FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 79-81
April 30, 1979

# REGULATION B--EQUAL CREDIT OPPORTUNITY

## Amendment Expanding Coverage and a Request for Comment on Rules Regarding Credit Scoring

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

Effective May 21, 1979, the Board of Governors of the Federal Reserve System is amending Regulation B, Equal Credit Opportunity, to clarify that it covers persons who regularly refer applicants or prospective applicants to creditors or who select the creditors to whom requests will be made. Regulation B now will cover real estate brokers, auto dealers, home builders, and others who are engaged in credit referral practices as a part of their business. The general prohibitions against discrimination and discouraging applications on prohibited bases will apply to the new category of "creditors," but recordkeeping and notification requirements will not apply.

At the same time, the Board is requesting comment through June 20, 1979, on how the specific rules of Regulation B should apply to credit scoring systems. The comments solicited are in the areas of assigning numerical scores to the number of jobs or sources of income an applicant has, not assigning a score to income from part-time employment, pension or alimony, and giving judgmental or model statement reasons for denial when a credit scoring system is used. Comments should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, and should refer to Docket No. R-203.

Printed on the reverse of this circular is a copy of the amendment. Member banks and others that maintain Regulations Binders should file the amendment in their binders. Enclosed is the Board's order regarding these two matters as it appeared in the *Federal Register*. Any questions regarding the Board's action should be directed to our Consumer Affairs Section of the Bank Supervision and Regulations Department, Ext. 6171.

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.

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## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

# EQUAL CREDIT OPPORTUNITY

## AMENDMENT TO REGULATION B†

Effective May 21, 1979, Section 202.2(l) is amended to read as follows:

### SECTION 202.2 — DEFINITIONS AND RULES OF CONSTRUCTION

* * * * *

(l) Creditor means a person who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit. The term includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of Sections 202.4 and 202.5(a), the term also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made. A person is not a creditor regarding any violations of the Act or this Part committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before its involvement with the credit transaction. The term does not include a person whose only participation in a credit transaction involves honoring a credit card.

* * * * *

†For this Regulation to be complete as amended effective May 21, 1979, retain:

1) Printed Pamphlet as amended effective March 23, 1977;
2) Amendment effective March 13, 1978;
3) Amendment effective April 21, 1978; and
4) This slip sheet.

**Extract from**
*Federal Register*
**VOL. 44, NO. 79**
**pp. 23865 - 23868**

**FEDERAL RESERVE SYSTEM**

**[12 CFR Part 202]**

### Equal Credit Opportunity; Application to Credit Scoring

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rulemaking.

**SUMMARY:** The Board solicits comment on how the specific rules of Regulation B should apply to the following credit scoring system practices: (1) scoring number of jobs or number of sources of income; (2) not scoring the amount of an applicant's income from part-time employment, pension, or alimony; (3) selecting the reasons for adverse action judgmentally; and (4) using reasons for adverse action from the model statement when they do not correspond to the characteristics scored.

**DATE:** Comments must be received on or before June 20, 1979.

**ADDRESS:** Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All comments should refer to docket number R-203.

**FOR FURTHER INFORMATION CONTACT:** Dolores S. Smith, Section Chief, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2412).

**SUPPLEMENTARY INFORMATION:** The Equal Credit Opportunity Act (ECOA) and its implementing Regulation B differentiate between "demonstrably and statistically sound, empirically derived credit systems" and "judgmental systems" of credit analysis. Credit scoring systems that meet specified tests of statistical validity qualify as demonstrably and statistically sound, empirically derived credit system. All other types of credit analysis constitute judgmental systems.

Regulations B's specific rules represent the Board's judgment about the general effect of selected credit practices on the population at large. When adopting the specific rules, the Board focused principally upon discriminatory practices of judgmental systems. Accordingly, the proper application of the specific rules to credit scoring systems remains unclear.

The Board invites comment on the four issues enumerated in the Summary. Resolving them could entail a variety of regulatory action, including amending Regulation B and issuing official interpretations. Before considering any extensive changes, the Board wishes to encourage a thorough public discussion that will address both the impact of possible changes and the need for any change at all. The options described for each issue are not mutually exclusive and do not constitute the only possible responses. The Board also solicits comment on the general subject of applying Regulation B's specific rules to credit scoring systems. After analysis of the comments received, the Board will determine what issues, if any, warrant its further consideration and what regulatory action appears appropriate.

