

**RECENT DEVELOPMENTS IN  
REGULATION B,  
EQUAL CREDIT OPPORTUNITY ACT**

**FULTON BANK, N.A.  
SEMINAR**

**PRESENTER:**

**ANTHONY L. LAMM, ESQUIRE  
FLAMM WALTON HEIMBACH & LAMM PC  
794 PENLLYN PIKE, SUITE 100  
BLUE BELL, PA 19422**

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**BUCKS COUNTY BAR ASSOCIATION  
135 E. STATE STREET  
DOYLESTOWN, PA 18901**

**REGULATION B, EQUAL CREDIT OPPORTUNITY ACT**  
**RECENT DEVELOPMENTS**

**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).

**A. Comments from Supplement I to Part 202 of ECOA**

- **2(c)(2)(v) Terms of Credit. Terms of credit versus type of credit offered.** When an applicant applies for credit and the creditor does not offer the credit terms requested by the applicant (for example, the interest rate, length of maturity, collateral, or amount of downpayment), a denial of the application for that reason is adverse action (unless the creditor makes a counteroffer that is accepted by the applicant) and the applicant is entitled to notification under Sec. 202.9.
- **2(e) Applicant. Request to assume loan.** If a mortgagor sells or transfers the mortgaged property and the buyer makes an application to the creditor to assume the mortgage loan, the mortgagee must treat the buyer as an applicant unless its policy is not to permit assumptions.
- **2(f) Application. General.** A creditor has the latitude under the regulation to establish its own application process and to decide the type and amount of information it will require from credit applicants.

**B. Procedures established.** The term refers to the actual practices followed by a creditor for making credit decisions as well as its stated application procedures. For example, if a creditor's stated policy is to require all applications to be in writing on the creditor's application form, but the creditor also makes credit decisions based on oral

requests, the creditor's established procedures are to accept both oral and written applications.

**C. When an inquiry becomes an application.** A creditor is encouraged to provide consumers with information about loan terms. However, if in giving information to the consumer the creditor also evaluates information about the applicant, decides to decline the request, and communicates this to the applicant, the creditor has treated the inquiry as an application and must then comply with the notification requirements under Sec. 202.9. Whether the inquiry becomes an application depends on how the creditor responds to the applicant, not on what the applicant says or asks.

**D. Examples of inquiries that are not applications.** The following examples illustrate situations in which only an inquiry has taken place:

- When a consumer calls to ask about loan terms and an employee explains the creditor's basic loan terms, such as interest rates, loan to value ratio, and debt to income ratio.
- When a consumer calls to ask about interest rates for car loans, and, in order to quote the appropriate rate, the loan officer asks for the make and sale price of the car and amount of the down payment, then gives the consumer the rate.
- When a consumer asks about terms for a loan to purchase a home and tells the loan officer her income and intended down-payment, but the loan officer only explains the creditor's loan to value ratio policy and other basis lending policies, without telling the consumer whether she qualifies for the loan.
- When a consumer calls to ask about terms for a loan to purchase vacant land and states his income, the sale price of the property to be financed, and asks whether he qualifies for a loan, and the employee responds by describing the general lending policies, explaining that he would need to look at all of the applicant's qualifications before making a decision, and offering to send an application form to the consumer.

## II. **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.

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).

15 USC § 1691 c-2 9(c) requires that the information be itemized as follows:

- (1) The number of the application and the date it was received;
- (2) The type and purpose of the loan or other credit being applied for;
- (3) The amount of the credit or credit limit being applied for and the amount of the credit transaction or the credit limit approved for each such applicant;
- (4) The type of action taken with respect to such application and the date of such action;
- (5) The census tract in which is located the principal places of business of the women-owned, minority-owned or small business loan applicant;
- (6) The gross annual revenue of the business in the last fiscal year for the applicant preceding the date of the application;
- (7) The race, sex and ethnicity of the principal owners of the business and
- (8) Any additional data that the CFPB determines would aid in fulfilling the purpose of this section.

