FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 78-39
April 7, 1978

REGULATION B--EQUAL CREDIT OPPORTUNITY

Amendment to Definition of Adverse Action

TO ALL BANKS, OTHER CREDITORS,
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System has amended its Regulation B (Equal Credit Opportunity) to specify what constitutes adverse action in a credit transaction at the point of sale.

The amendment corresponds to one of two alternative proposals (Proposal A) published by the Board and sent to you under Circular No. 77-117, dated October 19, 1977, to solicit comment on issues raised by the Justice Department and the Federal Trade Commission concerning a staff interpretation of the definition of adverse action as applied to point of sale credit. The amendment supersedes Official Staff Interpretation EC-0008, which is rescinded.

Regulation B provides that adverse action in a credit transaction must be followed by written notification to the consumer of the reason for refusal of credit, or notice to the consumer of the right to receive such an explanation.

In a separate action, the Board instructed its staff to withdraw Official Staff Interpretation EC-0007 dealing with the collection, for marketing purposes, of information otherwise prohibited under Regulation B, and to issue a new Official Staff Interpretation EC-0010 restricting the applicability of the interpretation.

Printed on the reverse of this circular is a copy of the amendment for insertion in your Regulations Binder. In addition, enclosed is a copy of the Board's order as it appeared in the FEDERAL REGISTER on March 23, 1978. Any questions may be directed to the Bank Supervision and Regulations Department, Consumer Affairs Section, at Ext. 6171 or 6181. Additional copies of the amendment will be furnished upon request to the Secretary's Office, Ext. 6267.

Sincerely yours,
Robert H. Boykin
First Vice President

Enclosure

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-492-4403 (intrastate) and 1-800-527-4970 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

EQUAL CREDIT OPPORTUNITY

AMENDMENT TO REGULATION B†

Effective March 13, 1978, Sections 202.2(c)(1)(i) and 2(c)(2)(iii) are amended and a new subsection (c)(3) is added to read as follows:

SECTION 202.2 — DEFINITIONS AND RULES OF CONSTRUCTION

* * * * *

(c) **Adverse action.** (1) For the purpose of notification of action taken, statement of reasons for denial, and record retention, the term means:

(i) A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor offers to grant credit other than in substantially the amount or on substantially the terms requested by the applicant and the applicant uses or expressly accepts the credit offered; or

* * * * *

(2) The term does not include:

* * * * *

(iii) A refusal or failure to authorize an account transaction at a point of sale or loan, except when the refusal is a termination or an unfavorable change in the terms of an account that does not affect all or a substantial portion of a classification of the creditor's accounts or when the refusal is a denial of an application to increase the amount of credit available under the account; or

* * * * *

(3) An action that falls within the definition of both subsections (c)(1) and (c)(2) shall be governed by the provisions of subsection (c)(2).

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†For this Regulation to be complete as amended effective March 13, 1978, retain:
1) Printed Pamphlet as amended effective March 23, 1977; and
2) This slip sheet.

Extract From
FEDERAL REGISTER,
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Thursday, March 23, 1978
pp. 11966 - 11969

[6210-01]

Title 12—Banks and Banking

CHAPTER II—FEDERAL RESERVE SYSTEM

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. B; EC-0010]

PART 202—EQUAL CREDIT OPPORTUNITY

Official Staff Interpretations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Official Staff Interpretations.

SUMMARY: In accordance with the Board's regulations, the Board is publishing the following official staff interpretation of Regulation B, issued by a duly authorized official of the Division of Consumer Affairs.

EFFECTIVE DATE: March 16, 1978.

FOR FURTHER INFORMATION CONTACT:

Anne J. Geary, Acting Chief, Equal Credit Opportunity Section, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, 202-452-3946.

SUPPLEMENTARY INFORMATION: (1) Identifying details have been deleted to the extent required to prevent a clearly unwarranted invasion of personal privacy. The Board maintains and makes available for public inspection and copying a current index providing identifying information for the public subject to certain limitations stated in 12 CFR 261.6.

(2) Official staff interpretations may be reconsidered upon request of interested parties and in accordance with 12 CFR 202.1(d). A request for reconsideration should clearly identify the number of the official staff interpretation in question, and should be addressed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

EC-0010 (SUPERSEDES EC-0007, WHICH IS RESCINDED)

[EC-0010]

MARCH 16, 1978.

