information they obtain as long as it is not used to discriminate against a credit applicant on a prohibited basis, and states more detailed rules that pertain to specific types of information.

Section 202.7 — Rules Concerning Extensions of Credit: This section

establishes rules regarding individual and joint accounts, signatures, collateral, and other issues relating to extensions of credit.

Section 202.8 — Special Purpose Credit Programs: This section provides for special purpose credit programs for economically disadvantaged persons and others who might have credit needs that are not met through ordinary channels.

Section 202.9 — Notifications: This section requires creditors to notify credit applicants regarding the disposition of their applications and reasons for the actions taken.

Section 202.10 — Furnishing of Credit Information: This section imposes requirements regarding how accounts held by spouses are to be identified (i) in reports to consumer reporting agencies, and (ii) in responses to inquiries.

Section 202.11 — Relation to State Law: This section states that Regulation B alters, affects, or preempts only those state laws that are inconsistent with ECOA and the regulation, and only to the extent of the inconsistency. It also provides details regarding what constitutes an inconsistency.

Section 202.12 — Record Retention: This section establishes a general 25–month recordkeeping requirement for consumer credit transactions and a 12–month requirement for business credit. This section also provides certain exceptions to those limits and an indefinite extension of the limits in cases where a creditor has actual notice of an official investigation or enforcement proceeding.

Section 202.13 — Information for Monitoring Purposes: This section requires creditors to inquire about applicants' ethnicity, sex, marital status, and age in connection with certain dwelling-related transactions in order to monitor compliance with several federal fair lending laws.

Section 202.14 — Rules on Providing Appraisal Reports: This section requires creditors to provide a copy of an appraisal report used in connection with a application for credit that is to be secured by a lien on a dwelling.

Section 202.15 — Incentives for Self-Testing and Self-Correction: This section encourages creditors to evaluate their own compliance with ECOA and Regulation B by establishing certain privileges and safe-harbors for properly done tests that are followed by necessary corrective actions.

Section 202.16 — Requirements for Electronic Communication: This section establishes that, in accordance with the E–SIGN Act, creditors may provide by electronic means the disclosures and notices required by Regulation B.

Section 202.17 — Enforcement, Penalties and Liabilities: This section provides for administrative enforcement of ECOA and Regulation B, as well as civil liability in individual or class actions.

III. Scope of Regulation B: Applicability, Exclusions, and Exemptions

Section Preview

A. Coverage of ECOA and Regulation B
B. Limited Exceptions to Coverage

A. Coverage of ECOA and Regulation B

As a general rule, the Equal Credit Opportunity Act and Regulation B apply to all credit, commercial as well as personal, without regard to the nature or type of credit or the creditor.

There are limited exceptions and special rules for certain classes of credit transactions and special provisions that apply in the context of dwelling-related transactions, with respect to joint applicants, and other specified circumstances. Those, however, are departures from the general rule, and it is the general rule that should always be taken as the starting place for any Regulation B analysis.

1. Credit Transactions Subject to ECOA and Regulation B

If a transaction allows for the deferral of the payment of a debt, it is a credit transaction and is subject to ECOA and Regulation B.[1] [Commentary 1(a)-1] This broad coverage sets the act and regulation apart from other bank compliance provisions, which generally apply only to consumer transactions.

Regulation B applies to a much broader range of credit transactions than Regulation Z. [12 CFR part 226 — Truth in Lending] As readers are aware, the latter regulation applies only to credit that is extended to consumers primarily for personal, family, or household purposes and is subject to a finance charge or is payable under a written agreement in more than four installments. [12 CFR 226.1(c)] Regulation B, by contrast, applies to all credit transactions regardless of whether the credit is for consumer or commercial purposes, the number of installments required for repayment, or whether the transaction is subject to a finance charge. [Commentary 2(l)]

[1] The Ninth Circuit Court of Appeals has held that ECOA applies to consumer lease transactions. Brothers v. First Leasing, 724 F2d 789 (9th Cir. 1984). A later decision from the Southern District of Ohio explicitly rejected that position to the extent that it held all lease obligations to be "credit" as defined in ECOA. Liberty Leasing v. Machamer, 6 F.Supp.2d 714 (S.D. Ohio 1998)

Compliance Pointer: *As used in Regulation B, the term "credit transaction" is not limited to the actual extension of credit, but includes every aspect of an applicant's dealings with a creditor regarding an application for credit or an existing extension of credit. This includes, among other things, a creditor's information requirements, investigation procedures, standards of creditworthiness, credit terms offered, revocation, alteration, or termination of credit, and collection procedures.*

2. Creditors Subject to ECOA and Regulation B

Regulation B applies to all creditors. The term *creditor* refers to all persons who, in the ordinary course of business, regularly participate in credit decisions, including those who set the terms under which credit is extended. It also applies to a creditor's assignees and transferees who participate in credit decisions.

The term also applies to persons who in the ordinary course of business regularly refer applicants and prospective applicants to creditors, or who select creditors to whom requests for credit may be made. This includes persons such as real estate brokers, auto dealers, home builders, and home improvement contractors who do not generally participate in credit decisions but merely accept applications or perform the referral or selection functions described in the preceding sentence. [12 CFR 202.2(l); Commentary 2(l)-2]

Again, the contrast with Regulation Z is instructive. As readers are aware, Regulation Z generally limits the term *creditor* to the persons to whom an obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract. [12 CFR 226.2(17)(i)] Regulation B includes no such limitations.

B. Limited Exceptions to Coverage

Although the scope of Regulation B is broad, it is not unlimited. The exceptions and exemptions, however, are very narrowly drawn and apply only to specific requirements imposed by the regulation. And there are no exceptions to the basic prohibition against discrimination on a prohibited basis in any aspect of a credit transaction.

1. Exemptions for Certain Classes of Transactions

Regulation B identifies four types of transactions for which some of its requirements are not as important. These include transactions for (i) public utilities credit, (ii) securities credit, (iii) incidental credit, and (iv) government credit. [12 CFR 202.3] These constitute credit transactions for purposes of Regulation B and they are therefore subject to the bar against discrimination on a prohibited basis. [Commentary 3(a)-1] But each is exempted from specific provisions of the regulation.

Financial institutions are rarely if ever involved in these credit transactions. Details regarding the exemptions, therefore, will not be reviewed here.

2. No Application to Foreign Transactions

Regulation B does not apply to lending activities that occur outside the United States. It does, however, apply regardless of an applicant's citizenship status to lending that is done within the United States, Puerto Rico, and U.S. territories and possessions. [Commentary 1(a)-2]

IV. IMPORTANT DEFINITIONS

Section Preview

A. General Importance of Definitions in ECOA and Regulation B
B. Defined Terms

A. General Importance of Definitions in ECOA and Regulation B

The Equal Credit Opportunity Act and Regulation B define several terms that are important for understanding the act's and regulation's requirements. The majority of these are found in 15 USC 1691a and 12 CFR 202.2. The regulation, however, includes a few definitions within other sections. For example, the term *adverse action* is defined in the act at § 1691, the term *self-test* is defined at 12 CFR 202.15, the term *special purpose credit* is defined at 12 CFR 202.8, and the term *electronic communication* is defined at 12 CFR 202.16.[2]

Most readers are aware that it is important to review the defined terms in laws and regulations and to pay special attention to commonly used words or phrases that are assigned meanings that differ from their common usage. It is also important to recognize that words and phrases that are assigned particular meanings in one law or regulation may be assigned different meanings in other laws and regulations.

The term *creditor* provides a good illustration of both these issues. The meaning of the word that is commonly understood among members of the general public fails to include many who are within the scope of the term as it is defined in Regulation B. In addition, as described in Section III.A.2 of this chapter, Regulation B and Regulation Z assign substantially different meanings to the term.

B. Defined Terms

The following is a discussion of the more important terms that are defined in ECOA and Regulation B.

[2] The Federal Reserve Board has issued a proposed rule that would remove § 202.16 and leave the matter of electronic communications subject only to the E-SIGN Act. [15 USC 7001 et seq.] Comments regarding the proposal were due by June 29, 2007. As of the date of this writing, the proposal has not been adopted. [72 Fed.Reg. 21125; Apr. 30, 2007]

1. Prohibited Basis — 12 CFR 202.2(z)

The term *prohibited basis* means (i) race, (ii) color, (iii) religion, (iv) national origin, (v) sex, (vi) marital status, (vii) age, provided that the applicant has the capacity to enter into a binding contract, (viii) the fact that all or part of the applicant's income derives from any public assistance program, or (ix) the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or any state law for which an exemption has been granted by the Federal Reserve Board.