1. *In developing and using a credit scoring system, what constitutes discounting of income and what consitutes exclusion of consideration of income?*

Section 202.6(b)(5) provides that a "creditor shall not discount or exclude from consideration the income of an applicant . . . because the income is derived from part-time employment. . . ." However, the "creditor may consider the amount and probable continuance of any income. . . ." The Board adopted this rule to prevent discrimination against married women, many of whom work only part-time, and to curtail the practice of arbitrarily

discounting the wife's income on joint applications. For a judgmental system, the rule means that the credit officer must accord reliable amounts of part-time income the same treatment given income from any other source. The Board did not consider how the rule should affect credit scoring systems.

1a. *For example, may a credit scoring system score the fact that an applicant has more than one job or multiple sources of income, and may it score secondary income differently from primary income?*

Assuming that "number of jobs" contributes to a system's predictive power, may the system assign fewer points or less weight to applicants holding multiple jobs (e.g., one—10, two or more—5 points)? Related issues include the proper treatment of the number of income sources and of the amount of income from different types of sources (earned, alimony, pension, dividend, etc.). The Board recognizes that these issues involve competing considerations and that how the question is phrased to some extent dictates the answer.

For example, those who would prohibit assigning negative points for multiple jobs argue that this practice has the effect of disadvantaging several protected classes of applicants. In addition, the literal text of the § 202.6(b)(5) rule could be interpreted to preclude discounting part-time income by type, as well as amount. Finally, to penalize an applicant for fully completing the application (e.g., providing information about part-time employment) may simply seem undesirable when selective omissions (e.g., not providing part-time employment information) would confer a greater probability of obtaining credit.

Conversely, proponents of the practice might show that "number of jobs" predicts creditworthiness. Prohibiting its use reduces system accuracy and therefore increases the aggregate risk of extending credit. Further, the regulation refers to the amount of part-time income, not its mere existence. Finally, the practice of assigning less weight to second jobs may not have the effect of discriminating on a prohibited basis since all manner of applicants "moonlights."

The Board hopes that public comments will bring additional considerations to its attention. At present, it contemplates one or more of the following options for addressing this issue.

A. Interpreting § 202.6(b)(5) as applying only to judgmental systems, thereby authorizing scoring number of jobs.

B. Interpreting the rule to prohibit scoring number of jobs, number of sources of income, or amount of income from different sources.

C. Interpreting the rule as not per se prohibiting the practice, but allowing ECOA enforcement agencies to detemine on a case by case basis whether scoring number of jobs or sources of income has the effect of impermissibly discriminating against an applicant on a prohibited basis.

1b. *How must a scoring system consider the amount of an applicant's income from part-time employment, pension, or alimony?*

Section 202.6(b)(5)'s prohibition on exluding part-time income from consideration also applies to pension and alimony income. These additional provisions seek to protect divorced women and the elderly from discrimination unrelated to their creditworthiness. When adopting them, the Board concentrated on arbitrary behavior by judgmental creditors. It now solicits comment on how this specific rule should apply to credit scoring systems.

Development of a scoring system typically uses statistical techniques to select the characteristics that, taken together, predict the repayment performance of the creditor's recent applicants. A properly designed development process may examine and reject other characteristics as nonpredictive. If secondary income does not contribute to the creditworthiness prediction, must the system score it anyway, or would having included secondary income as a trial characteristic during the intial phases of the development procedure suffice?

Proponents of scoring nonpredictive secondary income interpret § 202.6(b)(5) as requiring explicit treatment of these types of secondary income. They also point out that the section contemplates an individual analysis of the particular applicant's income and precludes assumptions based upon the experience with similar income of prior applicants. Thus, the creditor must consider the fact that a particular applicant can prove the regular receipt of alimony, even if most applicants' alimony does not arrive on schedule.

Opponents object to this interpretation as overliteral. The Board adopted the rule to deter credit officers from using stereotypes in lieu of individual analysis when dealing with divorcees, the elderly, and married women. A scoring system, however, uses only the combination of characteristics that best associate with creditworthiness. If secondary income does not statistically associate with creditworthiness, the government should not make it do so. Requiring a creditor to score a nonpredictive characteristic distorts the validity of the credit analysis process. This increases the creditor's overall risk of doing business and may result in less credit to economically disadvantaged applicants.

The Board invites comment on the issue of how a scoring system should consider the amount of an applicant's income from part-time employment, pension, or alimony, and on possible alternatives for addressing it, including:

A. Exempting credit scoring from the "consideration" rule in § 202.6(b)(5).

B. Deeming inclusion of secondary income as a trial characteristic in the system development process to constitute sufficient consideration.

