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Regulation B

When does it apply and why is it important?

All lenders are required to comply with Regulation B when extending credit, but why is it important and how can lenders ensure compliance in their credit applications and documentation practices?

What is the purpose of Regulation B?

Regulation B implements the Equal Credit Opportunity Act, a federal statute enacted in 1974. The ECOA's goal is to promote availability of credit to creditworthy applicants without regard to race, color, religion, national origin, sex, marital status or age; the fact all or part of the applicant's income derives from a public assistance program; or the fact the applicant has in good faith exercised any right under the Consumer Credit Protection Act. Regulation B prohibits creditor practices that discriminate on the basis of any of the above factors. It also prohibits creditors from making any oral or written statement that discourages on a prohibited basis a reasonable person from making or pursuing an application for credit.

What is discrimination under Regulation B?

Discrimination is a credit practice that treats applicants differently on a prohibited basis, regardless of whether it results from a conscious intent to discriminate or whether discrimination is the practical effect. Discrimination includes using disparate treatment or discouraging applicants on any prohibited basis (for example, race, color, religion, national origin, sex, marital status or age). Treating applicants differently on a prohibited basis is unlawful unless the creditor demonstrates a legitimate non-discriminatory reason for its action. If the action taken is found to be pretext for discrimination, a creditor is still in violation of Regulation B.

Examples of discrimination through disparate treatment:

- Requiring a minority applicant to provide greater documentation to obtain a loan than a similarly situated non-minority applicant.
- Waiving or relaxing credit standards for a non-minority applicant but not for a similarly situated minority applicant.

- Requiring the spouse of a loan applicant to be a guarantor without assessing the loan applicant's individual creditworthiness or other options to secure the requested loan.

Example of discrimination through discouragement:

- Informing an applicant to not bother applying for credit after the applicant states he is retired or after determining the applicant is a minority.
- Using interview scripts that discourage applications on a prohibited basis.

To whom does Regulation B apply?

Regulation B applies to all creditors, including banks, credit unions, credit card companies and others in the business of extending credit to applicants. Regulation B violations apply only in the context of creditworthy applicants who are of a protected class based on race, color, religion, etc. that are denied credit. It does not prohibit a lender from denying credit to an applicant who is not creditworthy.

A creditor is in the business of extending credit if it extends credit in any form to applicants, including but not limited to credit granted in addition to any existing credit or credit limit; credit granted through an open-end credit plan; the refinancing or renewal of existing credit; or the continuance of existing credit without any special effort to collect at or after maturity. Applicants are persons who request or have received an extension of credit, and include sureties and endorsers.

When does Regulation B apply?

Regulation B applies when an applicant initiates the application process for credit, including renewal of credit. An application can be either an oral or written request for the extension of credit. A creditor has latitude under Regulation B to establish its own application process and decide the type and amount of information required of applicants.

An application is different from an inquiry or prequalification request, which are not governed by Regulation B. An inquiry becomes an application when the creditor gives the consumer information and evaluates information

received from the consumer to determine whether to accept or decline the request.

Generally, Regulation B applies to applicants for consumer credit, but it can also apply to individuals seeking credit for a business where the individual has an ownership interest in the business. For example, where a business is applying for a line of credit the bank can assess the business' ability to secure the line of credit. If the bank determines it needs additional security for the extension of credit, it may turn to the owners of the business to provide a guaranty or additional collateral to secure the extension of credit. In such a situation, Regulation B applies to the bank's request for information to the business owners if the individuals are of a protected class (i.e., race, color, religion, national origin, sex, marital status or age).

Of particular importance is the instance in which a married business owner seeks a business line of credit and the spouse does not have an ownership interest in the business. In such an instance, a bank cannot automatically require a spouse to be a guarantor on the loan. To do so would be a Regulation B violation — discrimination based on marital status. If however, in this example a married couple owns the business jointly, the bank could require them to guaranty the loan. The bank has not discriminated against the married couple based on marital status here because it is reasonable to expect business owners to provide a guaranty to a bank to secure a line of credit.

Why is Regulation B compliance important?

Regulation B is enforced by the FDIC and other banking regulators, and violations can carry significant regulatory and monetary penalties. If the FDIC finds a creditor has violated Regulation B, the creditor can be subject to (1) civil liability for actual and punitive damages in both individual and class action lawsuits; (2) pay the costs and attorneys' fees for the civil lawsuits; (3) lowered CRA ratings; and (4) lowered FDIC compliance ratings in compliance exams.

One employee's Regulation B violation can cause penalties to be assessed against the lender, so compliance by loan officers and employees is imperative.

What information can you request under Regulation B from an applicant?

Regulation B does not require or endorse any particular method of credit analysis. Instead, a creditor can consider any information in evaluating applicants as long as the creditor does not have the intent or the effect of discriminating against an applicant on a prohibited basis.

When an applicant applies for individual credit, a

creditor may not ask the applicant's marital status unless (1) the credit transaction is to be secured; (2) the applicant resides in a community property state; or (3) the creditor lists assets to support the debt that are located in a community property state. When a request for credit is for joint credit (made by two or more individuals who will be primarily liable), the bank may ask the applicants' marital status.

When can you request a third-party guaranty, including a spousal guaranty?

Creditors can request a third-party guaranty or co-signor where personal liability of an additional party is necessary to support the applicant's request for credit under the lender's standards of creditworthiness. The applicant's spouse in that situation may serve as an additional party, but a creditor must not require the spouse to be the additional party. Instead, a creditor should inform the applicant that it requires an additional party or additional assets to secure the request for credit. The applicant should then be offered the opportunity to provide any third party to satisfy the collateral needs of the lender.

Can I automatically request a spouse to guarantee the debt of a loan applicant?

The important analysis under Regulation B is whether the applicant standing alone is creditworthy for the loan requested. If the applicant has sufficient assets to secure the requested credit, a creditor generally may not require the signature of an applicant's spouse or any other person, other than a joint applicant, on any credit instrument.

Married applicants often submit joint financial statements to support an application for credit. In that situation, it is important to clarify with the applicant if he intends to apply for joint credit, and that clarification needs to be made at the time the application is submitted. In making that clarification, the applicants' signatures or initials on a credit application affirming their intent to apply for joint credit can be used should a question ever arise. Signatures on a joint financial statement, however, affirming the truthfulness of information are not sufficient to establish applicants' intent to apply for joint credit.

How should application decisions be documented in the loan file?

Where a customer files a Regulation B complaint, or during regulatory examinations for compliance, documents in the loan file should protect the lender and show compliance. For example, the loan file should show appropriate documentation to support why a guarantor was requested for the extension of credit. It should also

show an acknowledgement that the applicants intended to apply for joint credit, if such is the case. It is imperative that key conversations, either by phone, email or otherwise are documented and included in the loan file to evidence proper compliance with Regulation B should an issue ever arise.

The overarching purpose of Regulation B is to avoid

discrimination of protected classes who are in the process of applying for credit. To comply, a lender should have reasoned and non-discriminating methods for reviewing credit applications. After those policies are established, lenders should ensure employee compliance with the policies, and require that documents establishing the basis for approving or denying credit are included in the loan file. **BN**