This term refers not only to characteristics of an applicant (or its personnel, if the applicant is not an individual), but also to the characteristics of those with whom an applicant is affiliated or with whom the applicant associates. [Commentary 2(z)-1]

Although creditors are not permitted to refuse to grant credit because an applicant comes from a particular country, they may take into account an applicant's immigration status. In addition, creditors must abide by applicable laws, regulations, and executive orders that restrict dealings with citizens or the government of a particular country or which impose limitations regarding credit extended for their use. [Commentary 2(z)-2]

2. Credit Transaction — 12 CFR 202.2(m)

The term *credit transaction* refers to every aspect of an applicant's dealings with a creditor regarding an application for credit or an existing extension of credit. The breadth of this definition forms the basis of the broad scope of the entire regulation. For purposes of Regulation B, the term encompasses a creditor's information requirements; investigation procedures; standards of creditworthiness; terms of credit; practices regarding the furnishing of credit information; revocation, alteration, or termination of credit; and collection procedures.

3. Credit — 15 USC 1691a(d); 12 CFR 202.2(j)

The term *credit* means the right granted by a creditor to an applicant to do one or more of the following three things: (i) defer payment of debt, (ii) incur a debt and defer its payment, or (iii) purchase a property or service and defer payment for it.

This definition makes no distinction between consumer credit and business credit. All extensions of credit are subject to ECOA and Regulation B without regard to its nature or type. It also makes no reference to the imposition of a finance charge or a minimum number of installment payments, as these are not relevant to the definition. [Commentary 2(j)-1]

4. Applicant — 15 USC 1691a(b); 12 CFR 202.2(e)

The term *applicant* refers generally to any person who requests or who has received an extension of credit from a creditor, including extensions, renewals, and continuations of existing credit arrangements. It also includes any person who is or may become contractually liable regarding an extension of credit. For purposes of §202.7(d) regarding signatures of spouses and other persons, the term includes guarantors, sureties, endorsers, and similar parties.

A person who makes use of an existing credit plan for an amount exceeding a previously established credit limit has made an indirect application and is considered to be an applicant in connection with that usage. [15 USC 1591a(b)]

5. Creditor — 15 USC 1691a(e); 12 CFR 202.2(l)

The term *creditor* refers to any person who, in the ordinary course of business, regularly participates in credit decisions, including setting the terms of the credit. The primary focus of this definition is on *participation*, and the scope of the term therefore extends far beyond lenders only.

This term includes a creditor's assignees and transferees who participate in credit decisions. And for purposes of § 202.4(a) and (b) of the regulation, which prohibit credit discrimination and discouragement of credit applications on any prohibited basis, it also includes those who, in the ordinary course of business, (i) regularly refer prospective applicants to creditors, or (ii) select or offer to select creditors to whom credit applications can be made.

6. Application — 12 CFR 202.2(f)

An *application* is a request for an extension of credit that is made in accordance with procedures used by a creditor. Neither ECOA nor Regulation B prescribe what procedures a creditor must use. But whatever choices a credit makes about them, the term refers to the *actual practices* followed by a creditor for making credit decisions, and not just to its written policy.

This term does not include a person's use of an account or line of credit to obtain credit that is within a previously established credit limit. This exclusion complements the point made just above at Section IV.B.4 regarding persons who make use of an existing credit plan for an amount that exceeds a previously established credit limit.

7. Completed Application (and Incomplete) — 12 CFR 202.2(f)

A *completed application* is an application in connection with which a creditor has received all the information that the creditor regularly obtains and considers in evaluating applications for the amount and type of credit requested. An incomplete application is one for which information regularly obtained and considered is missing.

Neither ECOA nor Regulation B prescribe the nature or amount of information that creditors must collect before calling an application complete. But creditors must use reasonable diligence to collect whatever information they determine to be necessary.

Compliance Pointer: *A creditor has the option to either deny an application that remains incomplete or to send a notice of incompleteness to the applicant. This issue is addressed in greater detail in Section VII.B of this chapter entitled* Notices of Actions Taken (Adverse Action Notices)

8. Adverse Action — 15 USC 1591(d)(6); 12 CFR 202.2(c)

The term *adverse action* has different meanings at the following three phases of a credit transaction described immediately below.

a. *Denial* of an Application for New Credit

In connection with an applicant's request to establish a debtor-creditor relationship where there was none before, a refusal to grant credit in substantially the amount or on substantially the terms requested constitutes adverse action, unless (i) the creditor makes a counteroffer to grant credit in a different amount or on other terms, and (ii) the applicant uses or expressly accepts the credit that is offered. [12 CFR 202.2(c)(1)(i)]

If a creditor does not offer the type of credit or the credit plan applied for, or if applicable law prohibits the extension of credit requested, the creditor's denial does not constitute adverse action. [12 CFR 202.2(c)(2)(iv) and (v)]

b. *Refusal to Increase Existing Credit*

If a person has an existing debtor-creditor relationship with a creditor and applies to the creditor for an increase in the amount of available credit, a denial of the increase constitutes adverse action. [12 CFR 202.2(c)(1)(iii)]

c. *Termination or Unfavorable Change in Terms of Existing Credit*

The termination or an unfavorable change in the terms of an existing credit account generally constitutes adverse action. But it is not adverse action if the termination or change of terms affects substantially all of a class of the creditor's accounts. [12 CFR 202.2(c)(1)(ii)]

In 2003, the words "substantially all" in the exception just noted were written into the regulation in place of "all or a substantial portion." The revision was adopted to emphasize that the exception applies only when the creditor's action is not based on the individual credit characteristics of the affected accountholders. For example, the exception would apply where a creditor terminates all secured credit accounts because it no longer offers that type of credit. But the exception would not apply if the creditor terminated only those secured credit accounts that could not be moved into another card program after an evaluation of the individual credit characteristics of the accountholders. [68 Fed.Reg. 13143; Mar. 18, 2003]

A change in the terms of an account that is expressly agreed to by the applicant does not constitute adverse action. In addition, a termination or other unfavorable change of terms, or any other action or forbearance, does not constitute adverse action if it is done in connection with an existing default, delinquency, or inactivity of the account. [12 CFR 202.2(c)(2)(i) and (ii)]

9. Credit Scoring Systems — 12 CFR 202.2(p)

For purposes of certain provisions of Regulation B, a credit scoring system is either (i) an empirically derived, demonstrably and statistically sound credit scoring system, or (ii) a judgmental credit scoring system. Every method of credit analysis falls into one category or the other, and no system falls into both categories.

The division into these two categories is important because a creditor that uses a scoring system that qualifies as empirically derived and demonstrably and statistically sound may take the age of an applicant directly into account as a predictive variable. Creditors that use judgmental systems may not do that.

In order to qualify as empirically derived and demonstrably and statistically sound, a credit scoring system must be:

- based on data that are derived either from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;
- developed for the purpose of evaluating the creditworthiness of applicants with respect to the legitimate business interests of the creditor that uses the system;
- developed and validated using statistical principles and methodology; and
- periodically evaluated and adjusted as necessary to maintain its predictive ability.

If a credit scoring system is not, or ceases to be, an empirically derived, demonstrably and statistically sound system, it is a judgmental system.

V. General Rule Regarding Fair Lending

Section Preview

A. Prohibition Against Lending Discrimination
B. Disparate Treatment, Disparate Impact, and the Effects Test

A. Prohibition Against Lending Discrimination

The general principle regarding fair lending is easily stated in two brief imperative sentences:

1. A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction. [12 CFR 202.4(a)]
2. 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. [12 CFR 202.4(b)]

A significant fraction of Regulation B is devoted to providing guidance regarding how the general principle applies in specific circumstances and various phases of a credit relationship.

Compliance Pointer: *The Commentary that pertains to the general rule states that the guidance provided in the regulation is not the final word regarding creditor practices that may be prohibited. "The general rule...covers all dealings, without exception, between an applicant and a creditor,* ***whether or not addressed by other provisions of the regulation****. ... Thus,* ***whether or not specifically prohibited elsewhere in the regulation****, a credit practice that treats applicants differently on a prohibited basis violates the law because it violates the general rule." [Commentary 4(a)-1, emphasis added]*

B. Disparate Treatment, Disparate Impact, and the Effects Test

In light of the Commentary provision just cited, one could expect that creditor practices that are not addressed in the regulation are occasionally criticized

in Reports of Examination or are the subject of judicial opinions. Reports of Examination are confidential documents whose distribution is severely limited. But judicial opinions are widely distributed, if not always easily understood.

The courts have recognized two types of proof of lending discrimination: evidence of disparate treatment and evidence of disparate impact.

