BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

## Office Correspondence

**Date:** June 18, 1999

**To:** Board of Governors

**From:** Dolores S. Smith

**Subject:** Review of Regulation B

The Committee on Consumer and Community Affairs has reviewed the attached matter and believes it is ready for Board action.

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

## Office Correspondence

**Date:** June 18, 1999

**To:** Board of Governors

**From:** Division of Consumer and Community Affairs
(D. Smith, A. Hurt, L. Chanin, N. Taylor)

**Subject:** Review of Regulation B (Equal Credit Opportunity)

**ACTION REQUESTED:**

Approval to publish for comment proposed changes to Regulation B (Equal Credit Opportunity) following a comprehensive review of the regulation.

**SUMMARY:**

The Equal Credit Opportunity Act makes it unlawful for a creditor to discriminate against an applicant in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), receipt of public assistance benefits, and the good faith exercise of a right under the Consumer Credit Protection Act. The Board's Regulation B implements the act.

The Board began the current review of Regulation B in March 1998 by publishing an Advance Notice of Proposed Rulemaking (Advance Notice). In addition to soliciting general comment on revisions to the regulation, the Board identified specific issues for comment

involving: (1) data notation for nonmortgage products; (2) preapplication marketing practices; (3) the distinction between an inquiry about credit and an application for credit; (4) the definition of "creditor"; (5) documentation for business credit loans; and (6) exceptions from specific requirements of the regulation for business credit. The Board received 330 comment letters. Most commented solely on the issues identified in the Advance Notice.

The staff has completed its initial review of the regulation, and recommends that the Board propose revisions to Regulation B on issues addressed in the Advance Notice as follows:

- Remove the prohibition against the notation of information about an applicant's race, color, religion, national origin, and sex
- Address concerns about how race, national origin, sex, or other prohibited bases of discrimination under the Equal Credit Opportunity Act are being used in preapplication marketing practices by requiring creditors to retain records for certain prescreened solicitations.

Other recommended revisions to the regulation include proposing to increase the record retention period from 12 months to 25 months for most business credit transactions (to assist in the examination process) and retaining the limited exceptions from the regulation for certain types of credit (such as securities credit). In addition, staff anticipates providing guidance in the commentary on the distinction between an inquiry about credit and an application for credit and on the definition of "creditor." The draft Federal Register notice is Attachment A at page 21.

**DISCUSSION:**

Regulation B implements the Equal Credit Opportunity Act (ECOA), which prohibits a creditor from discriminating against an applicant on a prohibited basis in any aspect of a credit transaction. In addition to a general prohibition against discrimination, the regulation contains specific rules concerning credit application procedures, how credit history information is reported, procedures and notices for credit denials, and limitations on requiring signatures of persons other than the applicant on credit documents. The regulation also contains exceptions from certain requirements for specialized types of credit (such as securities credit), and provides model forms for optional use by creditors.

The Board received 330 comment letters on the Advance Notice of Proposed Rulemaking that announced the comprehensive review of Regulation B. Most commenters addressed only the specific issues identified by the Board in the Advance Notice. Also, most commented on the issue concerning data notation on nonmortgage loans.

The staff is presenting two issues for Board consideration. The first concerns the general prohibition against the notation of data on applicant characteristics, and whether to remove it. The second concerns preapplication marketing practices, and whether to require creditors to keep records related to certain prescreened solicitations.

## I. The Prohibition against the Notation of Data about Applicant Characteristics

### A. Background

Because the ECOA makes it unlawful for creditors to consider any of the prohibited bases of discrimination in a credit transaction, Regulation B generally has prohibited creditors from inquiring about, or noting, applicant characteristics in any aspect of a credit transaction. This general prohibition was intended to discourage discrimination, based on the premise that if creditors cannot inquire about or note such information, they are less likely to unlawfully consider the information. For home mortgage lending (given frequent allegations and concerns about unlawful discrimination) the regulation has required creditors, since 1977, to note the applicant's national origin or race, marital status, sex, and age in applications for home purchase loans, so that enforcement agencies can better monitor home mortgage lenders' compliance with the ECOA. The Home Mortgage Disclosure Act (implemented by Regulation C) imposed a similar data collection requirement in 1989 that applies to mortgage loans more broadly, encompassing home improvement loans in addition to home purchase loans.

In 1995, the Board proposed to remove the prohibition against noting an applicant's race, color, religion, national origin, and sex for nonmortgage credit products. The proposed revision was published at the time the banking agencies were revising regulations that implement the Community Reinvestment Act; the proposal responded to concerns about whether creditors were meeting the needs of their communities, particularly for small business and farm lending. The majority of the comments received on the proposal opposed removal of the prohibition, generally expressing concern that voluntary data notation would lead to mandatory data collection and result in substantially increased costs and burden. In addition, many commenters raised concerns about the quality of the data that would be obtained, given that supplying information would be voluntary and not all applicants would choose to provide it. Commenters who supported removal of the prohibition believed that the data would allow creditors to better identify underserved groups and design programs to address unmet credit needs; they also believed that it would provide useful data for evaluating creditors' compliance with fair lending laws. After extensive deliberation, the Board withdrew the proposal in December 1996, and stated that, given the political sensitivity of the issues involved, the matter was better left to the Congress.

The Board's 1998 Advance Notice solicited comment on whether the Board should again consider removing the prohibition, in its review of Regulation B. The Advance Notice raised the issue in response to concerns that continue to be expressed by the Department of Justice and some of the federal financial enforcement agencies, pointing to anecdotal evidence of discrimination in connection with small business and other types of credit. They believe that the ability to obtain and analyze data about race and ethnicity (such as creditors might collect on a voluntary basis) would aid fair lending enforcement. In addition, some creditors continue to express interest in being able to note--on a voluntary basis--information about the ethnicity, sex, and race of their applicants and borrowers to evaluate compliance with fair lending laws, as well as for marketing and outreach initiatives. Small-business owners and community groups also continue to strongly support data notation, particularly for small business lending.

B. Summary of Comments

In the Advance Notice, the Board solicited comment on whether it should consider amending Regulation B to remove the prohibition against creditors' noting information about applicant characteristics for nonmortgage credit products. Removal would allow creditors to note the information on a voluntary basis.

More than 300 commenters addressed the issue. Many commenters--primarily banks and banking trade associations--urged the Board not to remove the prohibition. These commenters believed that, if the prohibition were to be removed, examiners and others would pressure depository institutions to collect data. They feared that a requirement to collect data would soon follow, which would then impose a substantial burden on institutions. These commenters expressed concern that creditors that obtained data about race, ethnicity, and other applicant characteristics would be subjected to greater scrutiny by enforcement agencies. They stated that data notation is intrusive of consumers' privacy, and would encourage a perception of creditors' using the data to discriminate. Some commenters stated that data noted on a voluntary basis would be unreliable and that the lack of standards for notation could render the quality of data questionable. (In some cases, commenters used this criticism to argue against lifting the prohibition; in other cases, they used it to argue for mandatory data collection.) Commenters also suggested that the current rule effectively discourages discrimination because loan officers often do not have access to information that would enable them to discriminate on a prohibited basis.

Many other commenters--including most of the federal financial enforcement agencies, the Department of Justice and Department of Housing and Urban Development, small businesses and their trade associations, consumer advocates, community organizations and some banks--favored removing the prohibition. A number of commenters favored removing it for all nonmortgage credit products, but most of those who favored lifting the ban were focused on small business lending. Some of these commenters believed that the most effective way to monitor and enforce fair lending compliance on small business loans is with mandatory collection, although they see voluntary notation for such loans as an important first step. They said that allowing data notation would enable creditors (and government agencies) to monitor for possible discriminatory practices, and might enable creditors to better target underserved markets for small business or other lending. Some commenters suggested that, in the case of home mortgage lending, the mandatory collection and disclosure of data have increased access to those products for low-income and minority consumers.

C. Issue and Alternative Actions

The issue for the Board's consideration is whether lifting the prohibition to allow creditors to note information about applicant characteristics is a better approach to deterring credit discrimination than retaining the prohibition in whole or in part. There are several alternatives the Board could consider. The Board could (1) leave the prohibition in place; (2) remove the prohibition for small business loans only or business loans generally; or (3) remove the prohibition for all credit products.

(1) Leave the prohibition in place. The act explicitly permits inquiries about public assistance income, marital status, and age, and allows creditors to consider these characteristics in limited circumstances. The regulation's prohibition against inquiries about race, religion, national origin, or sex is not explicitly mandated by the ECOA, but is consistent with the purpose of the law, which makes it generally unlawful to take these characteristics into account. Retaining the prohibition would continue to reinforce the idea that creditors generally may not consider information about such characteristics in making credit decisions. If creditors do not have the information, they cannot use it to discriminate.

Many enforcement agencies and others believe the general ability to note and analyze racial and ethnic information about who is applying for credit provides a better fair lending tool than prohibiting the notation of such information. In addition, the prohibition precludes creditors from demonstrating through data notation their compliance with fair lending laws, and from more readily establishing marketing and outreach programs to ensure fair lending. Furthermore, some applicant characteristics such as sex (and, in many instances, race) are evident, for example, at the application stage of in-person transactions.[1] Moreover, anecdotal evidence suggests that, despite the prohibition, discrimination can and does occur in small business lending and in other areas

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[1] Many transactions, however, are not in-person. Furthermore, if the person taking an application differs from the person involved in underwriting the loan, an applicant's race, for example, would not be evident unless documented.

such as automobile financing. Therefore, the general prohibition may not serve its intended purpose in all instances.

(2) Remove the prohibition for small business loans or business loans generally. The Board could revise the regulation to permit the notation of information about applicant characteristics for small business loans without extending the rule to other nonmortgage products. Small businesses represent more than 99 percent of all employers, and they employ more than 50 percent of the private workforce. They generate more than half of the nation's gross domestic product, and are the principal source of new jobs in the United States economy.[2]

Through the years, concerns have existed about ensuring availability and access to credit for small businesses on a nondiscriminatory basis. For example, the Congress amended the ECOA through the Women's Business Ownership Act of 1988 to require certain protections for small businesses in response to concerns about lack of access to credit. Concerns about whether creditors were meeting the needs of their communities under the Community Reinvestment Act--particularly for small businesses and small farm lending--prompted the Board's 1995 proposal to lift the prohibition on data notation. The Department of Justice has indicated its intention to increase its focus on small business lending in response to anecdotal evidence of discrimination. And papers presented at the Board's 1999 conference on "Business Access to Capital and Credit" offered findings consistent with possible discrimination in small business lending, although data limitations preclude drawing firm conclusions.

