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Statement by

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before the

Subcommittee on Consumer Affairs and Coinage

of the

Committee on Banking, Finance and Urban Affairs

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I appreciate the opportunity to appear before this subcommittee to discuss H.R. 1575, a bill to amend the Equal Credit Opportunity Act (ECOA) relative to business credit transactions.

Access to credit is an area in which I have a strong personal interest. Over the past two years, as a member of the Federal Reserve Board I have had the opportunity to meet with a variety of groups throughout the United States. Many of them have been women's groups and organizations of small business owners, and one recurring theme in these meetings has been access to credit for small businesses. In today's business climate, the availability of credit is critical, particularly to increasing numbers of women business owners. There are some 3.2 million businesses owned by women in the country today, according to a study by the Department of Commerce, and two out of three new businesses are started by women.

Access to credit is essential to all small business enterprises. They need capital to become established and to grow, and must depend not only on the resources of their owners but also on the credit market. And, they represent an important sector in our economy: data from the U.S. Small Business Administration (the SBA) show that small business establishments with fewer than 100 employees have accounted for over half our net employment growth in recent periods.

Yet obtaining credit can be a difficult process. Lenders are selective in granting loans. They have to be: they are not investors, and have an obligation to their stockholders and depositors to be sure that the loans they make will be repaid -- and many small businesses fail each year. A successful loan proposal must persuade the lender that the applicant is well qualified for the credit requested.

Getting credit is particularly difficult for first-time business borrowers, who not only must contend with managing the business and keeping it afloat, but also with making their way through the credit process. There is need for strong practical advice on the application process. And sometimes women and minority applicants may be concerned that they are receiving less favorable treatment than other applicants, not for credit-related reasons, but because of their sex, race, or marital status. Thus, there is need also to ensure that applicants know about their rights under the Equal Credit Opportunity Act, a law that ensures them equal treatment in the credit market.

The proposed legislation, H.R. 1575, seeks to address these concerns about access to credit by amending the ECOA regarding business credit. The Federal Reserve Board too is working toward improving access to credit, by launching a special educational effort. The Board recently completed the first step of this project, conceived almost a year ago, by publishing A Guide to Business Credit and the Equal Credit Opportunity Act. The Guide takes what we believe to be a useful approach, offering practical advice to entrepreneurs on the loan application process and on the preparation of an effective loan proposal. In drafting it, we had expert counsel from a number of sources. Industry groups -- the National Association of Bank Women, the American Bankers Association, the Consumer Bankers Association, the Independent Bankers Association of America, and the National Bankers Association -- participated in its development, as did the SBA. We were fortunate also to have the active participation of representatives from the National Association of Women Business Owners (NAWBO) who brought to the project the viewpoint of the business owner as credit applicant.

We believe this Guide will go a long way to facilitating the credit application process for the business owner and for those who aspire to own their own businesses. Having published it, we are now making every effort to see to it that the Guide reaches its intended audience. The Board is sending copies to all members of NAWBO, as well as to a variety of other organizations of women business owners, minority group entrepreneurs, and business owners generally, and will be making other distributions through the Reserve Banks. The SBA has plans for wide distribution of the pamphlet in response to calls from business owners. (They receive approximately 50,000 calls annually on SBA's toll-free "Answer Desk" telephone line, many of them dealing with requests for help on access to business credit.) The banking trade associations are sending copies to their member institutions to let them know of its availability. In addition, we have enlisted the support of the other banking regulators. By involving all parties to the credit process in this educational effort, we hope to achieve success in improving the availability of credit to women and minority entrepreneurs and in ensuring full compliance with the ECOA.

As noted earlier, the proposed legislation, H.R. 1575, also is directed toward improving access to credit for women and minorities. It seeks to do so by amending the ECOA with regard to the Board's rulewriting authority and implementation of the business credit exceptions.

There are three major provisions: first, the legislation would direct the Board to hold public hearings in accordance with the Administrative Procedure Act (APA) as a precondition to determining whether any exception in the business credit area would be granted or continued. Under existing law, the Board may make such a determination within the rulemaking requirements of the APA, but without the requirement for a public hearing.

Second, any exception granted by the Board for business credit would terminate after five years; the Board could only extend the exception by conducting a second public hearing. There is no comparable "sunset" provision in the current law.

Third, the legislation would permit Board exceptions only in the area of business or commercial transactions. Existing law also authorizes the Board to grant exceptions for other classes of transactions. Regulation B now provides certain exceptions for extensions of securities credit, public utility credit, and incidental credit -- categories that may essentially be consumer in nature, but for which exceptions have been found to be appropriate. H.R. 1575 appears to prohibit the Board from granting any exceptions for extensions of credit for personal, family, or household purposes, and thus would require elimination of these existing exceptions.