1. Disparate Treatment

Disparate treatment occurs when a creditor treats a credit applicant differently owing to one or more of the prohibited bases identified in the regulation at § 202.2(z). The difference of treatment itself constitutes a violation of ECOA and Regulation B, and it is not also necessary to show that the treatment was motivated by prejudice or by a conscious intention to discriminate against an applicant. Disparate treatment in that context is considered by courts to be intentional discrimination because the difference in treatment on a prohibited basis has no credible, nondiscriminatory explanation.

Evidence of disparate treatment is generally said to be either overt or comparative in nature. As the name of the former implies, overt evidence of disparate treatment is the more blatant of the two types and is the easier of the two to recognize. The Federal Reserve Board's *Consumer Compliance Handbook* and the FDIC's *Compliance Examination Handbook* call it what it is: discrimination.

Comparative evidence of disparate treatment can be more subtle and is generally recognized by differences in treatment that are not fully explained by legitimate nondiscriminatory factors.

a. *Overt Evidence of Disparate Treatment*

Overt evidence of discrimination exists when a creditor openly discriminates against an applicant on a prohibited basis. For example, the offer of credit cards with a limit of up to $750 for applicants age 21-30 and $1,500 for applicants over 30 constitutes overt discrimination. The policy violates ECOA's prohibition on discrimination on the basis of age.

Overt evidence of discrimination also exists when a creditor expresses a discriminatory preference, even if the creditor never acts on it. The mere expression of a discriminatory preference, without any accompanying action, violates the rule against making any statement to applicants or prospective applicants that would, on a prohibited basis, discourage a reasonable person from making or pursuing an application. [12 CFR 202.4(b)]

b. *Comparative Evidence of Disparate Treatment*

Comparative evidence of disparate treatment may be more common in connection with applicants who are neither clearly well qualified nor clearly unqualified. In such "close cases," there is often more room and need for lender discretion. In addition, whether or not an applicant qualifies may depend on the level of assistance provided by the lender in completing an application.

A creditor may, for example, propose solutions to credit or other problems relevant to an application, identify compensating factors, and provide encouragement to some applicants but not others. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

If a creditor has apparently treated similar applicants differently on the basis of a prohibited factor, it must explain the difference. If the explanation is found to be not credible, a regulator or court that is addressing the matter might conclude that the treatment was an instance of intentional discrimination.

2. Disparate Impact and the Effects Test

Disparate impact occurs when a creditor applies equally to all credit applicants a policy or practice that is neutral with respect to the prohibited bases, but the policy or practice nevertheless disproportionately excludes or burdens certain persons on a prohibited basis. For example, a creditor's policy of denying loan applications for single-family residences for less than $60,000 might have a disproportionate impact on minority applicants because of their income levels or the value of the houses in the areas in which they live.

It is not necessary to show evidence of discriminatory intent in order to establish that a particular policy or practice with a disparate impact constitutes a violation of the law. But it is also clear that a policy or practice that has a disparate impact on a prohibited basis is not, by itself, proof of a violation of the law or regulation. The *effects* of the policy or practice are sufficient to raise the possibility of a violation, but are not sufficient to show an actual violation.

The effects test is a judicial doctrine that was developed in a series of employment cases decided by the U.S. Supreme Court under Title VII of the Civil Rights Act of 1964. The legislative history of ECOA indicates that the Congress intended an "effects test" concept, as outlined in the employment field by the U.S. Supreme Court, to be applicable to a creditor's determination of creditworthiness.

If an examiner finds that a creditor's policy or practice has a disparate impact, the next step is to determine whether the policy or practice is justified by business necessity. The justification must be manifest and cannot be merely hypothetical or speculative. Factors that may be relevant to the justification include cost and profitability. But even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it may still constitute a violation if a different policy or practice could achieve the same business necessity with less discriminatory effect.

VI. COMPLIANCE AT SUCCESSIVE PHASES OF A CREDIT TRANSACTION

Section Preview

A. Taking an Application

The threshold principle regarding the taking of applications is well known: creditors are prohibited from making 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. [12 CFR 202.4(b)] The Office of Thrift Supervision has issued a similar, though more detailed, regulation that embodies the same principle: savings associations may not discourage, or refuse to allow, receive, or consider, any application, request, or inquiry regarding a loan or other service on any prohibited basis or on the basis of handicap, familial status, or other factors identified in the regulation. [12 CFR 528.3]

At the start of this chapter, we noted that the primary objective of the Equal Credit Opportunity Act and Regulation B is to prevent the denial of credit on the basis of characteristics or conduct that are not related to a borrower's creditworthiness. The regulation advances that objective by prohibiting creditors from requesting and collecting specific information about an applicant that (i) has no bearing on the applicant's ability or willingness to repay the credit requested and (ii) could be used to discriminate against the applicant.

Regulation B allows for certain general exceptions to this prohibition and a few other exceptions that pertain to specific types of information in specific contexts. [12 CFR 202.5(a)] Each is thought necessary to advance the goal of making credit fairly and widely available.

The exceptions for specific inquiries are addressed in subsections immediately below. The general exceptions include the permitted collection of otherwise prohibited information:

(i) for monitoring purposes as required by 12 CFR 202.13 in connection with applications for credit to be used for the purchase or refinancing of, and which is secured by, the applicant's dwelling;

(ii) that may be required by a regulation, order, or agreement issued by or entered into with a court, enforcement agency, or official in order to enforce compliance with ECOA, Regulation B, or other federal or state laws or regulations;

(iii) in order to determine an applicant's eligibility for a special purpose credit program that meets the requirements of 12 CFR 202.8.

[12 CFR 202.5(a)(2) and (3)]

1. Applicant Characteristics

The first exception for specific inquiries that would ordinarily not be relevant to an applicant's ability or willingness to repay a debt pertains to applicant characteristics. Creditors are ordinarily prohibited from inquiring about the (i) race, (ii) color, (iii) religion, (iv) national origin, or (v) sex of an applicant or any other person in connection with a credit transaction. [12 CFR 202.5(b)]

In addition to the general exceptions discussed above, there are also two specific exceptions that pertain to the five characteristics just mentioned. First, for the purpose of conducting a self-test that meets the requirements of § 202.15, creditors are permitted to inquire about the race, color, religion, national origin, or sex of an applicant or other person in connection with a credit transaction. [12 CFR 202.5(b)(1)] Second, creditors are generally permitted to ask applicants to designate a title on an application form (such as Mr., Ms., Mrs., or Miss), but

only if the form discloses that the designation of a title is optional. Subject to this single point, application forms must otherwise use only terms that are neutral as to sex. [12 CFR 202.5(b)(2)]

Compliance Pointer: *The specific exception regarding inquiries about the five applicant characteristics is separate and distinct from the more general exception about inquiries that are permitted for monitoring purposes as required by 12 CFR 202.13. When considering this and any other exceptions in the regulation, it is important to be clear in one's own mind about which specific rule the exception applies to and the precise nature and scope of the rule.*

If a creditor makes inquiries regarding these applicant characteristics, it must also disclose either orally or in writing, at the time the inquiry is made, that:

(i) the applicant is not required to provide the information;
(ii) the creditor is requesting the information to monitor its compliance with ECOA;
(iii) federal law prohibits the creditor from discriminating on the basis of the information being requested, or on the basis of an applicant's decision not to furnish it; and
(iv) if applicable, certain information will be collected based on visual observation or surname if it is not provided by the applicant or another person.

[12 CFR 202.5(b)(1)]

2. Information about a Spouse or Former Spouse

The second exception for specific inquiries that would ordinarily not be relevant to an applicant's ability or willingness to repay a debt pertains to information about an applicant's spouse or former spouse. As a general rule, creditors may not request any information concerning the spouse or former spouse of an applicant. The exceptions to this rule pertain to circumstances in which that information is relevant to business aspects of the credit transaction.

Creditors may request information concerning an applicant's spouse under any of the following circumstances (the last of which also pertains to former spouses);

(i) if the spouse will be permitted to use the account;
(ii) if the spouse will be contractually liable on the account;

(iii) if the applicant is relying on the spouse's income as a basis for repayment of the credit requested;

(iv) if the applicant resides in a community property state[3] or is relying on property located in such a state as a basis for repayment of the credit requested; or

(v) if the applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested.