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[2] Businesses with 500 or fewer employees represent over 99 percent of all employers; businesses with 20 or fewer employees make up 90 percent of all employers. See the Small Business Answer Card 1998, Small Business Administration, Office of Advocacy.

In response to these concerns, the Board could narrowly focus on small business lending by removing the prohibition only for those loans. To the extent that data notation could be a positive force, however, a narrow focus would preclude the potential for addressing concerns related to other types of lending through data notation. Moreover, removing the prohibition on small business loans but not other nonmortgage loans would add some complexity to the regulation. A definition of a small business would likely be needed, although that complexity could be minimized if the prohibition were removed for all business loans generally.

(3) Remove the prohibition for all credit products. The Board could remove the prohibition to permit data notation for all nonmortgage credit products. Absent the application of uniform standards, the reliability of the data to prove or enforce fair lending compliance could be of limited utility. If some creditors note only certain applicant characteristics, or selectively note applicant characteristics on an individual or piecemeal basis, such data notation would not appear to serve a useful purpose. And, in some instances, if creditors chose to note data on applicant characteristics, voluntary data notation could provide an opportunity for unlawful discrimination.

On the other hand, if the prohibition against noting applicant characteristics on all nonmortgage credit were removed, creditors could opt to collect the information to demonstrate compliance or to refute claims of discrimination, as well as for outreach to underserved consumers. For those creditors that noted applicant characteristics, notation could also assist the federal and state authorities in enforcing the fair lending laws.

D. Recommendation

The staff recognizes that removing the prohibition would allow loan officers to have access to information on applicant characteristics that might not otherwise be available and, thus, could provide the opportunity for unlawful discrimination. Also, the staff recognizes that the usefulness of the data for fair lending enforcement purposes would depend on whether creditors implement standards for uniform collection of the data--such as by product, for all applicants, for all borrowers, etc. On balance, removing the prohibition for all nonmortgage credit may allow issues of credit discrimination to be better addressed. Because notation would be on a voluntary basis, creditors could target those products where particular concern exists about potential discrimination.

The draft rule removes the prohibition against noting information about an applicant's race, color, religion, national origin, and sex in any credit transaction.[3] Consideration of such information in evaluating creditworthiness, except as permitted by law, would continue to be prohibited by the ECOA and Regulation B. The draft rule further provides that applicants may not be required to provide information about their race, color, religion, national origin, and sex.

## II. Regulation B Coverage of Preapplication Marketing Practices

### A. Background

The ECOA prohibits discrimination by a creditor against an *applicant*--a person who has requested or received credit--on a prohibited basis regarding any aspect of a credit transaction. A credit transaction is defined by Regulation B as covering every aspect of an applicant's dealings with a creditor, beginning with requests for information. Thus, the coverage of the ECOA is generally limited to a person who has, at a minimum, sought credit information. It does not extend to a creditor's preapplication marketing practices--such as the selection of

[3] Marital status inquiries would continue to be prohibited. The act suggests that such inquiries are permitted only in limited circumstances.

persons solicited for a credit card. The regulation applies only after individuals respond to a creditor's offer of credit. But because a person could be discouraged from seeking credit or credit information, the regulation expressly prohibits a creditor from engaging in any practice that would *discourage* a reasonable person (*on a prohibited basis*) from applying for credit.

Creditors use a number of techniques to identify potential recipients of credit. For instance, creditors will often specify criteria to consumer reporting agencies, which then draw on information from credit files to compile mailing lists of persons who meet those criteria. This marketing technique--involving prescreened solicitations--is typically carried out through mailed solicitations as well as by telemarketing.

Over the years, there has been concern that Regulation B generally does not apply to preapplication marketing.[4] During the 1985 review of Regulation B, the staff presented to the Board the issue of whether prescreened solicitations should be made subject to the regulation, but recommended against coverage. While recognizing the potential for unfair discrimination in such practices, available evidence did not support a finding that creditors were improperly making use of prohibited characteristics. Moreover, it was thought that prescreened solicitations could actually result in a greater availability of credit to all consumers. Accordingly, the Board did not expand the regulation's coverage to such practices.

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[4] When the regulation was originally implemented in 1975, the definition of "credit transaction" included "solicitation of prospective applicants by advertising or other means." Thus, the prohibition against discrimination based on marital status and sex applied to solicitations. In December 1976--when Regulation B was revised to govern discrimination based on race, national origin, and other prohibited bases--the definition of credit transaction omitted any reference to solicitations. In its place, the regulation added the prohibition against discouraging persons from applying for credit on a prohibited basis.

Over the past several years, the Board's staff has become aware (through its own observations and those of other federal financial regulatory agencies) of instances in which creditors, primarily in the credit card industry, use age to identify potential recipients of preapproved credit. In some instances, creditors have used zip codes to exclude credit solicitations in low-income communities that represent predominantly minority neighborhoods. In other cases, creditors have used ethnicity or gender to target potential customers in affirmative-outreach programs.

B. Summary of Comments

The Board raised the issue of prescreened solicitations for public comment in its Advance Notice. Specifically, the Board requested comment on how and to what extent creditors are using a prohibited basis in preapplication marketing. Of the industry commenters that addressed preapplication marketing, however, only a few discussed the extent to which the selection criteria include a prohibited basis. These commenters indicated that except for using age to identify consumers too young to approve for credit, or to identify potential customers for unique products such as reverse mortgages, they do not directly use prohibited bases in preapplication marketing.

The majority of commenters--primarily creditors and their trade associations--addressed the more general issue of whether the Board should expand the regulation's coverage to preapplication marketing practices. Most of these commenters opposed any expansion. These commenters were concerned that an expansion of Regulation B would prevent creditors from marketing their products to those most likely to respond. They stated, for example, that a creditor offering products that are used predominantly by women might be prohibited from targeting consumers on a mailing list for a magazine geared toward women. Some commenters believed that the regulation's protections need not apply to prescreened solicitations because they are only one aspect of a creditor's overall marketing program, and that consumers who are not solicited may nevertheless obtain credit from the creditor. A few questioned the Board's legal authority to expand the regulation's coverage beyond "applicants."

Others--including most of the federal financial enforcement agencies and consumer representatives that commented--favored expanding the coverage of Regulation B to preapplication marketing practices. Some of these commenters expressed concern that currently a creditor is permitted to use a prohibited basis to limit or avoid extending credit by target marketing to certain groups. Other commenters believed that regulatory coverage of solicitations is necessary to fulfill the act's purpose, arguing that those not solicited are denied information that could lead them to apply for credit. Some commenters expressed concern about the inconsistent approaches between the Fair Housing Act, whose coverage extends to preapplication marketing, and the ECOA, which does not.

C. Issue

One of the primary goals of the ECOA is to ensure fair lending, but the act focuses its protections on persons who request credit. Nonetheless, the Board's Regulation B expressly prohibits a creditor from engaging in any practice that would discourage (in advertising or otherwise) a reasonable person on a prohibited basis from applying for credit. The issue for Board consideration is whether, in addition to advertising, Regulation B should address any other aspects of a creditor's preapplication marketing practices. Specifically, should the regulation cover prescreened solicitations for credit.

Prescreened credit solicitations, particularly prescreened credit card solicitations, are not new. The use of prescreened solicitations has become more commonplace beyond credit cards, however, and in some instances may be an important vehicle for offering credit. In the marketing of some credit cards, prescreened solicitations often offer discounted introductory rates, attractive terms and enhancements (such as purchase discounts) to those solicited that may not be available through other application channels. They can be used to target consumers most likely to use a particular credit product, or to target segments of the population that in the creditor's experience are most likely to respond to the offer of credit. Conversely, prescreened solicitations can be used to exclude some consumers from receiving offers of credit. They can also be used to target consumers in low-income, predominantly minority neighborhoods for less favorable credit products or less favorable terms.

Covering preapplication marketing practices without providing many exceptions would likely have unintended consequences. For example, it could result in prohibiting practices that increase credit availability. Targeted marketing through prescreened solicitations can effectively increase access to credit for consumers. Moreover, while there is anecdotal evidence that creditors do target potential applicants on the basis of age and geographic location, such evidence is somewhat limited. It does not suggest that the application of Regulation B rules is warranted at this time. Because of concerns about the potential impact on some segments of the population, however, the staff believes that the Board could take other steps that would enable the Board to monitor solicitation practices in a more systematic way than has been possible to date.

D. Recommendation

The ECOA directs the Board to prescribe regulations to carry out the purposes of the act. Further, section 703(a)(1) of the act authorizes the Board to make "such classifications . . . adjustments and exceptions . . . as in the judgment of the Board are necessary or proper to effectuate the purposes of [the law] . . . or to prevent circumvention or evasion . . . ." The staff recommends that the Board use this authority to propose a requirement that creditors keep records related to prescreened solicitations.

The draft rule presented for Board consideration would require creditors to retain certain information related to prescreened solicitations: the list of criteria used to select potential recipients, the solicitation used, correspondence related to the solicitation, and the marketing plan to which the solicitation relates. For purposes of the proposed rule, a prescreened solicitation would be defined as the "firm offer of credit" described in the Fair Credit Reporting Act (FCRA). Under the FCRA, persons that use information in consumer reports to select consumers to receive offers of credit are required to maintain the criteria used to select the consumers for three years after the date the offer is made to the consumer.

The draft rule would require creditors to retain information that the staff believes they already retain for business and other reasons. The proposal would solicit comment on the incremental burden associated with retaining information beyond the records creditors already are required to retain under the FCRA.

The information required by the proposed rule--the criteria for selection, the solicitations, correspondence, and the marketing plans to which the solicitations relate--should allow for an effective review and analysis of creditors' possible use of prohibited bases in prescreened solicitations. Staff believes that for entities that are regularly examined, the most effective way to review and evaluate creditor practices would be through the use of that examination process.

## III. Other Proposed Changes to the Regulation

### A. <u>Record Retention for Certain Business Credit</u>

The ECOA requires creditors to retain records or other data related to business loans as may be necessary to evidence compliance with the act. Currently, the act and regulation require creditors to retain credit applications and other records related to business credit for not less than one year. Some Reserve Banks and other enforcement agencies have expressed concern about the duration of the retention period. Given the low volume of business loans on a yearly basis and as the agencies reduce the frequency of examinations (from 18 to 24 months, and in some instances to 36 months), the current 12-month retention period may limit the agencies' ability to examine records for lending patterns since the preceding examination.

The staff <u>recommends</u> that the Board increase the record retention period from 12 months to 25 months to assist the enforcement agencies in monitoring and enforcing compliance with the act. In 1989, the Board proposed to increase the 12-month retention period to 25 months to parallel the requirements for nonbusiness credit. Creditors expressed concern about the space required to store documents and the associated costs. These concerns may no longer be compelling given the greater use of technology and the use of electronic storage. The proposal would seek comment on the burden issue.