On April 13, 1977, the staff issued an official interpretation, subsequently designated EC-007, in response to your letter of February 8, 1977. As you know, the Board was asked by the Federal Trade Commission and the Department of Justice to rescind that interpretation. In September 1977, the Board considered the matter and affirmed the staff's position.

New requests for rescission have been filed by the FTC, Justice, and consumer representatives. Upon consideration of those requests, the staff is rescinding EC-0007 and is issuing this revised interpretation (designated EC-0010) in its place. This revised interpretation does not change the substance of our earlier letter to you, but is intended to emphasize certain aspects of the staff interpretation.

Your letter of February 8, 1977 was written on behalf of a seller of religious books and was based on the following facts. Your client operates primarily through home solicitation sales and permits customers to purchase the merchandise under an open end credit arrangement. The sales agent orally requests and records information about the customer (such as age, address, employer, bank account, and credit references) on an applicant information form printed on the reverse of the credit agreement that is signed by the customer. The sales agent also inquires about an applicant's religious affiliation and records this information in a box labeled "Church (group)" located on the first line of the applicant information form.

You stated in your letter that, given the nature of your client's business, information about a customer's religion is essential to selling the books in an effective, non-offensive way. You expressed concern, however, that asking for information about religious affiliation, even for non-credit purposes, might violate § 202.5(d)(5) of Regulation B. That section specifies in relevant part that a creditor shall not request the "religion * * * of an applicant or any other person in connection with a credit transaction."

The staff's opinion is that your client may inquire about a customer's religion in connection with the marketing of its books, since that characteristic is specifically and directly related to your client's product. We remind your client, however, that:

(1) This exception is available to your client only with regard to a customer's religion; it does not extend to information about other characteristics that Regulation B bars a creditor from soliciting.

(2) Although the information is available to your client under this limited marketing exception, information about a client's religious affiliation may not be considered by your client in making any credit decision.

(3) The record retention provisions of Regulation B provide that your client is required to retain a copy of any credit application form for a period of 25 months. Under the facts you describe, the customer's religious affiliation will be noted on the credit application form itself and, thus, will be available for review by the Federal Trade Commission, the federal enforcement agency that has jurisdiction over your client, should the occasion arise.

(4) If the information concerning an applicant's religion is solicited on a document other than the application form, that document will be deemed to be part of the credit application subject to the retention requirements of § 202.12(b).

The staff emphasizes that this interpretation sanctions the soliciting of information about religious affiliation only for marketing purposes. The interpretation in no way alters the prohibition against considering this type of information in an evaluation of creditworthiness. Moreover, the risk remains of your client's having to demonstrate that it does not discriminate against applicants on the basis of religion, even though it possesses such information. Whether to accept that risk is, of course, a decision that your client must make.

This is an official staff interpretation of Regulation B, issued pursuant to § 202.1(d) and limited in its application to the facts discussed in this letter.

Sincerely,

NATHANIEL E. BUTLER,
Associate Director.

Board of Governors of the Federal Reserve System, effective March 16, 1978.

THEODORE E. ALLISON
Secretary of the Board.

[FR Doc. 78-7728 Filed 3-22-78; 8:45 am]

[6210-01]

[Reg. B; Docket No. R-0117]

PART 202—EQUAL CREDIT OPPORTUNITY

Amendment to Definition of Adverse Action

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: This amendment to the Board's Equal Credit Opportunity regulation (Regulation B) clarifies the definition of adverse action and limits the cases in which failures or refusals to authorize an account transaction at point of sale or loan constitute adverse action for purposes of the regulation's notification requirements. The amendment corresponds to Proposal A, one of two alternative proposals published for comment on October 11, 1977 (42 FR 54834). It supersedes Official Staff Interpretation EC-0008, which is rescinded.

EFFECTIVE DATE: Immediately.

FOR FURTHER INFORMATION CONTACT:

Anne Geary, Chief Staff Attorney, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, 202-452-2761.

SUPPLEMENTARY INFORMATION: The Equal Credit Opportunity Act and Regulation B require that written notification be given to an applicant when adverse action occurs. Section 202.2(c)(1) of Regulation B, as amended on March 23, 1977, provides that adverse action occurs in three instances:

When there is a refusal to grant credit in substantially the amount or on substantially the terms requested by an applicant, unless the applicant uses or expressly accepts the amount or terms that the creditor offers,

When there is a termination of an account or an unfavorable change in its terms that does not affect all or a substantial portion of a classification of the creditor's accounts, and

Finally, when there is a refusal to increase the amount of credit available to an applicant who has requested an increase in accordance with the creditor's procedures for that type of credit.

