

FEDERAL RESERVE SYSTEM

12 CFR Part 202

[Regulation B; Docket No. R-1008]

Equal Credit Opportunity

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: Pursuant to its Regulatory Planning and Review Program, the Federal Reserve Board (the “Board”) is undertaking a review of Regulation B, which carries out the provisions of the Equal Credit Opportunity Act (the “ECOA”). The ECOA 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. The review will determine whether Regulation B should be revised to address technological and other developments; identify areas in the regulation that could be revised to better balance consumer protections and industry burden; and delete obsolete provisions. To gather information necessary for this review and to ensure the participation of interested parties, the Board is soliciting comment on several specific issues, while also soliciting comment generally on potential revisions to the regulation.

DATE: Comments must be received by May 29, 1998.

ADDRESSES: Comments should refer to Docket No. R-1008, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) any time. Comments may be inspected in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR section 261.12 of the Board’s Rules Regarding Availability of Information.

FOR FURTHER INFORMATION CONTACT: Natalie E. Taylor or Sheilah Goodman, Staff Attorneys, or Jane Jensen Gell, Senior Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, DC 20551, at (202) 452-2412 or 452-3667; for the hearing impaired only, contact Diane Jenkins, Telecommunications Device for the Deaf (TDD), at (202) 452-3544.

SUPPLEMENTARY INFORMATION:

I. Background on ECOA and Regulation B

The Equal Credit Opportunity Act, 15 U.S.C. 1691, enacted in 1974, makes it unlawful for a creditor to discriminate against an applicant in any aspect of a credit transaction on the basis of sex or marital status. In 1975, pursuant to section 703 of the ECOA, the Board issued Regulation B to implement the ECOA. The Congress amended the ECOA in 1976 to prohibit discrimination on the additional bases of race, color, religion, national origin, age (provided the applicant has the capacity to contract), receipt of public assistance benefits, and good faith exercise of a right under the Consumer Credit Protection Act. The Board issued an amended Regulation B in 1976 to reflect the amendments.

Under the Board's Regulatory Planning and Review Program, which requires periodic review of the Board's regulations, the Board reviewed Regulation B and revised it in 1985 (50 FR 48018, November 20, 1985). In 1989, the Board modified Regulation B to implement amendments to the ECOA contained in the Women's Business Ownership Act of 1988. Those amendments required that creditors give written notice to business applicants of the right to a written statement of reasons for a credit denial, and imposed a record retention requirement for records relating to business credit applications (54 FR 50482, December 7, 1989). The Board further modified the regulation in 1993 to implement amendments to the ECOA contained in the Federal Deposit Insurance Corporation Improvement Act of 1991. The amendments provided applicants with a right to obtain a copy of the appraisal report used in an application secured by residential real property, and expanded the enforcement responsibilities of the federal financial supervisory agencies when information about possible violations of the ECOA becomes known (58 FR 65657, December 16, 1993). The Board also modified the regulation in 1997 to implement amendments to the ECOA contained in the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The amendments created a privilege for information developed by creditors as a result of "self-tests" they conduct (62 FR 66412, December 18, 1997).

II. Review of Regulation B

The Board will review Regulation B with three goals in mind: (1) to determine whether regulatory amendments are needed to address technological and other developments; (2) to identify areas in the regulation that could be revised to better balance consumer protections and industry burden; and (3) to delete obsolete provisions.

This Advance Notice of Proposed Rulemaking is intended to gather information about broad policy issues that could be addressed by revisions to the regulation. The Board is soliciting comment on several specific issues, but also requests suggestions generally on other issues that commenters believe should be addressed or clarified. The Board will publish a proposed rule after evaluating the comments and further analysis.

Concurrently, the Board is undertaking a review of Regulation C (Home Mortgage Disclosure); an advance notice of proposed rulemaking is published elsewhere in today's Federal Register. Comment is specifically solicited on the following issues:

1. Preapplication Marketing Practices

The ECOA and Regulation B prohibit 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. Credit transaction is defined in the regulation as every aspect of an applicant's dealings with a creditor beginning with information requirements. Thus, the coverage of the ECOA is generally limited to a person who has, at a minimum, sought credit information. However, the Board recognizes that a person could be discouraged from seeking credit or credit information. Accordingly, 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. The official staff commentary provides that a creditor is prohibited from using words, symbols, or other forms of communication in advertising that express, imply, or suggest a discriminatory preference or a policy of exclusion, although a creditor is permitted to engage in affirmative advertising to solicit or encourage traditionally disadvantaged groups to apply for credit.

Aside from the prohibition against discouragement, the ECOA has not been interpreted to apply to a creditor's preapplication marketing practices -- such as the selection of persons

solicited for a credit card.¹ Creditors use a number of techniques to decide to whom solicitations will be sent. For instance, creditors will often specify criteria to credit bureaus, which then utilize credit reports to compile mailing lists that identify potential applicants who meet those criteria. This marketing technique -- involving prescreened solicitations -- is usually carried out through mailed solicitations as well as by telemarketing. Because individuals selected through the prescreening process have not requested credit, they are not deemed to be applicants for purposes of Regulation B when the prescreening occurs. It is only after the individuals respond to a creditor's invitation that the regulation applies.