Under the draft rule, the 25-month record retention period would apply to businesses with gross revenues of $1 million or less; the rule would remain unchanged for all other businesses. The record retention requirements for the majority of business credit would parallel those for consumer credit.

### B. **Limited Exceptions for Certain Classes of Transactions**

The regulation provides certain exceptions for public-utilities credit, securities credit, incidental credit, and government credit. Each of these types of credit remains subject to the general prohibition on discrimination; the exceptions are limited and generally cover issues such as record retention, inquiries about marital status and spouses, and the furnishing of credit information. The Board is required periodically to review the exceptions to determine whether they should be retained. The act provides that the Board may extend an exception if the Board determines, after making an express finding, that the application of the act to such transaction would not contribute substantially to effecting the law's purposes. After analyzing the exceptions, the staff believes that many of the exceptions are still appropriate.

Public-utilities credit refers to extensions of credit that involve public-utility services if the charges for the service, delayed payment, and any discount for prompt payment are regulated by a governmental unit, such as a public-utilities commission. Securities credit is credit subject to regulation under section 7 of the Securities Exchange Act of 1934 or extensions of credit by a broker or dealer subject to regulation under that act. Brokers and dealers are required to inquire about the financial activities of spouses to comply with the rules of the Securities Exchange Act and the National Association of Securities Dealers. Credit incidental to a service is limited to consumer credit. This type of credit might be extended by a local merchant to a long-standing customer or by a doctor or lawyer as an accommodation to a patient or a client. The staff recommends expanding incidental credit to include incidental business credit, as the staff believes that applying full regulatory coverage to business transactions that are entered into as more of a convenience rather than as a course of business would not effectuate the purposes of the act. With regard to government credit, the exceptions apply to extensions of credit made to governments or governmental subdivisions, agencies or instrumentalities.

The staff believes that most of the current exceptions for the types of credit previously discussed are appropriate, and recommends that the Board retain them; applying the full coverage of the regulation would not seem to effectuate the purposes of the act. Under the draft rule, a few exceptions from certain provisions of the regulation would be eliminated to reflect either proposed revisions to the regulation (i.e., lifting the prohibition against the notation of applicant characteristics) or changes in the industry (i.e., creditors' use of public-utilities credit payments as a source of payment history for underwriting purposes).

## IV. **Summary**

Regulation B would be modified by: (1) removing the prohibition against the notation of information about an applicant's race, color, religion, national origin and sex; (2) requiring creditors to retain records for certain prescreened solicitations for credit; and (3) extending the record retention period from 12 months to 25 months for credit applications from small businesses. The proposal also would retain the exceptions in the regulation for public-utilities, securities, incidental, and governmental credit, with some adjustments. The Federal Register notice (Attachment A) contains the proposed revisions to the regulation, many of which are technical or minor. The staff believes the proposed revisions will enhance both compliance and the protections of the regulation by providing clearer guidance about the regulation's requirements.

**FEDERAL RESERVE SYSTEM**

**12 CFR Part 202**

**[Regulation B; Docket No. R-****]**

**EQUAL CREDIT OPPORTUNITY**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rule and official staff interpretation.

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**SUMMARY:** The Board is issuing this proposal to revise Regulation B, which implements the Equal Credit Opportunity Act, pursuant to the Board's policy of periodically reviewing its regulations. The act makes it unlawful for creditors to discriminate against an applicant in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, and other specified bases. Major proposed revisions include removing the general prohibition against noting information about applicant characteristics, such as national origin or sex, although such information still generally may not be considered in extending credit; adding record retention requirements for selection criteria and certain related information in prescreened credit solicitations; and extending the record retention period for most business credit. Proposed revisions to the Official Staff Commentary are also included.

**DATES:** Comments must be received by [insert date 90 days after publication].

**ADDRESSES:** Comments, which should refer to Docket No. R-****, may be mailed to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments addressed to Ms. Johnson may be delivered to the Board's mail room between 8:45 a.m. and 5:15 p.m., and to the security control room at all other times. The mail room and the security control room, both in the Board's Eccles Building, are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, N.W. Comments may be inspected in room MP-500 between 9:00 a.m. and 5:00 p.m., pursuant to § 261.12, except as provided in § 261.14 of the Board's Rules Regarding the Availability of Information, 12 CFR §§ 261.12 and 261.14.

**FOR FURTHER INFORMATION CONTACT:** Natalie E. Taylor or Kathleen C. Ryan, Staff Attorneys, Jane Jensen Gell, Senior Attorney, or Jane E. Ahrens, Senior Counsel, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452-3667 or 452-2412; for the hearing impaired only, Dorothea Thompson, Telecommunications Device for the Deaf, at (202) 452-3544.

**SUPPLEMENTARY INFORMATION:**

**I. Background on ECOA and Regulation B**

The Equal Credit Opportunity Act (ECOA), 15 U.S.C. 1691, prohibits a creditor from discriminating against an applicant in any aspect of a credit transaction on the basis of the applicant's race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), receipt of public assistance benefits, and the good faith exercise of a right under the Consumer Credit Protection Act. The ECOA is implemented by the Board's Regulation B.

When enacted in 1974, the ECOA prohibited discrimination on the basis of marital status and sex. In 1976, the act was amended to add all of the other prohibited bases of discrimination. Over the years, several significant amendments have been made to the ECOA, including the following. In 1989, the ECOA was amended by the Women's Business Ownership

Act to require that creditors give written notice to business applicants of the right to a written statement of reasons for a credit denial, and to impose a record retention requirement for certain business credit applications. In 1991, the ECOA was amended by the Federal Deposit Insurance Corporation Improvement Act to provide applicants with a right to obtain a copy of the appraisal report used in connection with an application for credit to be secured by residential real property; the amendments expand the enforcement responsibilities of the federal financial supervisory agencies when information about possible violations of the ECOA becomes known. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended the ECOA to create a privilege for information developed by creditors as a result of "self-tests" they conduct.

**II. The 1998 Review of Regulation B**

The Board periodically reviews its regulations to update them. The Board's last comprehensive review of Regulation B occurred in 1985. The Board began the current review of Regulation B in March 1998 by publishing an Advance Notice of Proposed Rulemaking (Advance Notice) (63 FR 12326, March 12, 1998). In addition to soliciting general comment on revisions to the regulation, the Board identified specific issues for comment involving: (1) preapplication marketing practices, (2) the distinction between an inquiry about credit and an application for credit, (3) data notation for nonmortgage products, (4) the definition of creditor, (5) documentation for business credit, and (6) exceptions for business credit.

The Board received 330 comment letters on the Advance Notice. Most commenters addressed only the specific issues identified in the advance notice. Based on its review and on the comments received, the Board now proposes revisions to Regulation B and the official staff commentary.  In addition to comments on the proposed revisions, the Board requests specific suggestions for other revisions that would facilitate compliance with, or improve, the regulation.

## III.  Discussion of Proposed Revisions

Major proposed revisions include rules that require record retention for prescreened solicitations; lift the general prohibition against the notation--but not the use--of certain prohibited basis information; and extend the record retention period for certain business credit transactions. The following discussion covers the proposed revisions to the regulation and the official staff commentary section-by-section.  In some cases, proposed changes to a section have only been made to the regulation or to the commentary; in other cases, changes have been made to both the regulation and commentary.

### Section 202.2 -- Definitions

#### 2(c) Adverse action

#### 2(c)(1)

Section 202.2(c)(1)(ii) provides that adverse action includes a creditor's termination or unfavorable change in the terms of an account, unless the action affects "all or a substantial portion of a class of the creditor's accounts."   Commenters asked the Board to clarify the exception--namely, the meaning of "class of accounts" and "substantial portion" of a class of accounts.  Section 202.2(c)(1)(ii) would be revised to clarify the exception by changing the language from "substantial portion" to "substantially all" so that a creditor's action must affect the overwhelming majority of accounts in a designated class to be excluded from the definition of adverse action.

The ECOA requires creditors to give consumers specific reasons for an adverse credit decision. The notice requirement enables some recipients to avoid credit problems in the future, and may also help detect unlawful credit discrimination. The exception in section 202.2(c)(1)(ii) is intended to address the circumstance where a creditor takes action that affects all or most of a type of its accounts, rather than targeting specific customers, and an adverse action notice seems unnecessary. For example, if a creditor terminates its secured credit card program entirely, adverse action notices will not likely serve the intended educational or anti-discrimination goals.

**2(c)(2)**

Section 202.2(c)(2)(iii) would be revised to conform to changes proposed under section 202.2(c)(1)(ii).

**2(f) Application**

Section 202.2(f) would be revised to indicate that certain preapprovals are included in the definition of "application."

Inquiries about or applications for credit

In the Advance Notice, the Board solicited comment on whether it should provide additional guidance to further clarify the current distinction between an inquiry about credit and an application for credit. Specifically, the Board asked whether it should devise a different test for determining when a discussion becomes an application and, if so, what should be the test.

The ECOA requires creditors to provide notice of action taken within certain time frames following the creditor's receipt of a completed application. Regulation B defines an application as "an oral or written request for an extension of credit that is made in accordance with procedures established by the creditor for the type of credit requested." This enables the creditor to establish as formal or informal a process as it wishes.

The official staff commentary, through examples, encourages creditors to provide consumers with information that will assist them in the credit shopping process. The flexibility provided allows creditors to give information without entering into a formal application process, and thus to avoid triggering the notice and recordkeeping rules. To deter creditors from discouraging prospective applicants on a prohibited basis, however, the rule differentiates between an inquiry about credit and an application for credit. The distinction is currently based on what the creditor ultimately communicates to the person making the inquiry. That is, a credit inquiry can become an application if, in giving credit information to a potential applicant, the creditor evaluates information about the individual, decides that the individual does not meet the creditor's criteria for creditworthiness, and informs the individual accordingly. In that case, an adverse action notice is required and records are retained.

Many industry commenters expressed concern that the current test is difficult to apply because when a creditor has "declined" a request is not always clear. According to these commenters, it is often unclear when a creditor's discussion of negative factors, such as a person's poor payment history on loans, triggers an adverse action notice. Some commenters noted that, due to this lack of clarity, they often provide an adverse action notice to consumers to whom they give negative information--a procedure they view as burdensome and not necessarily helpful to many consumers. They believed the notice may discourage some consumers from later applying for credit, especially if those consumers initially were only seeking information.