[12 CFR 202.5(c)(1) and (2)]

Information about an applicant's spouse or former spouse may be indirectly disclosed in connection with other permitted inquiries. In particular, creditors are permitted to ask applicants to list other accounts on which they are contractually liable and to provide the names and addresses of persons in whose name the accounts are held. Creditors may also ask applicants to list the names in which they have previously received credit. [12 CFR 202.5(c)(3)]

3. Marital Status

The third exception for specific inquiries that would ordinarily not be relevant to an applicant's ability or willingness to repay a debt pertains to information about an applicant's marital status. [12 CFR 202.5(d)(1)]

As a general rule, creditors may not inquire about the marital status of an applicant for *individual unsecured credit*. The two permitted exceptions to this rule involve (i) applicants who reside in community property states,[4] and (ii) applicants who will be relying on property that is located in a community property state as a basis for repayment of the credit.

Creditors may inquire about the marital status of applicants for other kinds of credit (i.e., joint credit and secured credit), but they are strictly limited to using the terms *married*, *unmarried*, and *separated*. The term *unmarried* includes single, divorced, and widowed persons, and an application should not be structured in a way that encourages unmarried applicants to distinguish among those categories.

The remark at the conclusion of the preceding subsection regarding indirect disclosures in connection with other permitted inquiries also applies in this context. [Commentary 5(d)(1)-1] So the general rule against inquiries about marital status does not prohibit a creditor from asking about:

(i) an applicant's obligation to pay alimony, child support, or separate maintenance income;

[3] At the time of this writing, the following nine states are community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

[4] See preceding footnote.

(ii) the source of income to be used as the basis for repaying the credit requested, which could disclose that it is the income of a spouse;
(iii) whether an obligation disclosed by the applicant has a co-obligor, which could disclose that the co-obligor is a spouse or former spouse; or
(iv) the ownership of assets, which could disclose the interest of a spouse.

4. Alimony, Child Support, and Separate Maintenance Income

The fourth exception for specific inquiries that would ordinarily not be relevant to an applicant's ability or willingness to repay a debt pertains to information about whether any part of an applicant's stated income derives from alimony, child support, or separate maintenance payments. A creditor may inquire about this information only if it first discloses to the applicant that such income need not be revealed if the applicant does not want the creditor to consider it when determining the applicant's creditworthiness. [12 CFR 202.5(d)(2)]

A creditor must provide that disclosure whenever a creditor makes a *general request* concerning income and the source of that income. [Commentary 5(d)(2)-2] Model application forms in Appendix B to the regulation include sample language for the disclosure. In the alternative, a creditor can ask questions that are formulated in a way that solicits only information about *specific* sources of income (i.e., salary, wages, employment, or other specified categories of income), thereby making reference to alimony, etc. unlikely. [Commentary 5(d)(2)-3]

5. Childbearing and Childrearing

The fifth exception for specific inquiries that would ordinarily not be relevant to an applicant's ability or willingness to repay a debt pertains to matters regarding childbearing and childrearing. Creditors are permitted to ask applicants about the number and ages of their dependents and about dependent-related financial obligations or expenditures, provided this information is requested without regard to sex, marital status, or any other prohibited basis.

Creditors are prohibited, however, from inquiring about an applicant's birth control practices, intentions concerning the bearing or rearing of children, or capability to bear children. [12 CFR 202.5(d)(2)]

6. Residency and Immigration Status

The sixth exception for specific inquiries that would ordinarily not be relevant to an applicant's ability or willingness to repay a debt pertains to an applicant's residency and immigration status. Creditors are permitted to inquire about the permanent residency and immigration status of an applicant or any other person in connection with a credit transaction. [12 CFR 202.5(e)]

B. Evaluating an Application

After a creditor receives a completed application, it proceeds to evaluate the creditworthiness of the applicant. The pattern established above with respect to taking applications is repeated here: there are general rules and there exceptions to the rules.

The two most general of the general rules regarding the evaluation of applications work in tandem to reinforce the prohibition against discrimination on prohibited bases. Creditors are permitted to consider any information when evaluating applications so long as the information is not used to discriminate against an applicant on a prohibited basis. [12 CFR 202.6(a)] And in any system they may use for evaluating the creditworthiness of applicants, they are prohibited from taking into account any prohibited basis. [12 CFR 202.6(b)(1)]

But what the regulation grants, the Commentary reins in: "a creditor may not consider in its evaluation of creditworthiness any information that it is barred by § 202.5 from obtaining or from using for any purpose other than to conduct a self-test under § 202.15." [Commentary 6(a)-1] In light of this, some of what is addressed here regarding the evaluation of applications will be tied to issues addressed in the preceding section about the taking of applications.

1. Credit Scoring Systems and Consideration of Age

Regulation B does not require or endorse any particular method of credit analysis. Creditors may use traditional, judgmental methods that rely on a credit officer's subjective evaluation of an applicant's creditworthiness. They may also use more objective techniques, including "empirically derived, demonstrably and statistically sound, credit scoring systems." Important consequences for evaluating applications follow from this choice.

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. The distinction is

important because the former type of system is permitted to take an applicant's age directly into account as a predictive variable.

Age is excluded as a variable from judgmental systems. ECOA and Regulation B do, however, permit creditors to consider the applicant's age for the purpose of evaluating other applicant information that has a demonstrable relationship to creditworthiness. An applicant's age may also be considered under either type of evaluations system if that factor is used to favor elderly applicants. [12 CFR 202.6(b)(2)]

2. Applicant Characteristics

As noted above in Section VI.A.1, creditors are ordinarily prohibited from inquiring about the (i) race, (ii) color, (iii) religion, (iv) national origin, or (v) sex of an applicant or any other person in connection with a credit transaction. [12 CFR 202.5(b)] Except as may be permitted or required by law, they are also are prohibited from considering those characteristics (or an applicant's decision to withhold information about them) in any aspect of a credit transaction. [12 CFR 202.6(b)(9)]

3. Marital Status

As noted above in Section VI.A.3, creditors generally may not inquire about the marital status of an applicant for individual unsecured credit, but may do so when taking applications for other kinds of credit (i.e., joint credit and secured credit). Except as may be permitted or required by law, creditors must evaluate married and unmarried applicants by the same standards; and when evaluating joint applicants, creditors are prohibited from treating applicants differently based on whether they are married or not, or are likely to get married. [12 CFR 202.6(b)(8)]

4. Income — Including Alimony, Child Support, Separate Maintenance

When evaluating an applicant's income in connection with an application, creditors are prohibited from discounting or excluding the income of an applicant or the spouse of an applicant because of a prohibited basis or because the income is derived from part-time employment or is an annuity, pension, or other retirement benefit. They may, however, consider the amount of any income and the likelihood that it will continue into the future when evaluating an applicant's creditworthiness. If an applicant has included alimony, child support, or separate maintenance income on an application, a creditor must consider them to the extent that they are likely to be consistently made. [12 CFR 202.6(b)(5)]

5. Childbearing and Childrearing

As noted above in Section VI.A.5, creditors are prohibited from making inquiries regarding various issues involving childbearing and childrearing. When evaluating applications, they are also prohibited from making assumptions or using aggregate statistics relating to the likelihood that any category of persons will bear or rear children or will, for that reason, receive diminished or interrupted income in the future. [12 CFR 202.6(b)(3)]

6. Residency and Immigration Status

As noted above in Section VI.A.6, creditors are permitted to inquire about applicants' residency and immigration status in connection with the taking of credit applications. [12 CFR 202.5(e)] When evaluating an application, creditors are also permitted to consider that information and any additional information that may be necessary to ascertain their rights and remedies regarding repayment. [12 CFR 202.6(b)(7)]

C Extending Credit

A creditor's decision to approve an application marks a divide in the credit transaction. The balance between the creditor's and applicant's conflicting interests about information that we referred to in Section II.B of this chapter is no longer the focus of attention.

Once an application is approved, the focus shifts to discriminatory practices regarding the creation and administration of credit accounts. This section is, therefore, a list of prohibitions.

1. Establishment of Separate Accounts

Creditors are prohibited from refusing, on the grounds of sex, marital status, or any other prohibited basis, to grant a separate account to a creditworthy applicant. If a creditor offers separate accounts to unmarried applicants, it must offer separate accounts to creditworthy married applicants, and vice versa regardless of sex. [12 CFR 202.7(a)]

2. Designation of Names on Accounts

Creditors are prohibited from refusing to allow applicants to open or maintain accounts in (i) a birth-given first name and surname, (ii) a spouse's surname or birth-given first name, or (iii) a combined surname. [12 CFR 202.7(b)] They may require that applicants choose one name and use it consistently in connection with their accounts, but in the case of married joint borrowers, this need not be the husband's name. [Commentary 7(b)-1]

3. Changes Associated With Aging; Marital Status

Creditors are prohibited from taking certain actions with respect to existing open end credit accounts when any person who is contractually liable on such an account reaches a certain age, retires, or undergoes a change of marital status. In particular, creditors are prohibited from (i) terminating the account and (ii) changing its terms.