During the 1985 review of Regulation B, the Board considered whether prescreened solicitations should be covered by the regulation. It was generally recognized that prescreened solicitations could result in a greater availability of credit for consumers. Also, there was no evidence at that time that creditors were improperly making use of prohibited characteristics. Therefore, the Board deemed it unnecessary to modify the regulation.

The Board recognizes that prescreening on a prohibited basis may facilitate the identification of potential customers and provide greater access to credit for some consumers. For example, some creditors have used age to target “older” individuals for credit solicitations and related financial services. However, the Board and the other banking agencies have also found instances in which creditors, primarily in the credit card industry, have used age to exclude youth and elderly persons from receiving solicitations for preapproved credit. Given the potential for using prohibited bases in prescreening to improperly exclude certain categories of individuals, the Board seeks to gain a better understanding of current practices, and solicits comment on how and to what extent creditors are using any prohibited bases in preapplication marketing.

2. Inquiry v. Application

Regulation B allows creditors to establish their own application procedures, including what and how much information to provide to consumers who request information before applying for credit. Creditors and others have expressed concern that the current distinction under Regulation B between an inquiry and an application is difficult to apply. The rule distinguishes between an inquiry and an application based on what the creditor communicates to the consumer. When a consumer requests credit information, this inquiry may entail a discussion

¹ The Fair Housing Act (FHA), which bars discrimination in housing-related transactions, differs in its treatment of prescreened solicitations. The FHA has been interpreted to prohibit persons from prescreening on a prohibited basis, whereas the ECOA permits any prescreening since only “applicants” receive the protections of the act.

of the consumer's credit characteristics. Creditors have suggested that under the regulation it is unclear when a creditor is simply providing information rather than communicating a credit decision -- for example, when the creditor explains its underwriting standards in the context of the applicant's credit characteristics. A creditor is required to notify a consumer of action taken (including, as appropriate, a notice of adverse action) if in response to a consumer's request for credit information the creditor communicates a decision not to extend credit.

Creditors say that it is burdensome to provide an adverse action notice to every consumer who is provided with negative information in the information-gathering process. Also, they suggest that some consumers might be concerned about receiving adverse action notices when they are merely in the process of gathering information to shop for a loan.

Most questions that the Board receives regarding the distinction between an inquiry and an application arise in mortgage processes. With the increased use of prequalifications, preapprovals, and interactive loan-calculation tools provided over the Internet, creditors have had difficulty determining whether a notice is required. Sometimes, what begins with a creditor providing information turns into an evaluation of creditworthiness.

With prequalifications or preapprovals, consumers begin their loan-shopping by approaching a lender to determine the price of a home they could afford. In this process, creditors often obtain and review the consumer's credit report for a more accurate picture of the consumer's debt obligations and credit history. In most cases, the consumer has not identified a specific property, nor is the consumer necessarily ready to seek a loan from a particular creditor.

Some creditors provide loan-calculation tools on their home page on the Internet; and consumers are able to calculate the price of a home they could afford by entering information about income and other data. Some programs will calculate the maximum amount for which the consumer could qualify. Other programs encourage the consumer to call the financial institution when information has been entered and it appears from the calculation that the consumer would not qualify for a mortgage due to, for example, low income and high debt. Some creditors' home pages enable the consumer to take the next step of applying to the financial institution for a home loan.

In determining whether it is possible to provide additional guidance to clarify the distinction between an inquiry and application, the Board believes it is important to encourage creditors to provide information, counseling, and assistance to consumers seeking credit

information. The sharing of information through counseling programs, such as home-ownership counseling, is a prime example. In home-ownership counseling, a third-party organization and financial institution may partner to counsel potential home buyers -- typically first-time home buyers and, often but not necessarily, low-income home buyers -- on how to obtain a mortgage. A credit report is often obtained to determine the consumer's financial position and to assist in an ongoing counseling process that could span a year or longer. In some programs, the third-party organization may not only provide counseling services, but also may prescreen applicants for the lender. The Board solicits comment on whether the more formal the process becomes in providing information, counseling, and assisting potential applicants -- for example, verifying credit information, or prescreening applicants -- the more the process should be treated as an application. The Board also solicits comment on the following:

1) Should the Board devise a different test for determining when an informal discussion becomes an application? If yes, what should be the test?

2) Should the Board seek to establish a "bright-line" test? For example, should an inquiry become an application when a creditor evaluates or verifies credit information through third-party information (such as by obtaining a credit report or credit score)?

3) When, if at all, would the use of an interactive loan-calculation tool constitute an application?

4) Is it possible or desirable to apply the current notification rules to home-ownership counseling programs? If not, how should the rules be designed to distinguish education-oriented counseling from advice offered by a lender, for example, to a consumer requesting a prequalification decision?

5) Are there some home-ownership counseling programs that have elements of both counseling and applications such that they should be distinguished from education-oriented counseling?

6) Does the issue of distinguishing an inquiry from an application also arise in nonmortgage processes? If so, what are some of the distinguishing characteristics of such processes? Would a test developed for mortgage processes be effective for nonmortgage processes?