Other commenters supported the current test; they believed that the test provides the flexibility they need. These commenters expressed reservations about changing a rule that creditors are already familiar with. They were also concerned that a change in the rule could require creditors to change the way they conduct business. Some commenters, including industry and consumer representatives, stated that adverse action notices should be given whenever consumers are informed that they are ineligible or lack the qualifications for credit, regardless of the stage in the credit process.

In response to commenters' concerns about when an adverse action notice is required, the Board considered whether a different test is appropriate. The Board focused on creditors' use of new delivery channels for loan products and information (such as the Internet), and growth in credit counseling and prequalification programs. Many of these developments result in consumers asking for and receiving information about credit products prior to submitting an application for credit.

The Board solicited comment on a number of issues concerning the definition of "application." The Board asked whether a "bright-line" test would best distinguish between an inquiry and an application (for example, whether obtaining a credit report should always trigger an application). Some commenters believed that such a test could eliminate confusion and inconsistent treatment among lenders. Others opposed a bright-line test, stating that any proposed test needs to have sufficient flexibility to accommodate new approaches to lending (such as prequalification requests) and home-ownership and small business loan counseling. Commenters noted that given rapid changes in lending and technology, today's bright-line test may not be appropriate in the future.

The Board also asked whether it would be desirable or possible to apply the current notification rules to home-ownership counseling programs that engage in credit evaluations; often, a credit report is obtained to determine the consumer's financial circumstances and to assist in an ongoing counseling process. Most commenters did not believe the current rules should be applied to such programs. They generally supported a rule that would encourage counseling without imposing burdensome notification requirements.

Finally, the Board solicited comment on whether the issue of distinguishing an inquiry from an application also arises in nonmortgage credit. Most commenters believed the issues were similar, and that there was nothing unique about nonmortgage credit, such as credit card, automobile, and small business lending, that requires a different test; they generally believed that, for purposes of consistency, all credit should be subject to the same test.

In response to comments, and to address new approaches to lending, the Board proposes to clarify a creditor's responsibilities under the ECOA when evaluating information about a consumer before the consumer actually applies for credit. The Board would provide this guidance by means of the official staff commentary.

**2(l) Creditor**

The ECOA and Regulation B prohibit a creditor from discriminating against an applicant on a prohibited basis regarding any aspect of a credit transaction. The ECOA's definition of creditor includes anyone who "regularly extends" or "regularly arranges for" the extension of credit, as well as any assignee of an original creditor who "participates in the decision" to extend credit. Regulation B combines these concepts and defines a creditor as a person who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit, including persons such as a potential purchaser of an obligation who influences the decision of whether or not to extend credit. For purposes of sections 202.4 and 202.5(a) (the prohibitions against discrimination and discouragement), brokers or others who regularly refer applicants to creditors (or who select or offer to select creditors to whom applications can be made) are also creditors. Regulation B also provides that a person (who may otherwise be a creditor) is not a creditor regarding a violation of the ECOA or the regulation committed by another creditor unless the creditor knew or had reasonable notice of the act, practice, or policy that constituted the violation before becoming involved in the credit transaction.

In the Advance Notice of Proposed Rulemaking, the Board requested comment on the definition of the term "creditor." The Board noted that creditors' distribution systems for lending services and products have expanded over the years, and that creditors have increasingly asked for guidance about how the term applies when a lender acts in conjunction with other creditors and discrimination occurs. Specifically, the Board solicited comment on whether it is feasible for the regulation to provide more specific guidance given that most issues will depend on the facts of a particular case. A slight majority of commenters asked the Board to provide more specific guidance. Some of these commenters requested that the Board provide a clearer description of the conduct that triggers liability. Other commenters requested that the Board expressly state the types of persons that are considered to be creditors under the regulation. Some commenters opposed additional guidance on the belief that whether the definition applies must be determined on a case-by-case basis. Other commenters believed that any additional guidance could result in criteria that would ultimately restrict the way creditors conduct business.

The Board also solicited comment on whether the current test--which relies on whether a person knew or had reasonable notice of an act of discrimination--should be modified. Some commenters believed that the test should be modified to clarify that a creditor is not responsible for the acts of another creditor where the creditor does not have control over the other creditor's activities. Some commenters stated that the Board should change the test to "actual" notice. Other commenters were concerned that the Board may change the test to impose a stricter standard; these commenters believed that a stricter standard could force creditors to discontinue many types of credit programs. Some consumer representatives noted that the current test encourages creditors to pass on the ultimate underwriting responsibilities to avoid knowledge of another creditor's activities. Most commenters believed the current test should not be modified. Some of these commenters stated that the Board should clarify through the staff commentary what constitutes "reasonable notice."

Finally, comment was solicited on whether the regulation should address under what circumstances a creditor must monitor the pricing or other credit terms when another creditor (for example, a broker) participates in the transactions. Some commenters believed the regulation should address monitoring to explicitly state that there is no such requirement. Some of these commenters stated that creditors would not have sufficient information to evaluate another creditor's practices and policies. Other commenters stated that monitoring could force creditors to restrict the creditors with whom they conduct business based on the size and capability of their monitoring systems. Some commenters stated, however, that the regulation should explicitly state that there is a monitoring requirement implicit in the "reasonable notice" test. A slight majority of commenters opposed the regulation's addressing whether a creditor must monitor the acts of other creditors with whom they conduct business.

The Board considered whether, given the wide differences in how creditors conduct business involving more than one creditor, a new test could provide clearer guidance. While the application of the current test is subject to interpretation, the Board believes that it is not possible to specify by regulation the wide variety of circumstances under which a creditor may or may not be liable for violations committed by another creditor. Accordingly, Regulation B retains the "reasonable notice" standard for when a creditor may be responsible for the discriminatory acts of other creditors. In response to comments, the Board would provide additional guidance on the "reasonable notice" standard by means of the official staff commentary.

**Section 202.3 -- Limited Exceptions for Certain Classes of Transactions**

The regulation provides certain exceptions for public-utilities, securities, incidental, and government credit. Each of these types of credit remains subject to the general prohibition on discrimination; the exceptions are limited and generally cover issues such as record retention, inquiries about marital status and spousal information, and furnishing credit information. Credit that does not meet one of the definitions is subject to the full coverage of Regulation B.

The Board is required periodically to review the exceptions to determine whether they should be retained. The act provides that the Board may extend an exception for a class of transactions "if the Board determines, after making an express finding that the application of [the act] or of any provision of [the act] of such transaction would not contribute substantially to effecting the purposes of [the act]." 15 USC 1691(b). After analysis, the Board believes that extending some of them is still appropriate, as applying the rules in their entirety would not contribute substantially to effectuating the purposes of the act, as discussed below.

Public-utilities credit refers to extensions of credit that involve public-utility services if the charges for the service, delayed payment, and any discount for prompt payment are filed with or regulated by a governmental unit, such as a public-utilities commission. Public-utilities credit is subject to all of the regulatory requirements except those relating to collecting information about marital status, furnishing credit information (to credit reporting agencies), and retaining records. Regulation B permits inquiries into an applicant's marital status only in limited circumstances. The exception from this provision permits creditors offering public-utilities credit to request information concerning marital status in all instances. The Board believes this exception is no longer needed and is proposing to remove the exception. Specific comment is solicited on this change. The proposed rule also would remove the exception relating to the furnishing of credit information under section 202.10 (concerning accounts held or used by spouses). The requirements of section 202.10 apply only to creditors that furnish credit information to credit bureaus or to other creditors. Such creditors are required to furnish information that reflects the participation of both spouses if the applicant's spouse is permitted to use or is contractually liable on the account. Creditors are considering public-utilities payments more frequently as a source of repayment history for underwriting purposes. Thus, the Board believes public-utility companies that furnish payment information should be subject to the same reporting requirements as other creditors subject to the ECOA. The Board seeks specific comment on this approach.

The regulation requires creditors to retain certain records. Public-utilities credit is not subject to the record retention requirements. The Board would retain the exception regarding record retention because public-utility companies must keep records pursuant to regulations of other governmental bodies--often for longer periods of time than required by the ECOA. The Board believes that extending this exception is appropriate because requiring record retention would not contribute substantially to effectuating the purposes of the act.

Securities credit is credit subject to regulation under section 7 of the Securities Exchange Act of 1934 or extensions of credit by a broker or dealer subject to regulation under that act. Brokers and dealers are required to inquire about the financial activities of spouses to comply with the rules of the Securities Exchange Act and the National Association of Securities Dealers. For this reason, Regulation B excepts securities credit from several provisions including, among others, signature rule requirements, rules relating to record retention, and requesting information about the sex of an applicant. The Board proposes to lift the prohibition against the collection of information about certain applicant characteristics; in light of the proposal, the current exception in section 202.3(b)(2)(iii) would be redundant. The Board believes that it is appropriate to extend the exceptions related to information concerning a spouse or former spouse, marital status, name designations, open-end accounts, spousal signature requirements, the furnishing of credit information, and record retention. Securities credit is subject to an extensive regulatory scheme, and applying the rules would not contribute substantially to effectuating the purposes of the ECOA. Technical revisions would be made for clarity, with no substantive change intended.

Currently, incidental credit is limited to consumer credit that is not: 1) made pursuant to the terms of a credit card account, 2) subject to a finance charge under Regulation Z, or 3) payable by agreement in more than four installments. This type of credit might be extended, for example, by a local merchant, that does not normally extend credit, to a long-standing customer, or by a doctor or lawyer as an accommodation to a patient or a client. The proposed rule would expand the exception for incidental credit to include incidental business credit, as the Board believes that full regulatory coverage of such credit does not effectuate the purposes of the act. Incidental business credit would be defined as business credit that is not made pursuant to the terms of a credit card account, is not subject to interest charges or fees, and is not payable by agreement in more than four installments. The Board solicits specific comment on this change.

Incidental credit is excepted from a number of provisions in the regulation including requesting information about an applicant's marital status, spouse or former spouse, and certain sources of an applicant's income. The proposed rule would eliminate the exception for requesting information about the sex of an applicant, in light of the Board's proposal to lift the prohibition against the collection of information related to a prohibited basis. The proposed rule would extend the exceptions concerning information about an applicant's spouse or former spouse, marital status, income sources, signatures, notifications, the furnishing of credit information, and record retention. The Board believes that, given the nature of the credit extension, applying these rules would not contribute substantially to effectuating the purposes of the act.

With regard to government credit, the exceptions apply to extensions of credit made <u>to</u> governments or governmental subdivisions, agencies or instrumentalities. The Board believes that extending these exceptions remains appropriate, as applying the rules would not contribute substantially to effectuating the purposes of the act.