### **III. Adverse Action Notice:**

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

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. 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 either orally or 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. Should the company applying for the credit have gross revenues in excess of One Million Dollars for the preceding year, then 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.

#### **IV. Enforcement:**

**A. 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.

**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 guarantee rule".

**B. 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. 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.

Reg B provides in pertinent part as follows:

"Signature of spouse or other person –

(1) 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 creditors' standards of creditworthiness for the amount and terms of the credit requested."

12 CFR 202.7 (d) 1 was amended on April 15, 2003 to provide that:

"a creditor shall not deem a submission of a joint financial statement or other evidence of jointly held assets as an application for joint credit".

The lender must first perform a creditworthiness analysis on the applicant alone and make a determination that the applicant is not independently creditworthy.

In PA, 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. Therefore, because Pennsylvania 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.

This particular area of law is presently under scrutiny by the Supreme Court of the United States, who will be hearing arguments on issues regarding spousal guarantees in the next several months. Specifically in Hawkins v. Community Bank of Raymore, 761 F. 3d 937 (8<sup>th</sup> Cir. 2014), the Court held that a spouse could not have a guarantee invalidated based solely on the argument that she was discriminated against because she was married under ECOA, because ECOA specifically defines applicant as "any person who applies to a creditor directly for an extension, renewal, or continuation of credit, or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit,"<sup>1</sup> and therefore would not afford protection to a spousal guarantor who was not an "applicant." Hawkins v. Community Bank of Raymore, 761 F. 3d 937 (8<sup>th</sup> Cir. 2014).

The above analysis in the Hawkins case is in direct opposition to a case out of the sixth circuit, RL BB Acquisition, LLC v. Bridgemill Commons Development, 754 F. 3d 380 (6<sup>th</sup> Cir. 2014), in which the court looked directly to the definition of applicant from Regulation B, which defines applicant as "any person who requests or who has received an extension of credit from a creditor, and includes any person who is or may become contractually liable regarding an extension of credit. For purposes of §202.7(d), the term includes guarantors, sureties, endorsers, and similar parties,"<sup>2</sup> to determine if a guarantor could use ECOA as an affirmative defense to the

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<sup>1</sup> 15 U.S.C. §1691a(b).

<sup>2</sup> 12 CFR §202.2(e).

enforcement of a spousal guarantee. RL BB Acquisition, LLC v. Bridgemill Commons Development, 754 F. 3d 380 (6<sup>th</sup> Cir. 2014).

The Supreme Court will have to make a determination if the definition of 'applicant' in the Equal Credit Opportunity Act is applicable as written as the Hawkins court believes or whether the broader definition of 'applicant' as set forth in the Regulation implementing ECOA is the proper definition to use as the RL BB Acquisition, LLC court has held. ECOA was established in the 1970's and has been revised several times over the last 40 years without adjusting these definitions or removing the spousal guarantee rule, so one would be hard pressed to see the court changing the way the regulation has been operating over the last 40 years. However, there is no way of knowing what determination the Supreme Court will make.

### **C. Supplement I to Part 202 of ECOA**

- **Paragraph 7(d)(2)**

**1. 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 nonapplicant 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. 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.



**ii. Other options to support credit.** If the applicant's interest in jointly owned property does not support the amount and terms of credit sought, the creditor may offer the applicant other options to provide additional support for the extension of credit. For example—

a. Requesting an additional party (see Sec. 202.7(d)(5));

b. Offering to grant the applicant's request on a secured basis (see Sec. 202.7(d)(4)); or

c. 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.

**2. Need for signature--reasonable belief.** A creditor's reasonable belief as to what instruments need to be signed by a person other than the applicant should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general.

- **Paragraph 7(d)(4)**

**1. Creation of enforceable lien.** 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. However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require them to do so.

**2. 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.

**3. 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.

- **Paragraph 7(d)(5)**

**1. 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.

**2. 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 noncommunity 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. 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.)

**3. 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.

- **Paragraph 7(d)(6)**

**1. 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.

**2. 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).