Following a change of marital status, a creditor may require a person to reapply for an existing open-end credit account if (i) the initial decision to grant credit was based in whole or in part on the income of the applicant's spouse, and (ii) if the applicant's income would not support the amount of credit currently available. [12 CFR 202.7(c)92)] While the reapplication is being evaluated, the creditor must allow the accountholder to use the account under the existing terms. [Commentary 7(c)(2)-1]

4. Signature Requirements

The provisions of Regulation B regarding the signature requirements for spouses and others can be confusing. Before wading into the details, we will examine the purpose of the provisions and review three general principles that influence this entire subject.

a. *Purpose and Principles*

The purpose of the signature rules is to permit applicants (and particularly women) who are creditworthy in their own right to obtain credit on their own. The regulation achieves this purpose by removing, to the greatest possible extent, any dependence of an applicant on his or her spouse, whether as guarantor, surety, endorser, or other similar party.

Three general principles govern the application of specific signature rules:

(i) when an applicant is qualified in his or her own right for the amount and terms of credit requested, a creditor is generally prohibited from requiring the signature of another person in connection with the loan;

(ii) when an applicant is not qualified in his or her own right for the amount and terms of credit requested, a creditor may require the signatures or one or more guarantors, endorsers, or other similar parties; and

(iii) when collateral of any sort is pledged as security for the repayment of a loan, a creditor is permitted to require signatures of

any persons on any instruments necessary to enable the creditor to reach the property pledged as security.

The third general principle highlights an important distinction between debt instruments (such as a promissory note) and security (or lien) instruments that are necessary to secure a debt and to reach and seize property in the event of a borrower's default (such as a mortgage, deed of trust, or other security device). Debt instruments establish the legal existence of a debt, and a person who signs such an instrument accepts a personal obligation to repay the debt in full. Security instruments, however, establish only the right of a creditor to seize pledged property in the even of default to satisfy the secured debt.

b. *Specific Signature Rules*

When one considers the general principles just described in light of the prohibitions against discrimination on any prohibited basis, the signature rules make intuitive sense.

Joint Applicants. Creditors are permitted to require the signatures of all joint applicants on the debt instrument and security instrument. This is so regardless of whether the applicants are married, so long as the application is intended by the applicants to be joint (i.e., with the applicants jointly liable for repayment and the assets of both supporting the debt).

Cosigners. If a creditor determines that an applicant for individual credit does not qualify for the amount and terms of credit requested, it may then request that the applicant obtain a cosigner or guarantor. But the creditor:

- must require a cosigner or guarantor in all circumstances where the applicants are similarly situated (i.e., the creditor cannot require cosigners only for unmarried applicants, or only for married applicants, or only for women, or men, etc,);
- must not require that the cosignor or guarantor be the applicant's spouse;
- must not impose requirements on the cosigner or guarantor that it is prohibited from imposing on the applicant.

[12 CFR 202.7(d)(5)]

Signature of an Applicant's Spouse. In certain circumstances a creditor may request a spouse's signature, even when a married applicant applies for individual credit.

(i) *Secured Credit.* When a loan is to be secured by the pledge of property, a creditor may require any person who holds an interest in the property to sign any instrument that the creditor reasonably believes to be necessary under state law to make the

property being offered as security available to satisfy the debt in the event of default. [15 USC 1691d(a); 12 CFR 202.7(d)(4)]

(ii) *Unsecured Credit.* In connection with unsecured credit, if an applicant relies in part on property of some kind to establish creditworthiness, a creditor may require any person who holds an interest in the property to sign any instrument that is necessary, or reasonably believed to be necessary, under state law to make the property relied on available to satisfy the debt in the event of death or default of the applicant. [12 CFR 202.7(d)(2)]

(iii) *Community Property States.* Slightly different rules apply if a married applicant who resides in a community property state requests individual unsecured credit, or if the property upon which a married applicant is relying upon is located in a community property state. In such circumstances, a creditor may require the signature of the applicant's spouse on any instrument including the note necessary under the law of the state in which the applicant resides, or in which the property is located, to make the community property available to satisfy the debt in the event of default, but only if: (a) the applicable state law denies the applicant power to manage or control enough community property to qualify for the credit requested; and (b) the applicant does not have sufficient separate property to qualify for the amount and terms of credit requested.[5]

Integrated instruments. An integrated instrument is one that combines the note, security agreement, and other disclosures associated with a credit transaction. A creditor may not require an applicant's spouse to sign an integrated instrument in transactions where the non-applicant spouse's signature would not be required on the note under the rules stated above. If a spouse's signature is necessary to reach the property relied upon and the creditor habitually uses an integrated form, the creditor can include a legend next to the spouse's signature that makes it clear that the spouse is signing (i) only to grant a security interest in property, and (ii) does not undertake any liability for the debt. [Commentary 7(d)(4)-3]

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[5] Even in community property states, a creditor may require the spouse's signature on any security instrument that is necessary to reach the collateral for a secured loan. But a creditor may not automatically require a spouse's signature on the note, except in conformance with the rules stated above in the text.

VII. Other Compliance Requirements: Disclosures and Notices

Section Preview

A. General Remarks Regarding Notices and Disclosures
B. Notices of Actions Taken (Adverse Action Notices)
C. Furnishing Credit Information Regarding Consumers
D. Providing Appraisal Reports
E. Notices Given in Connection With Electronic Communications

A. General Remarks Regarding Notices and Disclosures

The Equal Credit Opportunity Act is not primarily a disclosure statute as are, for example, the Truth in Lending Act and Truth in Savings Act. But creditors are required to provide specific disclosures and notices to applicants and are subject to certain provisions when furnishing credit information. The Federal Reserve Board has included ten sample notification forms in Appendix C to the regulation.

1. General Disclosure Requirements

Regulation B includes the general requirement that all written disclosures must be made in a clear and conspicuous manner. [12 CFR 202.4(d)] In accordance with this standard, disclosures must be presented in a reasonably understandable format in a way that does not obscure the required information. Neither the act nor the regulation imposes[6] a minimum type size requirement, but disclosures must be legible, whether typewritten, handwritten, or printed by computer. [Commentary 4(d)-1]

Most disclosures that are required by Regulation B must be given in a form that applicants may retain. The exceptions to this rule are:

(i) disclosures regarding self testing that may be given as provided in § 202.5(b); and
(ii) disclosures regarding information gathered for monitoring purposes provided for in § 202.13(c).

[6] In December 2003, the Federal Reserve Board issued a proposed rule regarding the clear and conspicuous standard. [68 Fed.Reg. 68786; Dec. 10, 2003] The proposal was withdrawn in June the following year. [69 Fed.Reg. 35541; June 25, 2004]

2. Electronic Communication of Notices and Disclosures

Regulation B has for many years permitted the use of electronic communication for required notices and disclosures. Prior to the June 2000 passage of the Electronic Signatures in Global and National Commerce Act (the E–SIGN Act; 15 USC 7001 et seq.), the regulation left this matter to agreement between creditors and applicants and provided very little guidance regarding the details of such an arrangement.

In April 2001, the Federal Reserve Board published an interim rule to establish uniform standards for the electronic delivery of disclosures required by several consumer compliance laws and regulations, including ECOA and Regulation B. [66 Fed.Reg. 17779; Apr. 4, 2001] The mandatory compliance date for the interim rule was lifted later that year, and in April 2007, the Board published a proposed rule to address the issue.[7] [72 Fed.Reg. 21131; Apr. 30, 2007] Current guidance regarding this issue is addressed more fully in Section IX of this chapter entitled ELECTRONIC COMMUNICATIONS.

B. Notices of Actions Taken on Applications

ECOA and Regulation B require creditors to provide notice to applicants regarding actions taken on their applications, whether favorable or unfavorable. [15 USC 1691(d); 12 CFR 202.9(a)] Favorable notice can be implied, such as when a creditor provides the requested credit card. [Commentary 9(a)(1)-2]

With respect to applications that are incomplete, a creditor has three options regarding the required notice. It can (i) take adverse action on the application and provide the required notice described below in this section, (ii) provide a written notice of incompleteness that specifies what information is missing and designates a reasonable time within which the applicant must provide it, or (iii) inform the applicant orally of the need for additional information. [12 CFR 202.9(c)]

Compliance Pointer: *For complete discussions regarding (i) when an application is complete or incomplete and (ii) what constitutes adverse action, see Sections IV.B.7 and IV.B.8, respectively, of this chapter.*

[7] As this book was going to press, the Federal Reserve Board adopted the rule in final form largely as proposed in April. [72 Fed.Reg. 63445; Nov. 9, 2007]

1. Content of Notice Required When Adverse Action is Taken

If a creditor takes adverse action with respect to an application from a *consumer*, the creditor must provide a written notice that states either (i) the specific reasons for the action or (ii) a disclosure of the applicant's right to a statement of specific reasons within 30 days, if the statement is requested within 60 days of the creditor's notification. The latter disclosure shall include the name, address, and telephone number of the person or office from which the statement of reasons can be obtained. If the creditor chooses to provide the reasons orally, the creditor shall also disclose the applicant's right to have them confirmed in writing within 30 days of receiving the applicant's written request for confirmation. [12 CFR 202.9(a)(2)]

If a creditor takes adverse action with respect to an application from a *business applicant,* the notice requirements are somewhat different. And these requirements differ depending on whether a business applicant had gross revenues of more or less than $1 million during the previous fiscal year.