**Section 202.4--General Rule Prohibiting Discrimination**

The ECOA prohibits discrimination by a creditor against an *applicant*--a person who has requested or received credit--on a prohibited basis regarding any aspect of a credit transaction. A credit transaction is defined by Regulation B as covering every aspect of an applicant's dealings with a creditor, beginning with requests for information. Thus, the coverage of the ECOA is generally limited to a person who has, at a minimum, sought credit information. It does not extend to a creditor's preapplication marketing practices--such as the selection of persons solicited for a credit card. The regulation applies only after individuals respond to a creditor's offer of credit. But because a person could be discouraged from seeking credit or credit information, the regulation expressly prohibits a creditor from engaging in any practice that would *discourage* a reasonable person (*on a prohibited basis*) from applying for credit.

Creditors use a number of techniques to identify potential recipients of credit. For instance, creditors will often specify criteria to consumer reporting agencies, which then draw on information from credit files to compile mailing lists of persons who meet those criteria. This marketing technique--involving prescreened solicitations--is typically carried out through mailed solicitations as well as by telemarketing.

Dating back to the 1970s, there has been concern that Regulation B generally does not apply to preapplication marketing. During the 1985 review of Regulation B, the staff presented to the Board the issue of whether prescreened solicitations should be made subject to the regulation, but recommended against coverage. While recognizing the potential for unfair discrimination in such practices, available evidence did not support a finding that creditors were improperly making use of prohibited characteristics. Moreover, it was thought that prescreened solicitations could actually result in a greater availability of credit to all consumers. Accordingly, the Board did not expand the regulation's coverage to such practices.

Over the past several years, the Board has become aware (through its own observations and those of other federal financial regulatory agencies) of instances in which creditors, primarily in the credit card industry, use age to identify potential recipients of preapproved credit. In some instances, creditors have used zip codes to exclude credit solicitations in low-income areas that represent predominantly minority neighborhoods. In other cases, creditors have used ethnicity or gender to target potential customers in affirmative-outreach programs.

The Board raised the issue of prescreened solicitations for public comment in its Advance Notice. Specifically, the Board requested comment on how and to what extent creditors are using a prohibited basis in preapplication marketing. Of the industry commenters who addressed preapplication marketing, only a few discussed the extent to which the selection criteria include a prohibited basis. These commenters indicated that except for using age to identify consumers too young to approve for credit, or to identify potential customers for unique products such as reverse mortgages, they do not directly use prohibited bases in preapplication marketing.

The majority of commenters--primarily creditors and their trade associations--addressed the more general issue of whether the Board should expand the regulation's coverage to preapplication marketing practices. Most of these commenters opposed any expansion. These commenters were concerned that an expansion of Regulation B would prevent creditors from marketing their products to those most likely to respond. They stated, for example, that a creditor offering products that are used predominantly by women might be prohibited from targeting consumers on a mailing list for a magazine geared toward women. Some commenters believed that the regulation's protections need not apply to prescreened solicitations because they are only one aspect of a creditor's overall marketing program, and that consumers who are not solicited may nevertheless obtain credit from the creditor. A few questioned the Board's legal authority to expand the regulation's coverage beyond "applicants."

Others--including most of the federal financial enforcement agencies and consumer representatives that commented--favored expanding the coverage of Regulation B to preapplication marketing practices. Some of these commenters expressed concern that currently a creditor is permitted to use a prohibited basis to limit or avoid extending credit by target marketing to certain groups. Other commenters believed that regulatory coverage of solicitations is necessary to fulfill the act's purpose, arguing that those not solicited are denied information that could lead them to apply for credit. Some commenters expressed concern about the inconsistent approaches between the Fair Housing Act, whose coverage extends to preapplication marketing, and the ECOA, which does not.

Prescreened credit solicitations are not new, particularly credit card solicitations. The use of prescreened solicitations has become more commonplace beyond credit cards, however, and in some instances may be an important vehicle for offering credit. In the marketing of some credit cards, prescreened solicitations often offer discounted introductory rates, attractive terms and enhancements (such as purchase discounts) to those solicited that may not be available through other application channels. They can be used to target consumers most likely to use a particular credit product, or to target segments of the population that in the creditor's experience are most likely to respond to the offer of credit. Conversely, prescreened solicitations can be used to exclude some consumers from receiving offers of credit. They can also be used to target consumers in certain neighborhoods for less favorable credit products or less favorable terms.

Covering credit solicitations without providing many exceptions could have unintended consequences. For example, it could result in prohibiting practices that increase credit availability. Targeted marketing through prescreened solicitations can effectively increase access to credit for consumers. Moreover, while there is anecdotal evidence that creditors do target potential applicants on the basis of age and geographic location, such evidence is somewhat limited. It does not suggest that the application of Regulation B rules is warranted at this time. Because of concerns about the potential impact on some segments of the population, however, the Board believes it could take other steps that would enable the Board and the other enforcement agencies to monitor solicitation practices in a more systematic way than has been possible to date.

The ECOA directs the Board to prescribe regulations to carry out the purposes of the act. Further, section 703(a)(1) of the act authorizes the Board to make "such classifications . . . adjustments and exceptions . . . as in the judgment of the Board are necessary or proper to effectuate the purposes of [the law] . . . or to prevent circumvention or evasion . . . ." The Board is proposing to use this authority to require creditors to keep records related to prescreened solicitations.

The draft rule would require creditors to retain (for 25 months after a creditor solicits potential applicants for credit) certain information related to prescreened solicitations: the list of criteria used to select potential recipients, the solicitation used, correspondence related to the solicitation, and the marketing plan to which the solicitation relates. For purposes of the proposed rule, prescreened solicitations would be defined as the "firm offer of credit" described in

15 U.S.C. 1681b(c) of the Fair Credit Reporting Act (FCRA). Under the FCRA, persons that use information in credit reports to select consumers to receive offers of credit are required to maintain the criteria used to select the consumers for three years after the date the offer is made to the consumer.

The draft rule would require creditors to retain information that the Board believes they already retain for business and other reasons. The proposal would solicit comment on any incremental burden associated with retaining information beyond the records creditors already are required to retain under the FCRA.

The information required by the proposed rule--the criteria for selection, the solicitations, correspondence, and the marketing plans to which the solicitations relate--should allow for an effective review and analysis of creditors' possible use of prohibited bases in prescreened solicitations. For entities that are regularly examined, the Board believes that the most effective way to review and evaluate creditor practices would be through the use of that examination process.

Section 202.4 would be revised to include the general rules that apply under the regulation. The Board believes this approach would facilitate compliance with the regulation. Section 202.4(a) would provide the general rule against discrimination. Section 202.4(b) would provide the general rule against discouraging applications. Section 202.4(c) would provide the rule for when written applications are required.

Section 202.4(d) would contain clear and conspicuous and retainability requirements that the Board is proposing to apply to the disclosures and other information required by the regulation. In March 1998, the Board requested public comment on a proposal to permit the electronic delivery of disclosures for four of its consumer protection regulations: Regulation B; Regulation M, Consumer Leasing; Regulation Z, Truth in Lending; and Regulation DD, Truth in Savings (63 FR 14533-14552). Each of those regulations, except for Regulation B, expressly requires creditors to present required information in a clear and conspicuous manner, in a form the consumer may keep. Accordingly, the Board proposed that the clear and conspicuous and retainability requirements be applied to information required under Regulation B (63 FR 14552). For consistency with the proposal concerning electronic delivery of information, section 202.4 would include the clear and conspicuous and retainability requirements.

**Section 202.5--Rules concerning taking of applications.**

Because the ECOA makes it unlawful for creditors to consider any of the prohibited bases of discrimination in a credit transaction, Regulation B generally has prohibited creditors from inquiring about, or noting, applicant characteristics in any aspect of a credit transaction. This general prohibition was intended to discourage discrimination, based on the premise that if creditors cannot inquire about or note such information, they are less likely to unlawfully consider the information. For home mortgage lending (given frequent allegations and concerns about unlawful discrimination) the regulation has required creditors, since 1977, to note the applicant's national origin or race, marital status, sex, and age in applications for home purchase loans, so that enforcement agencies can better monitor home mortgage lenders' compliance with the ECOA. The Home Mortgage Disclosure Act (implemented by Regulation C) imposed a similar data collection requirement in 1989 that applies to mortgage loans more broadly, encompassing home improvement loans in addition to home purchase loans.

In 1995, the Board proposed to remove the prohibition against noting an applicant's race, color, religion, national origin, and sex for <u>nonmortgage</u> credit products. The proposed revision was published at the time the banking agencies were revising regulations that implement the Community Reinvestment Act; the proposal responded to concerns about whether creditors were meeting the needs of their communities, particularly for small business and farm lending. The majority of the comments received on the proposal opposed removal of the prohibition, generally expressing concern that voluntary data notation would lead to mandatory data collection and result in substantially increased costs and burden. In addition, many commenters raised concerns about the quality of the data that would be obtained, given that supplying information would be voluntary and not all applicants would choose to provide it. Commenters who supported removal of the prohibition believed that the data would allow creditors to better identify underserved groups and design programs to address unmet credit needs; they also believed that it would provide useful data for evaluating creditors' compliance with fair lending laws. After extensive deliberation, the Board withdrew the proposal in December 1996, and stated that, given the political sensitivity of the issues involved, the matter was better left to the Congress.

The Board's 1998 Advance Notice solicited comment on whether the Board should again consider removing the prohibition, in its review of Regulation B. The Advance Notice raised the issue in response to concerns that continue to be expressed by the Department of Justice and some of the federal financial enforcement agencies, pointing to anecdotal evidence of discrimination in connection with small business and other types of credit. They believe that the ability to obtain and analyze data about race and ethnicity (such as creditors might collect on a voluntary basis) would aid fair lending enforcement. In addition, some creditors continue to express interest in being able to note--on a voluntary basis--information about the ethnicity, sex, and race of their applicants and borrowers to evaluate compliance with fair lending laws, as well as for marketing and outreach initiatives. Small-business owners and community groups also continue to strongly support data notation, particularly for small business lending.

In the Advance Notice, the Board solicited comment on whether it should consider amending Regulation B to remove the prohibition against creditors' noting information about applicant characteristics for nonmortgage credit products. Removal would allow creditors to note the information on a voluntary basis.

More than 300 commenters addressed the issue. Many commenters--primarily banks and banking trade associations--urged the Board not to remove the prohibition. These commenters believed that, if the prohibition were to be removed, examiners and others would pressure depository institutions to collect data. They feared that a requirement to collect data would soon follow, which would then impose a substantial burden on institutions. These commenters expressed concern that creditors that obtained data about race, ethnicity, and other applicant characteristics would be subjected to greater scrutiny by enforcement agencies. They also stated that data notation is intrusive of consumers' privacy, and would encourage a perception of creditors' using the data to discriminate. Some commenters stated that data noted on a voluntary basis would be unreliable and that the lack of standards for notation could render the quality of data questionable. (In some cases, commenters used this criticism to argue against lifting the prohibition; in other cases, they used it to argue for mandatory data collection.) Commenters also suggested that the current rule effectively discourages discrimination because loan officers often do not have access to information that would enable them to discriminate on a prohibited basis.