As the Board indicated in a letter to Congress last November (commenting on a companion bill, S. 1486), we do not favor the enactment of these changes to the ECOA. We believe that the legislation would not significantly enhance or improve the Board's rulewriting processes. While holding a public hearing before granting or continuing any exception for business credit would provide an extra information-gathering effort, we have found written public comment (which always takes place as part of the Board's rulewriting process) to be both useful and more than adequate. And, the periodic reevaluation of regulatory provisions called for by the bill is a procedure that we already follow under the Board's Regulatory Improvement Project, a program calling for the review of regulations every five years or so. This Board program is in keeping with the Regulatory Flexibility Act, which requires federal agencies to make a periodic review of all regulations.

In exercising its statutory authority to write regulations, the Board has sought to ensure that business credit applicants enjoy the full protections provided by the ECOA. Consequently, no class of transactions -- of whatever type or size -- is exempt from the ECOA or Regulation B. Lenders are barred from discriminating against business applicants in any aspect of a business credit transaction just as they are in a consumer credit transaction.

Under the ECOA and Regulation B, in business as in consumer credit, lenders may not take into account the applicant's race, national origin, sex, marital status, or any of several other prohibited bases. Lenders are subject to all the limitations having to do with an evaluation of the applicant's creditworthiness. For example, in the case of a business applicant who is married, the creditor may not, as a general rule, ask about or take into consideration information about the applicant's spouse, unless that individual has some connection to the business. Similarly, all the restrictions of Regulation B dealing with the signature of a cosigner -- whether the spouse or some other person -- apply in the business credit transaction.

Some limited exceptions do exist in the business credit area. These were adopted by the Board after extensive notice and comment. They are not so broad as some people appear to believe, and are directly related to the practical distinctions between consumer credit and business credit.

First, there are the rules dealing with the notification given when credit is denied. Under the regulation the consumer applicant has the right to notice of the creditor's granting or denial of an application. So does the business applicant. The consumer applicant has the right also to receive a statement of the principal reason or reasons for the denial. So too the

business applicant. And each has the right, upon request, to receive a written statement of those reasons.

The difference between the two transactions is that the consumer receives a written statement either of the reasons, or of the right to request the reasons, whereas the business applicant does not automatically receive a written notice of that right. This exception in the notification rules reflects the close personal contact that generally marks the business credit application process. Lenders are a valuable source of business and financial counsel to business credit applicants. They commonly discuss the loan proposal with business credit applicants in person, and if credit is denied will have the opportunity to explain the reasons for the denial, in detail, and to address the elements of the loan proposal that will need to be strengthened before the application can be approved. This, of course, obviates the need for the written statement that consumer applicants receive telling them they are entitled to know the reasons for the denial.

The second exception for business credit pertains to record retention. Lenders are required to retain business records for only 90 days, and not the 25-month period applicable in consumer transactions. However, if the business credit applicant requests, the lender is required to retain the records for the full 25 months. Record retention for the longer period is not automatically required because the documentation for business credit applications can be quite voluminous -- much more so than in consumer credit applications. For example, the documentation may include business projections, financial statements (both personal and for the business), copies of income tax returns, itemizations and descriptions of collateral, certificates of incorporation, partnership agreements, invoices, vender quotes, etc. In addition, this

documentation is costly for the applicant to produce and is often returned, upon request, to the applicant.

The third exception for business credit has to do with inquiries about marital status. In consumer credit transactions, creditors are prohibited by Regulation B from asking about marital status in applications for unsecured credit, but may ask about marital status in secured transactions (to ascertain whether under state law the spouse might have an interest in the property). Under the Board's regulation, business credit applicants may be asked for this information regardless of whether the credit is secured or unsecured.

However, most business credit is secured by business and personal assets. As a matter of fact, therefore, the lender could properly inquire about marital status in most cases -- even if the business credit exception were eliminated. It also bears repeating that even in cases where the creditor is permitted to ask about marital status, the creditor may not deny credit based on marital status (or any prohibited basis), or take it into account in setting the account terms.

The Board recognizes and appreciates the difficulty that small business applicants generally, and some women and minorities in particular, may be experiencing in obtaining business credit. But we also believe that the ECOA and Regulation B in their present form provide an adequate legal basis for protection against credit discrimination, and that the exceptions established are sufficiently narrow in scope, carefully written, and respond directly to the distinctions between consumer and business credit.

We expect that our joint effort with industry and women's and minority group organizations will serve to better inform business credit applicants of their rights under the ECOA, besides giving them practical assistance

in obtaining credit. We will continue to publicize actively the availability of the Guide to Business Credit and the ECOA and the message it contains: that business credit is not exempt from the ECOA. In addition to the distribution efforts previously mentioned, for example, we are also investigating the use of public service announcements to increase the potential for reaching the widest possible audience. We would like to give these efforts a chance to succeed before considering any amendments to the regulation or reopening rulemaking on the business credit exceptions.