C. Requiring that any scoring of amount of income include all types of income as a single characteristic.

D. Requiring that scoring systems have a judgmental override that considers secondary income.

E. Requiring positive allocation of points to secondary income regardless of its predictive power.

F. Requiring systems to inclue a subsystem that predicts the reliability of the particular applicant's secondary income.

2. *How must a creditor using a scoring system select the "specific" reasons for adverse action?*

The ECOA and Regulation B provide that, when a creditor takes "adverse action" (e.g., by rejecting a credit request), it must give the applicant either the specific reasons for the action or a disclosure of the right to receive the reasons. Section 202.9(b)(2) of the regulation requires that a statement of reasons suffices if "specific and indicates the principal reasons for the adverse." A statement that the applicant failed to achieve a passing score does not suffice as a specific reason. Receiving the reasons for adverse action gives applicants an opportunity to take remedial action, correct erroneous assumptions of the creditor, and reapply when a mutable attribute changes (e.g., when income increases).

Recent FTC consent decrees contain a requirement that users of scoring systems select their adverse action using a specified mathematical formula. Under these decrees, the creditor must examine the scoring sheet for the rejected application, subtract the applicant's score from the median score for each characteristic, and disclose the four characteristics having the largest differences. The Board's staff, on the other hand, has unofficially interpreted § 202.9(b)(2) to permit judgmental selection of reasons for adverse action, even by creditors using scoring. Thus, the credit officer may select the reasons

from all the information on the application.

Proponents of the former interpretation argue that the scored characteristics alone contribute to the credit decision, and that therefore they comprise the real reasons for adverse action. Permitting the creditor to disclose unscored characteristics from the balance of an application does not provide information the applicant can use to take remedial action. ECOA enforcement agencies also suggest that some creditors use judgmental selection of reasons to conceal discriminatory credit analysis practices. By manually selecting among all the information on the application, they intentionally mislead applicants about the true reasons for their rejection.

Opponents of the mathematical process reason that under a judgmental system the credit officer makes the credit decision and selects the reasons manually. The same officer can also select the reasons where a scoring system makes the initial decision. In addition, some important reasons occur too infrequently for inclusion on the scoring sheet (e.g., bankruptcy), but would be selected by judgmental systems as critical. Finally, a suitable method for selecting reasons for adverse action will vary from case to case, depending upon the nature of the particular credit analysis process. A fixed, mathematical procedure may prove unsuitable in certain cases. For example, a scoring system that allocates half of its possible points for a single characteristic would select this characteristic as the reason so frequently as to obscure its specificity as a reason.

The Board hopes that public comment will more fully explore these considerations. It suggests the availability of a variety of approaches to the problem.

A. Authorizing either mathematical or judgmental selection of reasons for adverse action.

B. Requiring judgmental selection.

C. Requiring that applicants with similar financial characteristics receive similar reasons, but not specifying the method for selecting them.

D. Specifying the exact formula for relating scored characteristics to selection of reasons for adverse action.

3. *Under what circumstances may a creditor employing a credit scoring system use the reasons for adverse action from Regulation B's model statement?*

As noted above, the statute and § 202.9(b)(2) require disclosure of "specific" reasons for adverse action. Section 202.9(b)(2) also provides a model "statement of credit denial, termination, or change," proper use of which satisfies this requirement. The model statement contains twenty categories of reasons for adverse action, including "other, specify." The Board adopted the model statement to facilitate compliance by small creditors.

ECOA enforcement agencies have experienced some difficulties in the specificity with which model reasons must correspond to scored characteristics while still amounting to proper use. The problem arises because scored characteristics have greater specificity than the "pertinent elements of creditworthiness" used in a typical judgmental system. For example, a creditor might score: finance company loans, yes–0, no–15; bank loans, yes–6, no—1; or credit cards from prestigious department stores, none–0, one–4, two or more–16. None of the reasons on the model notice relate closely to any of these specific characteristics. Instead of filling in the "other, specify" line, a creditor may check whichever reason seems to be closest (e.g., insufficient credit references).

Critics of this practice suggest that forcing specific characteristics into model categories of reasons violates the requirement of specificity. The practice of discounting finance company loans relates only indirectly to insufficient credit references. In addition, this mischaracterization or lack of specificity deprives rejected applicants of the opportunity to remedy their credit deficiencies. The critics argue that it therefore constitutes a misuse of the model statement and does not satisfy the specific rule's requirements. Finally, ECOA enforcement agencies suggest that some creditors use the model reasons to mislead applicants about the characteristics scored in order to conceal discriminatory practices. The agencies believe that precise restrictions on proper use of the model statement will reduce this abuse.