The regulation also excludes five events from the definition of adverse action. Among the events excluded is a refusal to extend credit at point of sale or loan because the credit requested would exceed a previously established credit limit. A question remains as to whether, given this exclusion, adverse action occurs at point of sale or loan when a customer applies for an increase in the credit limit and the increase is denied.

In addition, neither the Act nor the regulation is explicit as to whether adverse action occurs when a point of sale or loan transaction that would not exceed the credit limit is denied.

The amendment to the definition of adverse action resolves these ambiguities by providing that a refusal or failure to authorize a point of sale or loan transaction is not adverse action unless it is (1) an unfavorable change in the terms of an account, (2) a termination of an account, or (3) a denial of an application (made in accordance with the creditor's procedures) to increase the credit limit.

The exclusion in the existing regulation regarding transactions that exceed the credit limit is subsumed into the new subsection (2)(iii). That is to say, denial of a point of sale or loan transaction that exceeds an existing credit limit is not adverse action unless the customer is applying for an in-

creased credit limit and is rejected. The Board believes this construction of the statutory language is supported by the legislative history. Senate Report 94-589 makes clear that Congress did not intend to rule out the possibility that a formalized application for an increased credit limit could occur at point of sale. Rather, the legislative intent was to establish the general rule that a customer's inexplicit or implied request for an increase (by an attempted purchase exceeding the limit) does not trigger the adverse action notification requirements.

The Board believes that excluding point of sale or loan denials that are under the credit limit from the definition of adverse action, except where such denials constitute a basic, unilateral change by a creditor, is also consistent with the statutory provisions and with the legislative history regarding adverse action. The Board emphasizes that the exclusion of most point of sale or loan denials from the adverse action requirements does not relieve creditors of the obligation to make credit available to creditworthy customers without regard to race, color, national origin, sex, or any other prohibited basis. In particular, the Board reminds creditors that the judicially constructed "effects test" is applicable to credit transactions. Accordingly, creditors should examine their security mechanisms and other operational aspects of the credit extensions to ensure that these measures do not discriminate against a protected class in an unlawful manner.

Based on the statutory definition of "applicant," the term "application" is defined in the regulation not to include transactions that are within a previously established credit limit. The denial of these transactions, therefore, does not constitute the denial of an application for credit. This leaves the question of whether the denial in an under-the-limit transaction is "a denial or revocation of credit [or] a change in the terms of an existing credit arrangement." Proponents of a broad adverse action definition argue that a denial at point of sale or loan is at least a temporary revocation of credit and, thus, should be categorized as adverse action. There is no clear statutory guidance on this point. However, the Board believes adoption of such an interpretation would be inconsistent with the legislative intent as evidenced in Senate Committee Report 94-589.

The report of the Committee on Banking, Housing and Urban Affairs makes clear that: "The (adverse action) provision is intended to operate in a sensible and flexible way." The report also explains that the term "adverse action" refers to "unilateral" changes in the terms of a credit plan, and that: "The Committee does not intend to require the giving of reasons where no such explanation can reasonably be expected by the debtor."

Point of sale or loan denials will frequently result from action initiated by a customer—for example because the customer (1) has failed to present a current credit card or the additional identification required by a merchant, (2) has reported the credit card to be lost or stolen, (3) has moved without notifying the creditor of the new billing address, or (4) has disavowed responsibility on the account.

In other instances, turndowns are not the result of a "change" in terms but rather relate to terms (such as security devices designed to prevent fraudulent use of credit cards) that have applied to the account since it was established. In these cases, requiring a creditor to describe the specific safeguard that resulted in the turndown could be detrimental to its continued effectiveness.

The Board recognizes that the amendment adopted does not respond to the concern expressed regarding the embarrassment and indignity experienced by a person who presents a current credit card and is turned down at point of sale or loan. In the Board's opinion, however, this problem is distinct from the problem of credit discrimination on a prohibited basis.

Moreover, categorizing point of sale or loan turndowns as adverse action would do little to alleviate the embarrassment and indignity to the customer at point of sale or loan. While a rejected customer would be entitled to an explanation, a creditor would not have to provide that explanation immediately. Under the statutory and regulatory provisions, a creditor has 30 days within which to notify the customer of the reason for the denial or, at tne creditor's election, of the customer's right to request the reasons.

