# ECOA'S REG. B

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# I - Application Process

- The Equal Credit Opportunity Act ("ECOA") which is implemented by Regulation B, applies to all creditors; consumer or commercial. ECOA pertains to any person who regularly extends, renews or continues credit. Sec. 15 §1691a. Specifically, Regulation B prohibits discrimination against an applicant for credit based on race, color, religion, national origin, sex, marital status or age. This has specific bearing on those items that can be solicited from an applicant in the credit application process. For the purposes of ECOA "Business Credit" has been defined as "extensions of credit primarily for business or commercial purposes." Sec. 12 CFR 202.2 (g).

# II - Is a Guarantor an Applicant?

- Whether signing a guaranty is an "application for credit" or whether the guarantor is an applicant is pivotal to whether a creditor violates Reg. B by requiring the applicant's spouse to sign a guaranty and also whether that act by the creditor can be used as an affirmative defense available to a guarantor who has been brought to charge concerning the guarantor's liability on the debt.
  - A. Hawkins v. Cmty. Bank of Raymore, 761 F.3d 937; 2014 U.S. App. Lexis 15006 (8th Cir.); WL 3826820
    - (i) The District Court concluded that Hawkins and Patterson were not "applicants" within the meaning of ECOA and thus that Community had not violated ECOA by requiring them to execute guarantees. Hawkins and Patterson appealed.

guarantors

they had not applied for credit.

# II - Is a Guarantor an Applicant? (continued)

- (ii) To determine whether we should defer to the Federal Reserve's interpretation of the ECOA's definition of applicant, we apply a two (2) step framework established by Chevron USA v. National Resource Defense Council 467 U.S. 837, 104 S. CT. 2778, 81 L. Ed. 2d 694 (1984)

  - (a) If we determine that Congress's intent is clear, that is the end of the matter. If we conclude that the statute is silent or ambiguous, we are required to consider whether the agency's reading fills a gap or defines a term in a reasonable way in light of the legislator's design.

  - (b) The Court, in Hawkins, concluded that the text of ECOA clearly provides that a person does not qualify as an applicant under the statute solely by virtue of executing a guaranty to secure the debt of another.

  - (c) Thus, the plain language of ECOA unmistakably provides that a person is an applicant only if she requests credit in Hawkins.

# II - Is a Guarantor an Applicant? (continued)

- B. RL BB Acquisition LLC v. Bridgemill Commons Dev. Grp. 754 F. 3d 380 (6th Circ. 2014)
  - (i) The Sixth Circuit recently reached the contrary conclusion to Hawkins, finding it to be ambiguous whether a guarantor qualifies as an applicant under ECOA.
  - (ii) In RL BB, The Court held that the statutory definition is ambiguous because it could be read to include third parties who do not initiate an application for credit and who do not seek credit for themselves – a category that includes guarantors.
  - (iii) The RL BB Court asserted that "The text could just as easily encompass all those who offer promises in support of an application – including guarantors, who make formal requests for aid in the form of credit for a third party."
  - (iv) The RL BB Court also asserted that "a guarantor does formally approach a creditor in the sense that the guarantor offers up her own personal liability to the creditor if the borrower defaults."

# II - Is a Guarantor an Applicant? (continued)

- (v) Since ECOA defines "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment" therefore as this definition makes clear, an "applicant" requests credit, but a "debtor" reaps the benefit. The use of these two different terms suggests that the applicant and the debtor are not always the same person…If an applicant is not necessarily the debtor, it would be reasonable to conclude that the applicant could be a third party, such as a guarantor."

# III - Reporting

- The Dodd Frank Act, Section 1071, which is also Section 1691 c-2 of the Equal Credit Opportunity Act, requires monitoring and reporting of applications for credit made by women-owned, minority-owned and small businesses by any financial institution to the Consumer Financial Protection Bureau ("CFPB"). As identified in this section, a financial institution is defined as "any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization or other entity that engages in any financial activity". This would include commercial lending groups of banks and commercial lessors.

# III – Reporting (continued)

- To comply with the Small Business Data Collection requirements, in the case of an application for credit made by any Small Businesses, one must inquire as to whether the business is a women-owned business, minority-owned business or small business itself as defined in the Small Business Act 15 USC 632, and whether the application is received in person, by telephone, by electronic mail or by any other means and you must maintain a record of the response to that inquiry, separate from the application. Sec. 15 USC § 1691 c-2(b). The applicant always has the right to refuse to provide that information to you when the request for same is made. 15 USC §1691 c-2(c).

# IV – Adverse Action

- A. A Notification of Adverse Action must be in writing and contain certain information, including the name and address of the creditor and the nature of the action that was taken. In addition, the creditor must provide an ECOA Notice that includes the identity of the federal agency responsible for enforcing compliance with the act for that credit. This notice is generally included on the notification of adverse action. The applicant shall be notified within thirty (30) days as to whether favorable or adverse action has been taken with respect to the completed application.