Many other commenters--including most of the federal financial enforcement agencies, the Department of Justice and Department of Housing and Urban Development, small businesses and their trade associations, consumer advocates, community organizations and some banks--favored removing the prohibition. A number of commenters favored removing it for all nonmortgage credit products, but most of those who favored lifting the ban were focused on small business lending. Some of these commenters believed that the most effective way to monitor and enforce fair lending compliance on small business loans is with mandatory collection, although they see voluntary notation for such loans as an important first step. They said that allowing data notation would enable creditors (and government agencies) to monitor for possible discriminatory practices, and might enable creditors to better target underserved markets for small business or other lending. Some commenters suggested that, in the case of home mortgage lending, the mandatory collection and disclosure of data have increased access to those products for low-income and minority consumers.

The Board proposes to remove the prohibition against noting information about an applicant's race, color, religion, national origin, and sex for all credit products. Consideration of such information in evaluating creditworthiness, except as permitted by law, would continue to be prohibited by the ECOA and Regulation B. The Board recognizes that removing the prohibition would allow loan officers to have access to information on applicant characteristics that might not otherwise be available and, thus, could provide the opportunity for unlawful discrimination. Also, the Board recognizes that the usefulness of the data for fair lending enforcement purposes would depend on whether creditors implement standards for uniform collection of the data--such as by product, for all applicants, for all borrowers, etc. On balance, removing the prohibition for all nonmortgage credit may allow issues of credit discrimination to be better addressed. Because notation would be on a voluntary basis, creditors could target those products where particular concern exists about potential discrimination. The proposed rule further provides that applicants may not be required to provide information about their race, color, religion, national origin, and sex.

In light of the proposal to remove the prohibition against certain data collection, proposed section 202.5 would be revised. Section 202.5(a) would be moved to section 202.4. Sections 202.5(b)-(d) would be redesignated as sections 202.5(a)-(c), and some of the rules barring information requests in those sections would be removed. The removal does not extend to substantive rules that the Board believes should be retained to effectuate the anti-discrimination provisions of the act, such as those relating to marital status. Also, section 202.5(e) would be moved to section 202.4 to facilitate compliance with the regulation.

**6(b) Specific rules concerning use of information**

**6(b)(8)**

Section 202.6(b)(8) would be added to state the general rule that a creditor may not consider marital status to determine the creditworthiness of individual or joint applicants. The Board believes that this guidance--currently in the commentary--is more appropriate in the regulation.

**6(b)(9)**

A new paragraph 202.6(b)(9) would be added to state the general rule that a creditor may not consider race, color, sex, religion or national origin in any aspect of a credit transaction, unless otherwise permitted by law.

**Section 202.7 -- Rules Concerning Extensions of Credit**

**7(d) Signature of spouse or other person**

A new paragraph 202.7(d)(1)(i) would be added to clarify the general rule concerning joint applications for credit. Regulation B does not require written applications for business credit. Many requests are made orally or without a formal written application. In such cases, a creditor usually requests that the applicant submit a financial statement for evaluation. As a general rule, Regulation B prohibits creditors from requiring the signature of a person other than the applicant on any credit instrument where the applicant is individually creditworthy. Where the financial statement (offered to support the business credit) lists jointly held property and is signed by both owners, some creditors are treating the financial statement as an indication that the owners intend to make a joint application for credit. In those cases, both owners often are being required to sign the note--even where the request for credit has been made by only one of the property owners. The Board believes that a joint property owner's signature on a financial statement (to attest to the accuracy or veracity of information) does not represent definitive evidence of a joint application.

In the Advance Notice of Proposed Rulemaking, the Board asked whether it should provide additional guidance to clarify the mechanisms through which an application for joint credit can be evidenced. Although some commenters stated that a written application is the best mechanism to establish an application for joint credit, other commenters believed the Board should provide additional guidance on the issue.

The Board does not propose to require written applications for business credit. However, paragraph 202.7(d)(1)(i) would be added to clarify that the submission of joint financial information does not of itself constitute an application for joint credit. The rule would apply to both consumer and business credit.

**Section 202.8 -- Special-Purpose Credit Programs**

**8(a) Standards for programs**

Section 202.8(a)(3) of the regulation, which addresses special-purpose credit programs offered by for-profit organizations, would be revised. The Board believes that paragraphs (a)(3)(i) and (ii) set forth the criteria; the phrase regarding "special social needs" would be deleted to eliminate confusion.

**Section 202.9 -- Notifications**

**9(a) Notification of action taken, ECOA notice, and statement of specific reasons**

**9(a)(3) Notification to business credit applicants**

The regulation provides for exceptions from certain notification and record retention requirements for business credit if the business had gross revenues in excess of $1 million in its preceding fiscal year, or if the business requested an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit. The Board is required periodically to review the exceptions to determine whether they should be retained. The act provides that the Board may extend an exception "if the Board determines, after making an express finding that the application of [the act] or any provision of [the act] of such transaction would not contribute substantially to effecting the purposes of [the act]." (See section 703(a)(3).)

The Advance Notice of Proposed Rulemaking requested comment on whether the limited exceptions are still appropriate. Some commenters stated that the exceptions should be eliminated; they believe business applicants, like consumer applicants, need adverse action notices to ensure that they have been treated fairly and not denied credit on a prohibited basis. Most commenters, however, favored retaining the current exceptions. These commenters stated that business applicants tend to be more sophisticated than consumer applicants, and, therefore, generally do not need the same protections as consumers. Some commenters suggested changing the test for when the exceptions apply; some commenters suggested lowering the $1 million threshold. Others suggested using the amount of the credit request rather than the size of the business.

The Board believes that applying the rules in full or changing the current test, which is based on a $1 million gross revenue threshold, would not contribute substantially to effectuating the purposes of the ECOA. Accordingly, the Board believes the exceptions based on the current threshold are still appropriate and should be extended. The $1 million threshold is consistent with the legislative history of the Women's Business Ownership Act of 1988, which amended the ECOA. That history suggests that the amendments were intended primarily to apply to small businesses. When the rule was adopted in 1989, 86 percent of all businesses had gross revenues of $1 million or less a year; thus, the annual gross revenue test was chosen as the appropriate measure for determining the size of businesses that should receive additional protections under the regulation. Retaining the $1 million threshold would provide nearly the same percentage of all businesses (currently 85 percent) with the additional protections. In addition, the Board believes that a gross revenue test is easier for creditors to administer than other suggested tests, such as basing the exception on the sophistication of the applicant.

Section 202.9(a)(3)(ii) would be revised to require that creditors orally disclose to businesses with gross revenues in excess of $1 million in the preceding fiscal year, the right to a written statement of reasons for adverse action. Currently, creditors must provide a written statement of reasons for adverse action if the applicant requests the statement within 60 days of being notified of adverse action. Requiring oral disclosure of the right should not significantly increase burden for creditors, and will benefit applicants who may not be aware of their right to the written statement of reasons.

**<u>9(b) Form of ECOA notice and statement of specific reasons</u>**

**<u>(b)(2) Statement of specific reasons</u>**

Section 202.9(b)(2) would be revised. The explanatory language being removed from the regulation would be placed in the commentary.

**Section 202.12 -- Record Retention**

**<u>12(b) Preservation of records</u>**

Section 703(a)(4) of the act requires creditors to retain records or other data related to business loans as long as necessary to evidence compliance with the act. These records must be retained no less than one year, unless otherwise excepted. Currently, section 202.12(b) requires creditors to retain credit applications and other records for 12 months for business credit. Under the proposal, a 25-month record retention period would apply to credit applications involving businesses with gross revenues of $1 million or less; the rule would remain unchanged for all other businesses.  The proposal would make the record retention requirements for the majority of business credit transactions consistent with those for consumer credit.

The Board believes that increasing the record retention period would assist regulatory agencies in monitoring and enforcing compliance with the act, particularly given the low volume of business loans on a yearly basis and as the agencies reduce the frequency of examinations (from 18 to 24 months, and in some instances to 36 months).  In 1989, the Board proposed to establish a 25-month record retention period.  Creditors expressed concern about the space required to store documents and the associated costs, and the Board adopted the 12-month record retention period.  The Board believes these concerns may no longer be compelling given technological advances and the use of electronic storage.

**<u>12(b)(7) Preapplication marketing information</u>**

A new section 202.12(b)(7) and two new comments would be added to clarify the record retention requirements for preapplication marketing information.

**Section 202.14--Enforcement, Penalties, and Liabilities**

Section 202.14(c) would be revised to reflect the Board's proposal to lift the prohibition against the collection of certain information.

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

**<u>15(b) Self-Test Defined</u>**

As discussed earlier, the Board proposes to lift the prohibition against the notation of information about an applicant's race, color, religion, national origin, and sex in connection with nonmortgage credit products. The Board has received questions about whether the self-testing provisions of section 202.15 would apply to the voluntary collection of this information. A self-test is defined as a program, practice or study designed and used specifically to determine compliance with the ECOA and Regulation B, and that creates data or factual information that is not available and cannot be derived from loan application files or other records related to credit transactions. If a self-test meets this definition, the results are privileged and cannot be obtained by an applicant or government agency in any examination, investigation or as part of any civil proceeding. The privilege may be lost or waived, however, under certain circumstances.

The Board believes that the voluntary collection of data about an applicant's characteristics in connection with nonmortgage credit is not itself a self-test, and thus is not privileged. A self-test exists only if the data can be used to determine compliance with the ECOA. The Board believes the collection of information about an applicant's characteristics is not by itself a practice that can be used to determine compliance with the law. Voluntary collection of applicant information alone does not meet this test since the information must be combined with other information that presumably is available or can be derived from loan application files or other records to conduct an analysis. For example, if a creditor voluntarily collects data about applicants' gender, for automobile loans, it could not use this data alone to determine compliance with the ECOA.

**Appendix B--Model Application Forms**

Appendix B would be revised to reflect the Board's proposal to lift the prohibition against the collection of certain information. In addition, model form 6-072 would be removed and replaced with an updated uniform residential loan application form (FHLMC65/FNMA 1003). The Board seeks specific comment on whether additional revisions should be made to the model application forms.

**Appendix C--Sample Notification Forms**

The Board seeks specific comment on whether additional revisions should be made to the sample notification forms.