For business credit applicants with gross revenues of $1 million or less, a creditor must generally comply with the same notification requirements as it does for consumer credit applicants. But the creditor has the following options regarding how it will comply:

(i) the creditor may provide the notice either orally or in writing;

(ii) if the creditor chooses to provide a notice that the business applicant has a right to receive a statement of specific reasons for action taken, it may provide that notice at the time of the application, *provided* that the notice includes additional information described at § 202.9(a)(3)(i)(B).

(iii) if the application was made entirely over the phone, the creditor may provide an oral statement of action taken and of the applicant's right to a statement of reasons for adverse action.

[12 CFR 202.9(a)(3)]

The notification requirements for business credit applicants with gross revenues of more than $1 million are relatively simple: the creditor must notify the applicant of the action taken within a reasonable time period, and the notice may be oral or in writing. A written statement of the reasons for adverse action and the ECOA notice must be provided only if the applicant makes a written request within 60 days after the creditor's notification of the action taken.

Compliance Pointer: *The Federal Reserve Board has included sample notification forms in Appendix C to the regulation that address the different applicant circumstances described here. Since examples are often more useful than descriptions, readers should review those model forms in connection with their review of this section.*

2. Notices Required Within 30 Days

Creditors are generally required to notify applicants of action taken within 30 days after receipt of a completed written or oral application. This time limit applies to approvals of, counteroffers to, and adverse action on credit applications, as well as adverse action taken with respect to existing accounts. This same time limit applies with respect to incomplete applications if the creditor selects the option of taking adverse action on the application and providing the required notice. [12 CFR 202.9(a)(1)(i), (ii) and (iii)]

There are two exceptions to the 30-day limit. When an applicant expressly withdraws an application, the creditor need not provide any notice regarding any action it may have taken prior to the withdrawal. [Commentary 9-2] A creditor may treat an application as having been withdrawn if the applicant is to inquire about the status of an application but fails to do so within 30 days. [12 CFR 202.9(e)] The second exception involves counteroffers and is addressed immediately below.

3. Notices Required Within 90 Days for Counteroffers

If a creditor denies an application but makes a counteroffer, it has 90 days from the date of the counteroffer to provide an adverse action notice if the applicant does not expressly accept or use the credit offered. [12 CFR 202.9(a)(1)(iv)] The regulation does not require that a creditor hold open a counteroffer for the entire 90 days or any other particular length of time. [Commentary 9(a)(1)-5] If a creditor provides a combined counteroffer and adverse action notice that complies with § 202.9(a)(2) (see model form C-4 in Appendix C), it need not send a second adverse action notice if the applicant does not accept the counteroffer. [Commentary 9(a)(1)-6]

C. Furnishing Credit Information Regarding Consumers

A frequently used method by which creditors determine a consumer applicant's creditworthiness is to examine a credit history that has been compiled and

maintained by one of the consumer credit reporting agencies from information supplied primarily by creditors themselves. Regulation B establishes requirements that govern the method by which the information must be maintained and reported.

These requirements are designed to enable customers, primarily women, to (1) develop their own credit histories; (2) have their joint accounts reflected in such a way that either joint or individual retrieval of information is possible; and (3) be assured that only the information pertinent to their own credit histories is reported and considered when they individually apply for credit.

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

(i) any new account to reflect the participation of both spouses if an applicant's spouse is permitted to use or is contractually liable on the account; and

(ii) any existing account to reflect the participation of both spouses within 90 days after receiving a written request to do so from one of the spouses.

[12 CFR 202.10(a)]

If a creditor furnishes credit information to a consumer reporting agency regarding an account that is designated to reflect the participation of both spouses, the creditor must furnish the information in a manner that will enable the agency to provide access to the information in the name of each spouse. [12 CFR 202.10(b)]

Also, if a creditor furnishes credit information in response to an inquiry concerning an account designated to reflect the participation of both spouses, the creditor shall furnish the information in the name of the spouse about whom the information is requested. [12 CFR 202.10(c)]

D. Providing Appraisal Reports

In 1991, ECOA was amended so as to require creditors to furnish copies of the appraisal reports used in connection with applications for loans that are or would have been secured by a lien on residential real property. Creditors are permitted to require applicants to reimburse the cost of the appraisal. [Pub.L. 102-242; 15 USC 1691(e)]

Creditors can comply with this requirement by routinely providing copies of the reports to applicants regardless of whether an application is approved, denied, or withdrawn. In the alternative, creditors can notify applicants of their right to receive the report. This notice must be given no later than the time that

a notice of action taken is given, must specify that the request be in writing, and must include the creditor's mailing address. The notice must also inform the applicant that a request for a copy of an appraisal report must be received no more than 90 days after the notice of action taken or no more than 90 days after an application is withdrawn. [12 CFR 202.14(a)]

E. Notices Given in Connection With Electronic Communications

The Electronic Signatures in Global and National Commerce Act (the E–SIGN Act; 15 USC 7001, et seq.) establishes standards under which notices, disclosures, and other information relating to consumer transactions in interstate or foreign commerce may be given in electronic form. In 2001, the Federal Reserve Board issued an interim final rule to provide guidance on the timing and delivery of electronic notices and disclosures required by ECOA and Regulation B. [66 Fed. Reg. 17779, Apr. 4, 2001]

When the interim final rule was published, the Federal Reserve Board established Oct. 1, 2001 as the mandatory compliance date. By August 2001, however, the Board was considering adjustments to the rule that would address concerns expressed by commenters. The Board lifted the October 1 mandatory compliance date [66 Fed.Reg. 41439; Aug. 8, 2001]

In April of 2007, the Federal Reserve Board published proposed amendments to Regulation B [72 Fed.Reg. 21125; Apr. 30, 2007] that address the issue of disclosures made by electronic communications.[8] Comments regarding the proposal were due by June 29, 2007.

Compliance Pointer: *For a detailed discussion of when and how disclosures and notices required by Regulation B may be provided by electronic means, see Section IX of this chapter entitled* ELECTRONIC COMMUNICATIONS.

[8] As this book was going to press, the Federal Reserve Board adopted the rule in final form largely as proposed in April. [72 Fed.Reg. 63445; Nov. 9, 2007]

VIII. Compliance Operations: Other Than Disclosures and Notices

Section Preview

A. Obtaining Information for Monitoring Purposes
B. Self-Testing and Self-Correction

A. Obtaining Information for Monitoring Purposes

In order to monitor compliance with federal statutes that prohibit lending discrimination, creditors are required to request and maintain information about applicants' ethnicity, race, sex, marital status, and age in connection with written applications for the purchase or the refinancing of a dwelling (i) that is occupied or will be occupied by the applicant as a principal residence and (ii) that is secured by a lien against the dwelling. Specific categories for ethnicity and marital status are prescribed in the regulation. [12 CFR 202.13(a)]

Creditors have the option of including this information request on their application forms or on separate pages that refer to the application. Applicants must be informed (i) of the reason the information is being requested, (ii) that disclosure of the requested information is optional, and (iii) that if the applicant declines to provide some or all of the information, the creditor will note that fact on the form and then fill in the information on the basis of visual observation and the applicant's surname. [12 CFR 202.13(b) and (c)]

Compliance Pointer: *This provision of Regulation B overlaps with some requirements of Federal Reserve Regulation C. [12 CFR part 203] The latter generally requires creditors subject to the Home Mortgage Disclosure Act to collect and report information about the race, ethnicity, and sex of applicants for home-improvement loans and home-purchase loans, including some types of loans not covered by § 202.13.*

B. Self-Testing and Self-Correction

In 1996, Congress amended ECOA to create a privilege against disclosure for information developed by creditors during voluntarily conducted self-tests. The

law also established a similar self-test provision in the Fair Housing Act. [Pub. L. 104-208, (Economic Growth and Regulatory Paperwork Reduction Act of 1996), title II, § 2302, Sept. 30, 1996, 110 Stat. 3009-420] The Federal Reserve Board amended Regulation B the following year to provide guidance regarding self-tests and the related privilege. [proposed rule at 62 Fed.Reg. 56; Jan. 2, 1997: final rule adopted at 62 Fed.Reg. 66411; Dec. 18, 1997]

By defining what constitutes a self-test, the regulation establishes the scope of what kinds of reports or results are eligible for the privilege.