# IV – Adverse Action (continued)

- B. There are two (2) exceptions to the thirty (30) day notification requirement; these include:

  - (1) Notification of the adverse action within ninety (90) days when the creditor makes a counteroffer unless the applicant accepts the counteroffer in that time period, and

  - (2) If the creditor has notified the applicant that the application was incomplete and required certain additional information that is not produced within the time period requested.

# IV – Adverse Action (continued)

- C. The creditor must also either provide the applicant with the specific principal reason for the action taken or disclose that the applicant has the right to request the reason(s) for denial within sixty (60) days of receipt of the creditor's notification along with the name, address and telephone numbers of the person who can provide the specific reasons for the adverse action. The reason may be given orally if the creditor advises the applicant of the right to obtain the reason in writing upon request.

# IV – Adverse Action (continued)

- D. With respect to business credit, if a business has gross revenues of One Million Dollars or less in the preceding fiscal year then the recipient of adverse action must be notified in writing; disclosure of the applicant's right to a statement of reasons may be given at the time of application rather than at the time the adverse action is taken, provided the Notice still adheres to the ECOA requirements. Should the application be made entirely by phone, this requirement is met by an oral statement and the applicant's right to a statement of reasons for the adverse action, rather than the written requirement for a consumer.

# IV – Adverse Action (continued)

- E. Should the company applying for the credit have gross revenues in excess of One Million Dollars for the preceding year, than the creditor is required to notify the applicant within a reasonable time, orally or in writing, of the action taken and provide a written statement of the reasons for adverse action if the applicant has made a written request for the reason, which should be provided within sixty (60) days.

# V – Enforcement

- A. **"Signature of spouse or other person –**

(i) Rule for qualified applicant. Except as provided in this paragraph, a creditor shall not require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested."

(ii) To prove a violation of the spouse guarantor rule, a spouse guarantor need only prove that her spouse applied for credit, and either the creditor required the signature of the applicant's spouse if the applicant was independently creditworthy or the creditor required that the spouse be the "additional party" when it determined that the applicant was not independently creditworthy and would need the support of an additional party. 12 C.F.R. 202.7(d)(5), 12 C.F.R. 1002.7(d)(5)

# V – Enforcement (continued)

- B. **Creditors who violate ECOA or Reg. B may be sued for actual damages, punitive damages and attorneys fees.**

  (i) Only Applicants have the ability to sue for ECOA violations.

  (ii) "A creditor who violates Regulation B necessarily violates ECOA itself. An applicant harmed by the creditor's violation of Regulation B has the full range of ECOA remedies available to her. 12 C.F.R. 202.16(b), 12 C.F.R. 1002.16(6). If a guarantor discovers a violation of the spouse-guarantor rule, she is free to bring an independent lawsuit (or a counterclaim) within ECOA's statute of limitations."

  a. "A defendant may raise a violation of ECOA and Regulation B as an affirmative defense of recoupment."

  b. Recoupment "allows a defendant to defend against a claim by asserting – up to the amount of the claim – the defendant's own claim against the plaintiff growing out of the same transaction." Bolduc, 167 F3d at 672.

# V – Enforcement (continued)

- C. **Additional Parties:** If under a creditor's standard of creditworthiness, the personal liability of an additional party is necessary to support the credit requested, a creditor may request a cosigner, endorser or similar party. The applicant's spouse may serve as an additional party but the creditor shall not require that the spouse be the additional party.

  - (i) "A creditor shall not require the signature of an applicant's spouse or other person other than a joint applicant on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of credit requested." 12 C.F.R. 202.7(d)

# V – Enforcement (continued)

- D. **Joint applicant.** The term joint applicant refers to someone who applies contemporaneously with the applicant for shared or joint credit. It does not refer to someone whose signature is required by the creditor as a condition for granting the credit requested. This joint applicant can be any other person and does not have to be and cannot be implied to be, the applicant's spouse. Unless the spouse is also a member/affiliated with the company that is applying for credit or has jointly applied for credit with the applicant, the creditor cannot require a spousal guarantee based solely on the basis of marriage which rule has been considered "the spousal guarantor rule".

# V – Enforcement (continued)

- E. **Spousal Guarantee.** Prohibited basis--marital status. A creditor may not use marital status as a basis for determining the applicant's creditworthiness. However, a creditor may consider an applicant's marital status for the purpose of ascertaining the creditor's rights and remedies applicable to the particular extension of credit. For example, in a secured transaction involving real property, a creditor could take into account whether state law gives the applicant's spouse an interest in the property being offered as collateral.

# V – Enforcement (continued)

- F. Except to the extent necessary to determine rights and remedies for a specific credit transaction, a creditor that offers joint credit may not take the applicant's marital status into account in credit evaluations. Because it is unlawful for creditors to take marital status into account, creditors are barred from applying different standards in evaluating married and unmarried applicants. In making credit decisions, creditors may not treat joint applicants differently based on the existence, the absence, or the likelihood of a marital relationship between the parties.

# V – Enforcement (continued)

- G. There is an interesting exception to ECOA involving marital property. Under 12 CFR 202.7 (d) where a married applicant requests credit and relies on property she owns jointly with her spouse, the creditor may require the signature of the spouse on the investments that are necessary, or that a creditor reasonably believes to be necessary, under the applicable state law, to make the property being offered as security available in the event of a default.