Conversely, the legislative history accompanying ECOA indicates that the Congress contemplated only the most general statement of reasons. One of the examples in the legislative history contains only seven reasons. Requiring that disclosed reasons for adverse action correspond exactly to scored characteristics will also disrupt the present operations of creditors that use scoring. Changing procedures and forms will entail extra compliance costs. In addition, increased specificity will mean greater uncertainty as creditors grope to comply with a new standard that lacks precise quantification. How specific is "specific"? Finally, using the model statement to evade the regulation presently constitutes a violation, and the enforcement tools for dealing with such practices already exist.

The Board perceives the question as being one of degree. Consider a system that scores the number of credit references from banks. An applicant with six references from stores, finance companies, and thrift institutions receives no points for them. Checking "insufficient credit references" on the adverse action notice seems insufficiently specific. Diclosing "no bank references" probably would suffice. What intermediate levels of specificity also comply with the requirements of a statement of specific reasons for adverse action, and how can the Board precisely articulate them? The Board envisions one or more of the following alternatives.

A. Increasing the number of reasons on the model statement.

B. Prohibiting creditors that use scoring systems from utilizing the model statement.

C. Deeming "specific" to be the general standard and leaving it to each enforcement authority to determine whether a particular reason conforms to this standard.

D. Promulgating more precise standards for relating scored characteristics to specificity of reasons for adverse action, but leaving the model statement unchanged.

E. Requiring creditors that use scoring systems to disclose that they use scoring, the exact characteristics scored, and the four characteristics for which the applicant lost the most points, in lieu of using the model statement.

Pursuant its authority under § 703 of ECOA, the Board proposes to adopt one or more of the following amendments to Regulation B. The amendments appear sequentially by issue and option. The proposed new language is in italics.

Issue 1a: Section 202.6(b)(5) would be amended to read:

Option A: *In a judgmental system,* a creditor shall not discount or exclude from consideration. . . .

Option B: A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis or because *of the amount or type of income* derived from part-time employment. . . .

Option C: A creditor shall not discount or exclude from consideration the *amount of* income of an applicant or. . . .

Issue 1b: Section 202.6(b)(5) would be amended to read:

Option A: *In a judgmental system,* a creditor shall not discount or exclude from consideration. . . .

Option B: . . . in evaluating an applicant's creditworthiness. *A demonstrably and statistically sound, empirically derived credit system may consider this income by including it as a trial characteristic during*

*the system construction process.* Where an applicant relies. . . .

Option C: *In a judgmental system,* a creditor shall not discount or exclude from consideration. . . . *In a demonstrably and statistically sound, empirically derived credit system that considers the amount of income of an applicant or the spouse of an applicant, the creditor shall consider all reliable income as a single characteristic.* Where an applicant relies. . . .

Option D: . . . in evaluating an applicant's creditworthiness. *A demonstrably and statistically sound, empirically derived credit system shall comply with this requirement by using a judgmental override that considers such income.* Where an applicant relies. . . .

Option E: . . . in evaluating an applicant's creditworthiness. *A demonstrably and statistically sound, empirically derived credit system shall comply with this requirement by allocating at least x per cent of the possible total points to receipt of such income.*

Issue 2: Section 202.9(b)(2) would be amended to add a new sentence at its end:

Option A: *A creditor may select the reasons either judgmentally or by using a mathematical formula.*

Option B: *A creditor using a demonstrably and statistically sound, empirically derived credit system shall select the reason(s) judgmentally.*

Option C: *A creditor using a demonstrably and statistically sound, empirically derived credit system shall select the reason(s) using a procedure that will result in applicants with similar financial characteristics receiving identical reasons.*

Option D: *A creditor using a demonstrably and statistically sound, empirically derived credit system shall select as reasons up to four characteristics on which the applicant's score differed most from the maximum possible score.*

Issue 3: Section 202.9(b)(2) would be amended as follows:

Option B: . . . for the adverse action. *A judgmental creditor may use all or a portion of the sample form printed below. . . .*

Option D: . . . for the adverse action. *A statement's reasons are specific if a reasonable consumer receives sufficient information to determine the changes in characteristics that would have resulted in approval of the application.* A creditor may formulate. . . .