**IV. Form of Comment Letters**

Comment letters should refer to Docket No. R-****, and, when possible, should use a standard typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text to machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Also, if accompanied by an original document in paper form, comments may be submitted on 3½ inch computer diskettes in any IBM-compatible DOS- or Windows-based format.

**V. PAPERWORK REDUCTION ACT**

In accordance with section 3506 of the Paperwork Reduction Act of 1995 (44 U.S.C. Ch. 35; 5 CFR 1320 Appendix A.1), the Board reviewed the proposed revisions under the authority delegated to the Board by the Office of Management and Budget.

The collection of information that is proposed to be revised by this rulemaking is found in 12 CFR Part 202. This information is mandatory to evidence compliance with the requirements of the (15 USC 1691(b)(a)(1) and Public Law 104-208, § 2302(a)) and also to ensure that credit is made available to all creditworthy customers without discrimination on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), receipt of public assistance, or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act (15 USC 1600 et. seq.). The respondent/recordkeepers are for-profit financial institutions, including small businesses. Creditors are required to retain records for twelve to twenty-five months as evidence of compliance.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, an information collection unless it displays a currently valid OMB number. The OMB control number for information collection under this regulation is 7100-0201.

The current estimated total annual burden for this information collection is 123,892 hours, as shown in the table below. This amount reflects the burden estimate of the Federal Reserve System for the 988 state member banks under its supervision. This regulation applies to all types of creditors, not just state member banks. However, under Paperwork Reduction Act regulations, the Federal Reserve accounts for the burden of the paperwork associated with the regulation only for state member banks. Other agencies account for the paperwork burden for the institutions they supervise.

It is believed the paperwork burden will increase slightly due to the addition of a new record retention requirement for prescreened solicitations, and an extension of the record retention period for most business credit.

| | *Number of respondents* | *Estimated annual frequency* | *Estimated response time* | *Estimated annual burden hours* |
|---|---|---|---|---|
| Notification | 988 | 1,715 | 2.50 minutes | 70,601 |
| Credit history reporting | 988 | 850 | 2.00 minutes | 27,713 |
| Monitoring information | 988 | 360 | .50 minute | 2,964 |
| Appraisal | | | | |
| Appraisal report upon request | 988 | 190 | 5.00 minutes | 15,643 |
| Notice of right to appraisal | 988 | 1,650 | .25 minute | 6,793 |
| Self-testing | | | | |
| Recordkeeping of test | 45 | 1 | 2 hours | 90 |
| Recordkeeping of corrective action | 11 | 1 | 8 hours | 88 |
| *total* | | | | 123,892 |

Since the Federal Reserve does not collect any information, no issue of confidentiality normally arises. However, any information collected by the respondents may be protected from disclosure under exemptions (b)(4), (6), and (8) of the Freedom of Information Act (5 USC 522 (b)). The adverse action disclosure is confidential between the institution and the consumer involved.

Comments are invited on: a) whether the proposed revised collection of information is necessary for the proper performance of the Federal Reserve's functions, including whether the information has practical utility; b) the accuracy of the Federal Reserve's estimate of the burden of the proposed revised information collection, including the cost of compliance; c) ways to enhance the quality, utility, and clarity of the information to be collected; and

d) ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. Comments on the collection of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (7100-0201), Washington, DC 20503, with copies of such comments to be sent to Mary M. West, Chief, Financial Reports Section, Division of Research and Statistics, Mail Stop 97, Board of Governors of the Federal Reserve System, Washington, DC 20551.

**VI. Initial Regulatory Flexibility Analysis**

The Regulatory Flexibility Act (5 U.S.C. 603) requires an agency to publish an initial regulatory flexibility analysis with any notice of proposed rulemaking. Two of the requirements of an initial regulatory flexibility analysis--a description of the reasons why action by the agency is being considered and a statement of the objectives of, and legal basis for, the proposed rule--are addressed in the supplementary material above.

Some provisions in the proposal should reduce burden. For example, creditors are not required to provide a notice of action taken for incidental credit. By broadening the definition of incidental credit to cover incidental business credit, fewer notices would be required. The proposal to lift the prohibition against data notation for nonmortgage products should not impose any burden on institutions, because data notation would be voluntary.

Creditors would be required to retain certain records in connection with prescreened solicitations. This would impose a new requirement. However, the Board has sought to minimize burden by tracking existing legal requirements and current business practices. For example, users of consumer reports are required to retain some prescreening information under the Fair Credit

Reporting Act. The proposal parallels this requirement. In addition, many lenders retain part or much of the solicitation information for business purposes, such as to evaluate marketing plans.

Creditors would be required to retain records for a longer period of time for certain types of business credit. Creditors would be required to retain records for 25 months rather than 12 months. This approach would track the record retention rules for consumer credit and could simplify compliance. Burden should be minimized in light of the variety of methods that could be used to retain these records.

In light of the purposes of the Equal Credit Opportunity Act, the Board believes it is not feasible to create different rules for large and small creditors; and therefore, except as discussed above, alternatives for small creditors are not provided. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

**List of Subjects in 12 CFR Part 202**

Aged, Banks, banking, Civil rights, Consumer protections, Credit, Discrimination, Federal Reserve System, Marital status discrimination, Penalties, Religious discrimination, Reporting and recordkeeping requirements, Sex discrimination.

Certain conventions have been used to highlight the proposed revisions to the text of the regulation and the staff commentary. New language is shown inside bold-faced arrows, while language that would be deleted is set off with bold-faced brackets. Paragraphs are numbered to comply with Federal Register publication rules.

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 202 as follows:

**PART 202 -- EQUAL CREDIT OPPORTUNITY ACT (REGULATION B)**

1. The authority citation for part 202 continues to read as follows:

**Authority:** 15 U.S.C. 1691-1691f.

2. Under <u>Section 202.2--Definitions</u>, the following amendments would be made:

a. Under <u>Paragraph 2(c) Adverse Action</u>, paragraphs (1)(ii) and (2)(iii) would be revised; and

b. <u>Paragraph 2(f) Application</u> would be revised;

The revisions would read as follows:

* * * * *

<u>Section 202.2 -- Definitions</u>.

* * * * *

<u>2(c) Adverse action</u>.

(1) * * *

(ii) a termination of an account or an unfavorable change in the terms of an account that does not affect all or **[**a substantial portion**]** **<**substantially all**=** of a class of the creditor's accounts; or

* * * * *

(2) * * *

(iii) a refusal or failure to authorize an account transaction at a point of sale or loan, except when the refusal is a termination or an unfavorable change in the terms of an account that does not affect all or **[**a substantial portion**]** **<**substantially all**=** of a class of the creditor's accounts, or when the refusal is a denial of an application for an increase in the amount of credit available under the account;

* * * * *

(f) Application means an oral or written request for an extension of credit that is made in accordance with procedures **[**established**]** **<**used**=** by a creditor for the type of credit requested. **<**The term includes requests for preapprovals where, for creditworthy persons, the creditor provides a written commitment to extend credit up to a specified amount--even if subject to certain conditions--and the commitment is valid for a designated period of time. (See comment 202.2(f)-3).**= [**The term does not include the use of an account or line of credit to obtain an amount of credit that is within a previously established credit limit.**]** * * *

* * * * *

3. Under Section 202.3--Limited Exceptions for Certain Classes of Transactions, the following amendments would be made:

a. Under Paragraph 3(a) Public-Utilities Credit., paragraph 2 would be revised, and paragraphs 2(i), (ii), and (iii) would be removed;

b. Under Paragraph 3(b) Securities Credit, paragraph 2(iii) would be removed, paragraphs (iv) and (v) would be revised, and paragraphs (iv) through (viii) would be redesignated as (iii) through (vii); and

c. Under Paragraph 3(c) Incidental Credit, paragraphs 1 and 1(ii) would be revised; paragraph 2(iv) would be removed, and paragraphs (v) through (viii) would be redesignated as paragraphs (iv) through (vii).

The revisions and removal would read as follows:

* * * * *

Section 202.3--Limited Exceptions for Certain Classes of Transactions.

3(a) Public-utilities credit.

* * * * *

3(a)(2) Exceptions. **[**The following provisions**]** **<**Section 202.12(b)**=** of this regulation **<**relating to record retention**=** **[**do**]**<does**=** not apply to public-utilities credit**[:]**<.**=**

**[**(i) section 202.5(d)(1) concerning information about marital status;

(ii) section 202.10 relating to furnishing of credit information; and

(iii) section 202.12(b) relating to record retention.**]**

* * * * *

3(b) Securities credit. * * *

* * * * *

3(b)(2) Exceptions. The following provisions of this regulation do not apply to securities credit:

(i) section 202.5(c) concerning information about a spouse or former spouse;

(ii) section 202.5(d)(1) concerning information about marital status;

(iii) [section 202.5(d)(3) concerning information about the sex of an applicant;

(iv)] section 202.7(b) relating to designation of name[, but only] to the extent necessary to [prevent violation of] <comply with= rules regarding an account in which a broker or dealer has an interest, or rules [necessitating] <regarding= the aggregation of accounts of spouses [for the purpose of determining] <to determine= controlling interests, beneficial interests, beneficial ownership, or purchase limitations and restrictions;

[(v)]<(iv)= section 202.7(c) relating to action concerning open-end accounts, [but only] to the extent the action taken is on the basis of a change of name or marital status;

[(vi)]<(v)= section 202.7(d) relating to the signature of a spouse or other person;

[(vii)]<(vi)= section 202.10 relating to furnishing of credit information; and

[(viii)]<(vii)= section 202.12(b) relating to record retention.

* * * * *

3(c) Incidental credit.

3(c)(1) Definition. Incidental credit refers to extensions of consumer <and business= credit other than [credit of] the types described in paragraphs (a) and (b) of this section --

(i) that are not made pursuant to the terms of a credit card account;

(ii) that are not subject to a finance charge (as defined in Regulation Z, 12 CFR 226.4) **<**for consumer credit, or not subject to interest charges or fees for business credit**=**; and

(iii) that are not payable by agreement in more than four installments.