# V – Enforcement (continued)

- H. Therefore, because courts protect jointly held assets that are pledged as collateral by only one spouse, this exception allows creditors to require the signature of an applicant's spouse as necessary to obtain a valid security interest in any property that is offered as collateral by the applicant.

# V – Enforcement (continued)

- l. **Jointly owned property**. If an applicant requests unsecured credit, does not own sufficient separate property, and relies on joint property to establish creditworthiness, the creditor must value the applicant's interest in the jointly owned property. A creditor may not request that a non-applicant joint owner sign any instrument as a condition of the credit extension unless the applicant's interest does not support the amount and terms of the credit sought.

    - (i) Valuation of applicant's interest. In determining the value of an applicant's interest in jointly owned property, a creditor may consider factors such as the form of ownership and the property's susceptibility to attachment, execution, severance, or partition; the value of the applicant's interest after such action; and the cost associated with the action. This determination must be based on the form of ownership prior to or at consummation, and not on the possibility of a subsequent change

# V – Enforcement (continued)

- (ii) For example, in determining whether a married applicant's interest in jointly owned property is sufficient to satisfy the creditor's standards of creditworthiness for individual credit, a creditor may not consider that the applicant's separate property may be transferred into tenancy by the entirety after consummation. Similarly, a creditor may not consider the possibility that the couple may divorce. Accordingly, a creditor may not require the signature of the nonapplicant spouse in these or similar circumstances.

# V – Enforcement (continued)

- (iii) Asking for the signature of the joint owner on an instrument that ensures access to the property in the event of the applicant's death or default, but does not impose personal liability unless necessary under state law (e.g., a limited guarantee). A creditor may not routinely require, however, that a joint owner sign an instrument (such as a quitclaim deed) that would result in the forfeiture of the joint owner's interest in the property.

# V – Enforcement (continued)

- J. **Creation of enforceable lien.**
  - (i) Some state laws require that both spouses join in executing any instrument by which real property is encumbered. If an applicant offers such property as security for credit, a creditor may require the applicant's spouse to sign the instruments necessary to create a valid security interest in the property. The creditor may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default.
  - (ii) However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require them to do so.
  - (iii) Need for signature--reasonable belief. Generally, a signature to make the secured property available will only be needed on a security agreement. A creditor's reasonable belief that, to assure access to the property, the spouse's signature is needed on an instrument that imposes personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

# V – Enforcement (continued)

- K. **Integrated instruments.** When a creditor uses an integrated instrument that combines the note and the security agreement, the spouse cannot be required to sign the integrated instrument if the signature is only needed to grant a security interest. But the spouse could be asked to sign an integrated instrument that makes clear, for example, by a legend placed next to the spouse's signature, that the spouse's signature is only to grant a security interest and that signing the instrument does not impose personal liability.

# V – Enforcement (continued)

- L. **Qualifications of additional parties.** In establishing guidelines for eligibility of guarantors, cosigners, or similar additional parties, a creditor may restrict the applicant's choice of additional parties but may not discriminate on the basis of sex, marital status or any other prohibited basis. For example, the creditor could require that the additional party live in the creditor's market area.

  - (i) Reliance on income of another person--individual credit. An applicant who requests individual credit relying on the income of another person (including a spouse in a non community property state) may be required to provide the signature of the other person to make the income available to pay the debt. In community property states, the signature of a spouse may be required if the applicant relies on the spouse's separate income.

  - (ii) If the applicant relies on the spouse's future earnings that as a matter of state law cannot be characterized as community property until earned, the creditor may require the spouse's signature, but need not do so--even if it is the creditor's practice to require the signature when an applicant relies on the future earnings of a person other than a spouse. (See Sec. 202.6(c) on consideration of state property laws.)

# V – Enforcement (continued)

- M. **Renewals.** If the borrower's creditworthiness is reevaluated when a credit obligation is renewed, the creditor must determine whether an additional party is still warranted and, if not, release the additional party.

# V – Enforcement (continued)

- N. **Guarantees.** A guarantee on an extension of credit is part of a credit transaction and therefore subject to the regulation. A creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy. The requirement must be based on the guarantor's relationship with the business or corporation, however, and not on a prohibited basis. For example, a creditor may not require guarantees only for women-owned or minority-owned businesses. Similarly, a creditor may not require guarantees only from the married officers of a business or married shareholders of a closely held corporation.

# V – Enforcement (continued)

- O. **Spousal guarantees**. The rules in Sec. 202.7(d) bar a creditor from requiring a signature of a guarantor's spouse just as they bar the creditor from requiring the signature of an applicant's spouse. For example, although a creditor may require all officers of a closely held corporation to personally guarantee a corporate loan, the creditor may not automatically require that spouses of married officers also sign the guarantee. If an evaluation of the financial circumstances of an officer indicates that an additional signature is necessary, however, the creditor may require the signature of a spouse in appropriate circumstances in accordance with Sec. 202.7(d)(2).