Option E: . . . for the adverse action. A *judgmental* creditor may formulate its own statement of reasons. . . . *A creditor using a demonstrably and statistically sound, empirically derived credit system must disclose the use of the system, the manner of its operation, the applicant's score, the passing score, the maximum possible score, and the characteristics scored.*

* * * * *

By order of the Board of Governors, April 13, 1979.

Theodore E. Allison,
*Secretary of the Board.*

[Reg. B; Docket No. R-203]
[FR Doc. 79-12515 Filed 4-20-79; 8:45 am]
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## FEDERAL RESERVE SYSTEM

### 12 CFR Part 202

### Definition of Creditor

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Final rule.

**SUMMARY:** The Board is amending its Regulation B, Equal Credit Opportunity, to clarify that it covers persons, such as real estate brokers, home builders, and automobile dealers, who regularly refer applicants or prospective applicants to creditors, or who select or offer to select creditors to whom requests for credit may be made. The amendment provides that those persons are creditors, but only for the purposes of the regulation's general prohibitions of discrimination against credit applicants or discouraging applications on a prohibited basis. Those persons are not subject to the mechanical requirements of the regulation, such as those relating to notices and record retention.

**EFFECTIVE DATE:** May 21, 1979.

**FOR FURTHER INFORMATION CONTACT:** Dolores S. Smith, Section Chief, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202–452–2412).

**SUPPLEMENTARY INFORMATION:** The Board's Regulation B, which implements the the Equal Credit Opportunity Act, applies to all persons who are creditors, as that term is defined by the regulation. The existing § 202.2(1) definition provides that a creditor is a person who in the ordinary course of business "regularly participates in the decision of whether or not to extent credit."

The staff of the Federal Trade Commission has urged the Board to amend that definition to include persons who in the ordinary course of business regularly "arrange for the extension of credit." The FTC staff expressed concern that real estate brokers may not be covered by Regulation B since ostensibly they do not regularly participate in credit decisions. The FTC staff points out that, by their participation in the credit application process, real estate brokers nevertheless may be in a position to influence the outcome. The FTC staff cites a recent HUD study [1] in support of the proposition that discriminatory "steering" by real estate brokers is the cause of severe problems faced by members of minority groups in obtaining housing and that credit discrimination may exacerbate this problem. The FTC staff believes there is authority for making the regulation applicable to steerers based on the statutory definition of "creditor," which includes "any person who regularly arranges for the extension" of credit (§ 702(e), 15 U.S.C. 1691a(e)).

In response to the FTC staff's request, the Board published for comment on October 26, 1978 (43 FR 49987), along with other proposals,[2] a proposed amendment to § 202.2(e) of Regulation B that, if adopted, would expressly include within the definition of creditor "any person who in the ordinary course of business regularly arranges for the extension of credit but does not participate in the credit decision * * *." The proposal defined "arranges for the extension of credit" as meaning "to refer applicants or prospective applicants to other creditors, or to select or offer to select creditors to which requests for credit may be made."

Comments on the proposed creditor definition amendment contain conflicting views on the need for any change and the form that a change should take. Real estate industry commenters strongly deny the existence of significant discriminatory steering when assisting customers in obtaining home financing. They point out that self-interest (the receipt of a commission) dictates that a broker make every reasonable effort to assure that a potential purchaser finds both a house and a source of credit. On the other hand, commenters representing minority groups and public interest organizations assert that discrimination in credit referrals is a serious problem and that minority group applicants need to be protected from credit steering toward available, but more onerous, credit terms. Industry commenters also noted that the ECOA applies only to "applicants" and does not reach prospective applicants such as persons still looking at houses to buy. Other commenters observed, however, that the statute expressly covers "arrangers," regardless of when the formal application process begins.

The extent to which possible discriminatory practices by brokers may be barred by other laws, such as the Fair Housing Act (42 U.S.C. 3601–3619), is not clear. That statute covers brokers in their selling and leasing activities, but not necessarily in their referral of clients to credit sources. Several commenters, including the Department of Housing and Urban Development and the Federal Home Loan Bank Board, therefore emphasized the desirability of amending Regulation B even if it might duplicate coverage under other anti-discrimination laws since the ECOA provides for both private and public enforcement initiatives.