Explanation of Amendment

The words "in an application" have been substituted for the words "by an applicant" in subsection (1)(i) of the existing adverse action definition. The change is intended to clarify that this provision is applicable only with regard to a refusal of an application for credit. Action on an existing account is governed by the succeeding provisions regarding termination, unfavorable change, and a refusal to increase a credit limit.

"Application" as defined in the existing regulation means a request made "in accordance with procedures established by a creditor." Thus, adverse action does not occur if a customer applies for an increased credit limit and, while the application is pending, is turned down at point of sale or loan because the transaction would exceed the previously established credit limit.

As used in existing § 202.2(c)(1)(ii) and in the new § 202.2(c)(2)(iii), the phrase "unfavorable change in terms or conditions" refers, for example, to a change in such contract terms as the annual percentage rate, credit limits, schedule of repayments, and the like. Where the underlying credit arrangement remains in effect subject to its original terms, the phrase does not refer to a temporary failure or refusal to permit transactions on the account occasioned, for example, by the following types of occurrences:

1. Presentation of a credit card that has expired or that is presented in advance of its effective date,
2. A customer's failure to present the credit card or required identification,
3. A malfunction in equipment at the authorization center, at point of sale or loan, or elsewhere,
4. An inability to communicate with the authorization center because it is closed,
5. The application of security control mechanisms designed to prevent fraudulent use of credit cards (such as limits on the number or dollar amount of daily transactions, or patterns of use),
6. The reservation of the amount of a previous transaction, which when added to authorizations previously approved by the card issuer on that account, would exceed the credit limit, or
7. Presentation of a credit card reported by the cardholder as lost or stolen.

The amendment adopted is essentially the same as Proposal A, published for comment on October 11. The following clarifying changes are not intended to alter the effect of the proposed amendment in any substantive way:

(1) The language in subsection (c)(2)(iii) as proposed read: "The term does not include a refusal or failure to authorize the use of an account * * *, except when the refusal *is caused by* a termination or an unfavorable change * * * or when the refusal *results in* the denial of an application * * *" (Emphasis added).

The provision adopted substitutes "is" for the words "is caused by" and "results in." This change is intended to make clear that when an account is terminated, for example, this constitutes adverse action, and notice of adverse action is required as to that termination within 30 days. However, the creditor is not required to notify a customer whose account has been terminated each time the customer subsequently tries to use the account and is turned down at point of sale or loan.

(2) While the majority of point of sale or loan denials will occur in the context of an open end credit arrangement, there may also be some closed end credit plans involving under-the-

limit point of sale or loan turndowns. To make clear that the new § 202.2(c)(2)(iii) is not limited to open end credit, the words "the use of an account" in the phrase "* * * a refusal or failure to authorize the use of an account" have been changed to read "an account transaction."

(3) The new subsection (c)(3) establishes that the exclusions set forth in subsection (c)(2), defining what does not constitute adverse action, will take precedence over the provisions of subsection (c)(1) in the event an action has characteristics of both subsections.

The amendment supersedes Official Staff Interpretation EC-0008, which is rescinded.

TEXT OF AMENDMENT

Pursuant to the authority granted under section 703 of the Equal Credit Opportunity Act (15 U.S.C. 1691(b)), the Board amends 12 CFR 202.2(c) as follows:

§ 202.2 Definitions and rules of construction.

* * * * *

(c) *Adverse action.* (1) For the purpose of notification of action taken, statement of reasons for denial, and record retention, the term means:

(i) A refusal to grant credit in substantially the amount or on substantially the terms requested in an application unless the creditor offers to grant credit other than in substantially the amount or on substantially the terms requested by the applicant and the applicant uses or expressly accepts the credit offered; or

* * * * *

(2) The term does not include:

* * * * *

(iii) A refusal or failure to authorize an account transaction at a point of sale or loan, except when the refusal is a termination or an unfavorable change in the terms of an account that does not affect all or a substantial portion of a classification of the creditor's accounts or when the refusal is a denial of an application to increase the amount of credit available under the account; or

* * * * *

(3) An action that falls within the definition of both paragraphs (c)(1) and (c)(2) of this section shall be governed by the provisions of paragraph (c)(2) of this section.

* * * * *

By order of the Board of Governors, effective March 13, 1978.

THEODORE E. ALLISON,
Secretary of the Board.

[FR Doc. 78-7727 Filed 3-22-78; 8:45 am]