A self-test, as defined in § 202.15, must meet two criteria. First, it must be a program, practice, or study that a creditor designs and uses specifically to determine the extent or effectiveness of its compliance with ECOA and Regulation B. Second, 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. [12 CFR 202.15(b)(1)]

If a self-test satisfies the foregoing criteria and is conducted voluntarily by a creditor, the report or results of the self-test, data and factual information created by the self-test, and any analysis, opinions, and conclusions pertaining to the self-test report or results are privileged against discovery or use by outside parties. Specifically, they are privileged against discovery or use by (1) a government agency in any examination or investigation related to ECOA or Regulation B, and (2) a government agency or an applicant in any legal proceeding involving an alleged violation of ECOA or Regulation B. [12 CFR 202.15(d)(1)]

The privilege applies, however, only if the creditor has taken or is taking appropriate corrective action if the self-test shows that it is more likely than not that a violation occurred. In this context, appropriate action would be action that is reasonably likely to remedy the cause and effects of a likely violation by (i) identifying the policies or practices that are the likely cause of the violation; and (ii) assessing the extent and scope of any violation. [12 CFR 202.15(c)]

The privilege does not extend to (i) information about whether a self-test was conducted; (ii) the methodology, scope, time period, or dates covered by the self-test; (iii) loan or application files or other business records related to credit transactions; and (iv) information derived from such files and records, even if aggregated, summarized, or reorganized. [12 CFR 202.15(b)(3)]

IX. Electronic Communications

Section Preview

A. Disclosures and Notices Provided by Electronic Communications
B. Proposed Amendment to Regulation B Regarding Electronic Communications

A. Disclosures and Notices Provided by Electronic Communications

For many years Regulation B has permitted the use of electronic communication for required notices and disclosures. Prior to the June 2000 passage of the Electronic Signatures in Global and National Commerce Act (the E–SIGN Act; 15 USC 7001 et seq.), the regulation left this matter to agreement by private parties and provided very little guidance regarding the details of any arrangements they made.

In April 2001, the Federal Reserve Board published an interim rule to establish uniform standards for the electronic delivery of disclosures required by several consumer compliance laws and regulations, including ECOA and Regulation B. [66 Fed.Reg. 17779; Apr. 4, 2001] In response to comments that identified operational and security concerns with respect to some aspects of the interim rules, the Board lifted the Oct. 1, 2001 mandatory compliance date but left the rules in place.

During the more than six years since then, the interim final rules have remained in effect as part of the respective regulations. But because the compliance date was lifted, financial institutions were never required to comply with them. In light of this, it is not surprising that when the Federal Reserve Board published proposed rules in April of 2007 to address the issue of electronic communications, it made reference to the "confusion about the status of the electronic disclosure provisions."[9] [72 Fed.Reg. 21131; Apr. 30, 2007]

1. What is an Electronic Communication?

For purposes of Regulation B, an *electronic communication* is a message that is transmitted between a creditor and an applicant in a format that allows visual text to be displayed on equipment such as a computer monitor. [12 CFR 202.16(a)]

[9] As this book was going to press, the Federal Reserve Board adopted the rule in final form largely as proposed in April. [72 Fed.Reg. 63445; Nov. 9, 2007]

2. Electronic Communications and the E–SIGN Act

The E–SIGN Act establishes standards under which notices, disclosures, and other information relating to consumer transactions in interstate or foreign commerce may be given in electronic form. After passage of the act in 2001, the Federal Reserve Board published interim rules amending Regulations B, E, M, Z, and DD to establish uniform standards for the electronic delivery of disclosures required by those regulations and the laws they implement. The focus in this chapter is on Regulation B.

Neither the E–SIGN Act, the interim rule regarding electronic communications published in 2001, nor the proposed rule published in 2007 affects any Regulation B requirement other than any provision that requires disclosures to be in paper form. Requirements regarding the timing, content, format, and retainability of disclosures made by electronic means, as well as the requirement that such disclosures be clear and conspicuous, are exactly the same as those given in paper form. [Commentary 16(b)-1]

a. *Prerequisites to Use of Electronic Communications*

The number of people who own or regularly use computers continues to grow, but not everyone has access to the Internet. And among those who do have access, some may wish to continue to handle credit matters on paper. Because of that, the interim rule establishes certain prerequisites that must be met before a creditor may use electronic communications to make disclosures mandated by Regulation B.

The first and perhaps most important prerequisite is not mentioned in Regulation B, but is addressed instead in the E–SIGN Act. This is the requirement that a creditor must (i) provide specific information about the electronic delivery of disclosures, and (ii) obtain the consumer's affirmative consent to receive electronic disclosures. [15 USC 7001(c)]

In addition to that basic prerequisite, the E–SIGN Act also requires the creditor to (i) disclose the requirements for accessing and retaining disclosures in electronic form, and (ii) provide the disclosures in accordance with the specified requirements. Finally, the consumer must demonstrate the ability to access the information electronically and affirmatively consent to electronic delivery. [15 USC 7001(c); Commentary 16(b)-2]

b. *Timing, Delivery, and Duration of Electronic Communications*

Creditors that use electronic means to provide required disclosures may do so in one of the following two ways:

(i) they may send the disclosures to an electronic address designated by the consumer; or

(ii) they may make the disclosures available at some other location, such as an Internet web site.

If a creditor uses the second method, it must also send a notice to the consumer's electronic address or to a postal address to alert the consumer to the fact that the disclosures are available. The notice must identify the account involved and the address of the Internet web site or other location where the disclosure is available. The disclosure must remain available for at least 90 days from the later of (i) the date the disclosure first becomes available, or (ii) the date of the notice that alerts the consumer that the disclosure is available.

c. *Returned or Undeliverable Electronic Communications*

From time to time and for a variety of reasons, emails and other electronic communications are returned to the sender. When that happens to a disclosure sent by a creditor to a consumer in accordance with 12 CFR 202.16, the creditor is required to take reasonable steps to attempt to redeliver it. This can be done, for example, by sending the disclosure to a different email address or to a postal address that the creditor has on file for the consumer. Sending the disclosure a second time to the same electronic address is not sufficient if the creditor has a different address for the consumer on file. [12 CFR 202.16(e); Commentary 16(e)-1]

B. Proposed Amendment to Regulation B Regarding Electronic Communications

The Federal Reserve Board's April 2007 proposed amendments to Regulation B accomplish three basic objectives. First, they retain the substance of certain provisions in the interim final rules that provide regulatory relief or guidance regarding electronic disclosures. Second, they remove from the regulations those provisions regarding electronic disclosures that restate or cross-reference provisions of the E–SIGN Act. And third, they remove other parts of the interim final rules that the Board believes may impose undue burdens on electronic banking and may be unnecessary for consumer protection.

Because compliance with the interim final rules never became mandatory, the Board believed that removing some of the provisions and revising others would simplify the regulations and reduce confusion about the status of electronic disclosures. But certain provisions in the interim final rules (including those that address foreign language disclosures) were not affected by the lifting of the mandatory compliance date and accordingly are now in final form. The Board's proposed amendments do not delete those provisions.

1. Regulatory Provisions Directly Related to Electronic Communications

The 2001 interim final rules added § 202.16 to Regulation B to address the general requirements for electronic communications. The proposed amendment would delete that section, as well as the Official Staff Commentary related to it.

The deleted content generally addresses the same requirements that are established in the E–SIGN Act. Its removal therefore does not negate the basic disclosure requirements. Those requirements, including the requirements to provide disclosures within specified timeframes and in a form that the consumer may keep, continue in force.

Further, the deletion does not generally affect the application of the E–SIGN Act to consumer disclosures under 15 USC 7001(c). The proposed amendment does, however, supersede the consumer consent and other provisions of the E–SIGN Act in specific circumstances, as discussed immediately below.

2. General Disclosure Requirements

The proposed amendment will revise the regulation so as to clarify that, subject to compliance with the consumer consent and other applicable sections of the E–SIGN Act, creditors may provide in electronic form those disclosures that must be given in writing. If, however, a creditor provides required disclosures in paper *and* electronic form, and relies on the paper form of the disclosures to satisfy its compliance obligation, the duplicate electronic form of the disclosures may be provided without regard to the consumer consent or other provisions of the E–SIGN Act. The reason for this is that the electronic forms of the disclosures are not the ones being used to satisfy a regulation's disclosure requirements.