Having carefully considered the comments and the arguments for and against the proposed change in the definition of creditor, the Board has decided expressly to include within the definition persons who regularly in the ordinary course of their business refer applicants to creditors or select creditors to whom credit applications will be submitted. In adopting that change, the Board has simplified the amendment, without altering its intended purpose. The proposal used the phrase "arranges for the extension of credit" and then defined that phrase to mean "to refer applicants or prospective applicants to other creditors, or to select or offer to select creditors to which requests for credit may be made." As adopted, the amendment eliminates the "arranges for the extension of credit" phrase and substitutes the explanation (with a few minor, stylistic changes) of what constitutes arranging for the extension of credit, thereby avoiding a proliferation of definitions.

Like the original proposal, the final amendment provides that persons who become creditors under the Regulation B definition solely because they regularly refer applicants or submit applications to other creditors who may extend

[1] "Housing Market Practices Survey," prepared jointly by the Department of Housing and Urban Development and the National Committee Against Discrimination, April 1978.

[2] The other proposals published for comment will be considered in the Board's review of Regulation B pursuant to its regulatory improvement project.

credit are not subject to the so-called "mechanical" regulatory requirements relating to applications (§ 202.5(b) through (e)), notices (§ 202.9), credit reporting (§ 202.10), record retention (§ 202.12), and collection of monitoring information (§ 202.13). However, instead of expressing the limited nature of the regulation's coverage in terms of the provisions from which those who engage in credit referral activities are exempt, as was done in the original proposal, the final amendment specifies the coverage simply and positively. They are subject to only two sections: the general ban on discrimination against applicants on a prohibited basis found in § 202.4 and the ban on discouraging applicants on a prohibited basis from applying for credit found in § 202.5(a).

The Board elected not to subject persons who engage in credit referral activities to the regulation's mechanical requirements because those rules were not designed to apply in a pre-application context. For example, a real estate broker, in assisting a buyer to find appropriate housing, may have a legitimate need for more information about the buyer and the buyer's family than § 202.5 of Regulation B would permit a credit extender to obtain. Furthermore, since the credit extender to whom a referral is made would have to comply with the mechanical rules, there appears to be little point in placing essentially duplicative notice, record retention, and monitoring information gathering requirements on a person solely engaged in referral activities.

Finally, the amendment, as adopted, modifies the definition of creditor to make clear that a creditor to whom an applicant or application has been referred is not liable for any violation of the ECOA or Regulation B committed by the person who made the referral unless the creditor receiving the referral knew or had reasonable notice of the violation before its involvement with the transaction. This is the same protection accorded under the regulation to assignees, transferees, subrogees, and similar parties.

The effect of the amendment is twofold. First, it expressly bars discrimination against credit applicants on a prohibited basis by persons who regularly as part of their business channel applicants or applications to credit sources. Second, it clearly places those creditors under the administrative enforcement jurisdiction of the agencies specified in § 704 of the ECOA, principally the FTC, and makes available to applicants and the Department of Justice the civil suit remedies set forth in § 706 of the Act (15 U.S.C. 1691c and 1691e).

The Board decided to adopt the amendment for two reasons. First, it believes that persons who regularly engage in credit referral activities in effect may participate in decisions of whether or not to extend credit as that standard is used in § 202.2(e) of Regulation B and therefore may be creditors for purposes of the regulation. From that perspective, the change merely clarifies the pre-amendment coverage of the regulation.

Second, to the extent that a person engaged in credit referral activities does not participate in credit decisions and therefore would not be considered a creditor absent the amendment, the Board believes that that person should be covered, at least to the extent of the basic proscriptions on discrimination, as a person "who regularly arranges for the extension" of credit as that phrase is used in the ECOA. Since persons making credit referrals would not be subject to any mechanical requirements, the Board saw no reason not to make clear that all parties involved in the credit application process, even those who only refer applicants or applications to credit sources, are barred from discriminating against applicants on a prohibited basis. As the Board recently stated in connection with its consumer and civil rights compliance program: "The Board believes that any type of discrimination prohibited by the civil rights laws is detrimental to the nation and to society."

Accordingly, for the reasons stated above and pursuant to § 703(a) of the ECOA (15 U.S.C. 1691b(a)), the Board amends 12 CFR 202.2(l) as follows:

**§§ 202.2 Definitions and rules of construction.**

* * * * *

(l) *Creditor* means a person who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit. The term includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of §§ 202.4 and 202.5(a), the term also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made. A person is not a creditor regarding any violation of the Act or this Part committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before its involvement with the credit transaction. The term does not include a person whose only participation in a credit transaction involves honoring a credit card.

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By order of the Board of Governors, April 11, 1979.

**Theodore E. Allison,**
*Secretary of the Board.*

[Reg. B: Docket No. R-0185]
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