<u>3(c)(2) Exceptions</u>. The following provisions of this regulation do not apply to incidental credit:

* * *

(i) section 202.5(c) concerning information about a spouse or former spouse;

(ii) section 202.5(d)(1) concerning information about marital status;

(iii) section 202.5(d)(2) concerning information about income derived from alimony, child support, or separate maintenance payments;

(iv) **[**section 202.5(d)(3) concerning information about the sex of an applicant, but only to the extent necessary for medical records or similar purposes;

(v)**]** section 202.7(d) relating to the signature of a spouse of other person;

**[**(vi)**]<**(v)**=** section 202.9 relating to notifications;

**[**(vii)**]<**(vi)**=** section 202.10 relating to furnishing of credit information; and

**[**(viii)**]<**(vii)**=** section 202.12(b) relating to record retention.

* * * * *

4. Under Section 202.4--General Rule Prohibiting Discrimination, the following amendments would be made:

* * * * *

a. A new Paragraph (a) Discrimination would be added;

b. A new Paragraph (b) Discouragement would be added; and

c. Two new paragraphs, Paragraph (c) Written applications and Paragraph (d) Disclosures and Other Required Information would be added.

The additions would read as follows:

* * * * *

Section 202.4--General Rule**<s= [**Prohibiting Discrimination**]**

**<**(a) Discrimination.**=** A creditor shall not discriminate against an applicant on a prohibited basis regarding any aspect of a credit transaction.

**<**(b) Discouragement. 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.

(c) Written applications. A creditor shall take written applications for the types of credit covered by § 202.13(a).

(d) Disclosures and other required information. A creditor shall provide in writing, in a clear and conspicuous manner, and in a form the person may retain, the disclosures and information required by §§ 202.5a, 202.9, and 202.13(c) of the regulation.**=**

* * * * *

5. Under Section 202.5--Rules Concerning Taking of Applications, the following amendments would be made:

a. Paragraph 5(a) Discouraging applications., would be removed;

b. Paragraph 5(b) General rules concerning requests for information., would be redesignated as paragraph 5(a), Paragraph (3) Special-purpose credit would be revised, and a new Paragraph (4) Obtaining of information would be added;

c. Paragraph 5(c) Information about a spouse or former spouse., would be redesignated as paragraph 5(b), and paragraph (c)(3) would be revised; and

d. Paragraph 5(d) Other limitations on information requests., would be redesignated as paragraph 5(c); Paragraph (d)(3) Sex would be revised; and Paragraph (d)(5) Race, color, religion, national origin would be removed; and

e. Paragraph (e) Written Applications would be removed.

The revisions and removals would read as follows:

* * * * *

Section 202.5--Rules concerning **[**taking of applications**]** **<**requests for information**=**.

* * * * *

(a) **[**Discouraging applications. 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.

(b)**]** General rules concerning requests for information.

* * * * *

(2) Required collection of information. Notwithstanding paragraphs [(c) and(d)] <(b) and (c)= of this section, a creditor shall request information for monitoring purposes as required by section 202.13 for credit secured by the applicant's dwelling. In addition, a creditor may obtain information required by a regulation, order, or agreement issued by, or entered into with, a court or an enforcement agency (including the [attorney general] <Attorney General= of the United States or a similar state official) to monitor or enforce compliance with the act, this regulation, or other federal or state statute or regulation.

(3) Special-purpose credit. A creditor may obtain information that is otherwise restricted to determine eligibility for a special-purpose credit program, as provided in [section] <§= 202.8<(b),= (c) and (d).

<(4) Obtaining of information. Except as otherwise permitted or required by law, an applicant shall not be required to supply information regarding race, color, religion, national origin, or sex.=

* * * * *

[(c)] <(b)= Information about a spouse or former spouse.

* * * * *

(3) Other accounts of the applicant. A creditor may request an applicant to list any account [upon] <on= which the applicant is liable and to provide the name and address [in which] <of the person in whose name= the account is [carried] <listed=. A creditor may also ask <an applicant to list= the names in which [an] <the= applicant has previously received credit.

[(d)] <(c)= Other limitations on information requests.

* * * * *

(3) Sex. **[**A creditor shall not inquire about the sex of an applicant.**]** An applicant may be requested to designate a title on an application form (such as Ms., Miss, Mr., or Mrs.) if the form discloses that the designation of a title is optional. An application form shall otherwise use only terms that are neutral as to sex.

* * * * *

**[**(5) Race, color, religion, national origin. A creditor shall not inquire about the race, color, religion, or national origin of an applicant or any other person in connection with a credit transaction. A creditor may inquire about an applicant's permanent residency and immigration status.

(e) Written applications. A creditor shall take written applications for the types of credit covered by section 202.13(a) but need not take written applications for other types of credit.**]**

* * * * *

6. Under Section 202.6--Rules Concerning Evaluation of Applications, two new paragraphs (b)(8) and (b)(9) would be added to read as follows:

* * * * *

Section 202.6 -- Rules concerning evaluation of applications.

* * * * *

(6)(b) Specific rules concerning use of information.

**<**(8) Marital status. Except as otherwise permitted or required by law, a creditor shall not consider an applicant's marital status to determine the applicant's creditworthiness. Married and unmarried applicants must be evaluated by the same standards. In evaluating joint applicants, creditors may not treat applicants differently based on the existence, absence, or likelihood of a marital relationship between the parties.

(9) Race, color, religion, national origin, sex. Except as otherwise permitted or required by law, a creditor shall not consider race, color, religion, national origin, or sex (or an applicant's decision not to provide the information) to determine the applicant's creditworthiness.**=**

* * * * *

7. Under Section 202.7--Rules Concerning Extensions of Credit, under paragraph 7(d) Signature of spouse or other person, paragraph 1. would be revised to add a new paragraph (1)(i) to read as follows:

* * * * *

Section 202.7 -- Rules concerning extensions of credit.

* * * * *

7(d) Signature of spouse or other person

(1) * * *

**<**(i) Joint financial information. A creditor shall not deem the submission of joint financial information an application for joint credit.**=**

* * * * *

8. Under Section 202.8--Special Purpose Credit Programs, paragraph 8(a)(3) would be revised to read as follows:

* * * * *

Section 202.8 -- Special purpose credit programs.

(a) Standards for programs. * * *

(1) * * *

(2) * * *

(3) any special-purpose credit program offered by a for-profit organization or in which such an organization participates **[**to meet special social needs**]**, if-- * * *

* * * * *

9. Under <u>Section 202.9--Notifications</u>, the following amendments would be made:

a. Under <u>Paragraph 9(a)(3) Notification to business credit applicants</u>, paragraph (ii)(A) would be revised; and

b. <u>Paragraph 9(b)(2) Statement of Specific Reasons.</u>, would be revised.

The revisions would read as follows:

* * * * *

<u>Section 202.9 -- Notifications</u>**.**

* * * * *

<u>(a) Notification of action taken, ECOA notice, and statement of specific reasons</u>.

* * * * *

<u>(3) Notification to business credit applicants</u>.

* * * * *

<u>9(a)(3)(ii)</u>. * * *

* * * * *

(A) **<**Within a reasonable time of the action taken,**= [**Notify**] <**notify**=** the applicant, orally or in writing, **[**within a reasonable time**]** of the action taken **<**and of the right to a written statement of reasons.**=**; * * *

* * * * *

9(b) Form of ECOA notice and statement of specific reasons.

* * * * *

(2) Statement of specific reasons. The statement of reasons for adverse action required by paragraph (a)(2)(i) of this section must be specific and indicate the principal reason(s) for the adverse action. **[**Statements that the adverse action was based on the creditor’s internal standards or policies or that the applicant failed to achieve the qualifying score on the creditor’s credit scoring system are insufficient.**]**

* * * * *

10. Under Section 202.12--Record Retention, under paragraph 12(b) Preservation of records., the following amendments would be made:

a. Paragraphs (1), (2), (3), and (4) would be revised; new paragraphs (7) and 7(i) and 7(ii) would be added.

The revisions and additions would read as follows:

* * * * *

Section 202.12--Record Retention.

* * * * *

12(b) Preservation of records.

(1) Applications. For 25 months **[**(12 months for business credit)**]** after the date that a creditor notifies an applicant of action taken on an application or of incompleteness, **<**(except as provided in paragraph (5) of this section)**=** the creditor shall retain in original form or a copy thereof-- * * *

* * * * *

(2) Existing accounts. For 25 months **[**(12 months for business credit)**]** after the date that a creditor notifies an applicant of adverse action regarding an existing account, **<**(except as provided in paragraph (5) of this section)**=** the creditor shall retain as to that account, in original form or a copy thereof-- * * *

* * * * *

(3) Other applications. For 25 months **[**(12 months for business credit)**]** after the date that a creditor receives an application for which the creditor is not required to comply with the notification requirements of **[**section**]** **<§=** 202.9, **<**(except as provided in paragraph (5) of this section)**=** the creditor shall retain all written or recorded information in its possession concerning the applicant, including any notation of action taken.

(4) Enforcement proceedings and investigations. A creditor shall retain the information beyond 25 months **[**(12 months for business credit)**]** **<**(except as provided in paragraph (5) of this section)**=** if it has actual notice that it is under investigation or is subject to an enforcement proceeding for an alleged violation of the act or this regulation by the **[**attorney general**]** **<**Attorney General**=** of the United States or by an enforcement agency charged with monitoring that creditor's compliance with the act and this regulation, or if it has been served with notice of an action filed pursuant to section 706 of the act and **[**section**]** **<§=**202.14 of this regulation. * * * * *

(7) Preapplication marketing information. For 25 months (12 months for business credit subject to paragraph (5) of this section) after the date that a creditor solicits potential applicants for credit, the creditor shall retain in original form or a copy thereof--

(i) prescreened solicitations, the criteria used by the creditor to prescreen the solicitations, correspondence related to the prescreened solicitations; and

(ii) any component of the marketing plans to which such solicitations relate.**=**

* * * * *

11. Under Section 202.14--Enforcement, Penalties, and Liabilities, paragraph (c) Failure of compliance., would be revised to read as follows:

* * * * *

Section 202.14--Enforcement, Penalties, and Liabilities

* * * * *

(c) Failure of compliance. A creditor's failure to comply with sections 202.6(b)(6), 202.9, 202.10, 202.12 or 202.13 is not a violation if it results from an inadvertent error. On discovering an error under sections 202.9 and 202.10, the creditor shall correct it as soon as possible. **[**If a creditor inadvertently obtains the monitoring information regarding the race or national origin and sex of the applicant in a dwelling-related transaction not covered by section 202.13, the creditor may act on and retain the application without violating the regulation.**]**

* * * * *

12. Appendix B--Model Application Forms would be revised to read as follows:

* * * * *

**Appendix B--Model Application Forms**

* * * * *

If a creditor uses an appropriate appendix B model form, or modifies a form in accordance with the above instructions, that creditor shall be deemed to be acting in compliance with the provisions of paragraphs **<**(b) and**=** (c) **[**and (d)**]** of section 202.5 of this regulation.

* * * * *

By order of the Board of Governors of the Federal Reserve System, July ____, 1999.

Jennifer J. Johnson
Secretary of the Board