The Federal Reserve Board has also proposed to require creditors to provide certain disclosures in electronic form without regard to the consumer consent or other provisions of the E–SIGN Act. The mandatory electronic disclosures are limited to those circumstances in which the use of electronic communication was initiated by an applicant, or in which consent is implied by the applicant's action.

X. Enforcement and Liability

Section Preview

A. Administrative Enforcement of ECOA and Regulation B
B. Civil Liability for Violations of ECOA and Regulation B
   1. Civil Liability
   2. Safe Harbors

The Equal Credit Opportunity Act and Regulation B provide for various consequences in the event of violations. These include administrative enforcement measures imposed by the federal bank regulators and civil liability to consumers for damages, attorney fees, and litigation costs. Each of these are addressed in this section.

A. Administrative Enforcement of ECOA and Regulation B

Administrative enforcement of ECOA and Regulation B is distributed among several federal regulatory agencies, including the federal financial institution regulators. As a general rule, the federal agencies with general supervisory authority over a particular group of creditors are given ECOA enforcement responsibility over those creditors. For example, the Comptroller of the Currency is responsible for enforcing compliance by national banks, and the National Credit Union Administration is responsible for compliance by federally chartered credit unions. For those creditors that are not under the specifically delegated supervision of another government agency, enforcement authority is granted to the Federal Trade Commission. [15 USC 1691c(a) and (c)]

For purposes of administrative enforcement, a violation of any requirement imposed by ECOA is also deemed to be a violation of the primary federal law under which a particular enforcement agency takes its authority. This means that ECOA violations by national banks, state member banks, state nonmember banks, and savings associations are also considered to be violations of the Federal Deposit Insurance Act; and ECOA violations by federal credit unions are considered also to be violations of the Federal Credit Union Act.

In addition, all the powers and functions of the Federal Trade Commission under the FTC Act are available to the FTC to enforce ECOA compliance by any creditor that is within the FTC's jurisdiction, regardless of whether that creditor

is engaged in commerce or meets any other jurisdictional tests in the FTC Act. [15 USC 1691c(c)]

B. Civil Liability for Violations of ECOA and Regulation B

ECOA and Regulation B establish a general principle regarding civil liability, but also provide exceptions and other safe harbors.

1. Civil Liability

The general rule regarding civil liability is that any creditor that fails to comply with any provision of ECOA or Regulation B can be subjected to civil liability in a court of law. Permissible damages fall into the following four categories:

(i) actual damages sustained by an applicant;

(ii) punitive damages (i.e., additional liability that is imposed in order to punish the creditor or to deter other creditors that might otherwise commit a similar violation) up to $10,000 in individual actions and up to the lesser of $500,000 or 1 percent of the net worth of the creditor in class actions;

(iii) equitable and declaratory relief that may be necessary to enforce the requirements imposed by the law; and

(iv) attorney fees and other costs associated with the lawsuit in actions where the applicant has prevailed.

[15 USC 1691e(b), (c), and (d)]

2. Safe Harbors

ECOA provides for two safe harbors. These are shields against liability in circumstances where a creditor would otherwise be vulnerable to administrative enforcement or civil liability for a violation of the law or regulation.

a. *Good Faith Reliance on Official Guidance*

Creditors and others who are subject to ECOA and Regulation B are safe from liability with respect to acts done or omitted in good faith reliance on Regulation B or the Board's Official Staff Commentary to the regulation. This safe harbor also extends to good faith reliance on any interpretation or approval by an official or employee of the board, so long as the official or employee has authority to give such interpretations or approvals. [15 USC 1691e(e)]

b. *Inadvertent Errors*

Certain violations of Regulation B are not subject to enforcement and liability if they occur through a creditor's inadvertent error. For purposes of this safe harbor, an inadvertent error is a mechanical, electronic, or clerical error that a creditor demonstrates was not intentional and occurred notwithstanding the maintenance of procedures reasonably adapted to avoid such errors. [12 CFR 202.2(s)]

This safe harbor for inadvertent errors applies to the following five sections or subsections of Regulation B:

(i) § 202.6(b)(6) regarding the use of applicants' credit histories;
(ii) § 202.9 regarding notifications;
(iii) § 202.10 regarding the furnishing of credit information;
(iv) § 202.12 regarding record retention; and
(v) § 202.13 regarding information for monitoring purposes.

Creditors must correct errors involving §§ 202.9 and 202.10 as soon as possible after they are discovered. Errors involving §§ 202.12 and 202.13 must be corrected prospectively. [12 CFR 202.17(c); Commentary 17(c)-2]

XI. EFFECT ON STATE LAWS AND ON FEDERAL LAWS AND REGULATIONS

Section Preview

A. Interaction With State Laws
B. Laws Regarding Finance Charges and Loan Ceilings

A. Interaction With State Laws

Regulation B preempts only those state laws that are inconsistent with ECOA or the regulation, and then only to the extent of the inconsistency. States are free to provide more protection to applicants than is provided by ECOA and Regulation B, and such laws are not held to be inconsistent with the law and regulation. [12 CFR 202.11(a)]

Other state laws, however, may be inconsistent with the law and regulation and *less protective* of applicants, and therefore are preempted. Among such laws are those that (i) require or permit acts or practices that are prohibited by ECOA and Regulation B, (ii) prohibit individual extensions of credit to spouses who individually and voluntarily apply for individual credit, and (iii) prohibit inquiries or collection of information that is required by the law and regulation. [12 CFR 202.11(b)]

Regulation B does not alter any provision of state property laws, laws relating to the disposition of a decedent's property, or federal or state regulations aimed at ensuring the solvency of financial institutions. [12 CFR 202.11(d)]

B. Laws Regarding Finance Charges and Loan Ceilings

Regulation B prohibits the aggregation of accounts, for purposes of determining permissible finance charges and loan ceilings, of married applicants who voluntarily apply for and obtain individual accounts with the same creditor. State laws regarding permissible loan ceilings must be construed so as to permit each spouse to become individually liable up to the amount of the loan ceilings, less the amount for which the applicant is jointly liable. [12 CFR 202.11(c)]

XII. Record Retention Requirements

Section Preview

A. Retention Requirements for Consumer and Business Credit
B. Extension of the 25–Month Retention Period

A. Retention Requirements for Consumer and Business Credit

ECOA § 703 establishes a basic rule that requires all creditors to maintain such records as may be necessary either to demonstrate compliance with the law or to facilitate enforcement of it. Except for a requirement that the retention period be at least one year, all details are left to the discretion of the Federal Reserve Board and its authority to issue regulations to carry out the purposes of the law. [15 USC 1691b(a)(4)]

Regulation B establishes a general 25–month record retention period for documentation pertaining to consumer credit accounts and 12 months for business credit. The record retention time period generally begins on the date that a creditor provides a notice of action taken or a notice that an application is incomplete. But with respect to applications for which a creditor is not required to comply with the notice requirements in § 202.9, the time period begins on the date the application is received. [12 CFR 202.12(b)]

The retention period can be substantially shorter for records involving businesses that had gross revenues in excess of $1 million in the preceding fiscal year, and extensions of trade credit, credit incident to factoring agreements, and similar business credit. For these, a creditor must retain records for 60 days after providing a notice of action taken. During those 60 days, if the applicant submits a written request for a statement of reasons for the adverse action or asks that records be retained, the creditor must hold them for 12 months. [12 CFR 202.12(b)(5)]

The record retention requirements apply to applications, information obtained in connection with monitoring requirements, and written information that is used in evaluating an application that is not returned to an applicant. They also apply to written copies and memoranda of oral communication if a notice of action taken or a statement of specific reasons for adverse action is furnished, and any statement the applicant may have submitted alleging an ECOA or Regulation B violation. [12 CFR 202.12(b)(1)]

If a creditor takes adverse action with respect to an existing account, the retention requirements apply to any written or recorded information regarding the adverse action and any statement the applicant may have submitted alleging an ECOA or Regulation B violation. [12 CFR 202.12(b)(2)]

B. Extension of the 25–Month Retention Period

The record retention periods established by § 202.12 are extended whenever applicants' account records become relevant to investigations, enforcement proceedings, or civil actions for damages. If a creditor has actual notice that it is under investigation or is subject to an enforcement action for an alleged violation, or if it has been served with notice of a legal action for civil liability, it must retain records beyond the otherwise applicable retention period until final disposition of the matter, unless an earlier time is allowed by order of the agency or court. [12 CFR 202.12(b)(4)]