3. Voluntary Data Collection

Regulation B generally prohibits creditors from inquiring about an applicant's sex, marital status, race, color, religion, and national origin. This provision was included in the regulation in the belief that if creditors did not have this information, they could not use it to discriminate

against applicants. At the same time, exceptions to this prohibition were also included in Regulation B. The regulation requires creditors to collect “monitoring information” (age, sex, marital status, and race or national origin) for mortgage loan applicants. This requirement was added because of the specific concern that the data was needed to help detect mortgage lending discrimination.

The regulation also allows creditors to collect data if required by another regulation, order, or agreement of a court or enforcement agency to monitor or enforce compliance with the ECOA, Regulation B, or any other federal or state statute or regulation. This exception was included in the regulation so that lenders would not have to choose between competing regulations or statutes. For example, creditors can collect data pursuant to the Home Mortgage Disclosure Act without concerns about violating Regulation B.

In April 1995, the Board published for comment a proposed amendment to Regulation B that would have allowed, but not required, creditors to collect information about an applicant’s sex, marital status, race, color, and national origin for nonmortgage credit products. The regulation would have continued to bar creditors from considering this information in a credit decision. In December 1996, the Board withdrew the proposed amendment, noting that this issue might be more appropriate for the Congress to consider.

Since issuance of the final action, the Board has received requests from the other federal financial regulatory agencies, creditors, and community groups asking for further consideration of this matter. The Board believes that in light of the overall review of Regulation B it is appropriate to evaluate whether the prohibition on data collection should be changed. The Board solicits comment on whether to consider amending Regulation B to remove the prohibition barring creditors from collecting certain information about applicants for nonmortgage credit products.

4. Definition of 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. Regulation B combines the 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

§§ 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 deemed creditors.

As creditors expand their distribution systems for lending services and products, they have increasingly asked for guidance about how the definition of "creditor" applies when a lender acts in conjunction with other parties and discrimination occurs. The question could arise in the context of transactions in which a mortgage broker discriminates in originating loans that are funded by or closed in the name of the lender, for example, and also could arise in other types of lending, such as automobile financing.

Regulation B 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 person knew or had reasonable notice of the act, practice, or policy that constituted the violation before becoming involved in the credit transaction. The Board solicits comment on whether it is desirable or feasible to provide further guidance in this area, such as the circumstances under which a creditor is deemed to have knowledge of the acts of other parties when the creditor has participated in the decision to extend credit or set the credit terms.

Comment is solicited on the following:

- 1) Is it feasible for the regulation to provide more specific guidance given that most issues will depend on the facts of a particular case?
- 2) Should the current test -- which relies on whether a person knew or had reasonable notice of an act of discrimination -- be modified? If so, in what way?
- 3) Should the regulation address whether, and under what circumstances, a creditor must monitor the pricing or other credit terms when another creditor (for example, a broker) participates in the transactions?

5. Documentation for Business Credit

Currently, Regulation B requires written applications if the credit is primarily for the purchase or refinancing of an applicant's principal dwelling. This rule does not apply to business credit. Many requests for business credit 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 a joint application. Accordingly, both owners often are required to sign the note -- even where the request for credit is being made by only one of the property owners. The Board does not believe that a joint property owner's signature on a financial statement to attest to the accuracy or veracity of information is definitive evidence of a joint application.

Without documentation in the files other than the financial statement, institutions may be required to spend considerable time and expense establishing that an application was for joint, rather than individual, credit. In addition, agencies that examine for compliance with Regulation B may impose costs and other burdens on institutions when it is difficult to determine whether a joint property owner actually intended to be a joint applicant. Accordingly, the Board has been asked to revise the regulation to provide guidance on what mechanisms may be used by creditors to establish a joint property owner's intent to apply for joint business credit.

The Board solicits comment on the following:

- 1) What are some mechanisms through which evidence of an application for joint credit can be established?
- 2) Should the Board provide guidance to clarify the mechanisms through which an application for joint credit can be evidenced? If not, how can creditors ensure that their practices do not violate the regulation?

6. Business Credit Exemptions

The ECOA authorizes the Board to exempt a class of transactions, or a particular type of transaction within a class, if the Board determines that the application of all or part of the regulation to such transactions would not contribute substantially to effectuating the purposes of the regulation. Pursuant to Section 703 of the ECOA, the Board has exercised its authority to exempt business credit from certain notification and record retention requirements for consumer 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.

Amendments to the ECOA contained in the Women's Business Ownership Act of 1988 require the Board to review exemptions after five years to determine whether an additional extension is appropriate. While the exemptions for certain business credit do not affect the basic prohibition against discrimination in credit transactions, the exemptions do reduce burden for

creditors by modifying the notice requirements of the regulation under section 202.9(a)(3) and the record retention rules under section 202.12(b)(5). The Board solicits comment on whether these exemptions are still appropriate.

7. Other Issues

The Board solicits comments on any other broad policy issues that should be addressed in the regulation.

By order of the Board of Governors of the Federal Reserve System, March 6, 1998.

William W. Wiles
Secretary of the Board
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