FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 82-63
June 3, 1982

REGULATION B

Equal Credit Opportunity

Credit Scoring Interpretations

Withdrawal of Proposed Business Credit Amendments

TO ALL MEMBER BANKS
AND OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System has asked for public comment on two proposed interpretations of Regulation B concerning credit scoring. The Board also proposed to withdraw possible amendments to the business credit provisions of Regulation B. The amendments were first published for comment in 1978. Interested persons are invited to submit comments to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, by July 1, 1982. Comments should refer to Docket No. R-0203.

Printed on the following pages are copies of the press release and the Federal Register documents. Questions regarding this material should be directed to this Bank's Legal Department, Ext. 6171.

Additional copies of this circular will be furnished upon request to the Department of Communications, Financial and Community Affairs, Ext. 6289.

Sincerely yours,

William H. Wallace

William H. Wallace
First Vice President

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

FEDERAL RESERVE press release

For immediate release May 25, 1982

The Federal Reserve Board today asked for public comment on two proposed interpretations of Regulation B (Equal Credit Opportunity) and on the proposed withdrawal of three previously proposed amendments to the regulation.

The Board requested comment by July 1, 1982.

The interpretations upon which the Board requested comment concern credit scoring. They are revisions of previous proposals following staff assessment of comment received. As revised and proposed for further comment, they are:

1. An interepretation concerning the use of judgmental and credit scoring systems in the treatment of income derived from alimony, child support, separate maintenance, part-time employment, retirement benefits or public assistance under the regulation's requirement forbidding exclusion from consideration of such income.

2. An interpretation concerning the selection and disclosure of reasons for adverse action on a credit applicaton.

At the same time the Board proposed to withdraw possible amendments to the business credit provisions of Regulation B first published for comment late in 1978.

There are attached the text of the Board's proposed interpretations and the introduction to its proposal to withdraw the previously proposed amendments. The text of the latter notice may be obtained from the Federal Reserve Board and the Federal Reserve Banks.

Attachments

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FEDERAL RESERVE SYSTEM

12 CFR Part 202

[Reg. B; Docket No. R-0203]

EQUAL CREDIT OPPORTUNITY

Proposed Board Interpretations; Consideration of Income and Disclosure of Reasons for Adverse Action

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed Board interpretations.

SUMMARY: The Board proposes to adopt two interpretations of Regulation B, Equal Credit Opportunity. The Board seeks comment on whether creditors affected by the interpretations will encounter technical problems in complying with these interpretations. The first interpretation discusses how users of judgmental and credit scoring systems must treat income derived from alimony, child support, separate maintenance, part-time employment, retirement benefits or public assistance to comply with the regulation's requirement that creditors not "discount or exclude from consideration" such income. The second interpretation explains how creditors should select and disclose the principal reason or reasons for adverse action. These interpretations derive from questions that have been raised about the application of Regulation B to credit scoring systems, but the basic principles apply to judgmental systems as well.

DATE: Comments must be received on or before July 1, 1982.

ADDRESS: Comments may be mailed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washington, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m. All material submitted should refer to Docket No. R-0203.

FOR FURTHER INFORMATION CONTACT: Lucy Griffin, Senior Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-2412).

SUPPLEMENTARY INFORMATION: (1) Introduction. In response to requests for clarification on how certain provisions of its Regulation B (12 CFR Part 202) apply to the operation of numerical credit scoring systems, */ the Board asked for public comment (44 FR 23865, April 23, 1979) on four questions about Regulation B's application to credit scoring systems:

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*/ Basically, credit scoring is the use of statistical techniques to assign points or weights to various applicant characteristics (e.g., income, credit history) or other factors relevant to the transaction (e.g., type of security) in order to predict the likelihood that the applicant will satisfactorily repay the credit. In Regulation B, an empirically and statistically derived credit scoring system is contrasted with the judgmental evaluation performed by a credit officer or committee; compare the definition of "a demonstrably and statistically sound, empirically derived credit system" in § 202.2(p) with the definition of "judgmental system of evaluating applicants" in § 202.2(t).

- 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?

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

- How must a creditor using a scoring system select the specific reasons for adverse action?

- Under what circumstances may a creditor employing a credit scoring system use the reasons for adverse action contained in Regulation B's model statement?

The Board received almost 300 written comments from members of Congress, industry, academics, and others. The comments expressed a wide diversity of views about how Regulation B's rules should apply to credit scoring systems. The multiplicity of viewpoints and the underlying technical complexity of the questions raised in the comment process led to a thorough reconsideration of the issues and the policy options available. Based on that review, the Board issued for public comment (45 FR 56818, August 26, 1980) two proposed interpretations. The first proposal addressed several issues concerning consideration of income and income reliability. The second proposal set forth several principles governing the selection and disclosure of adverse action. Both proposed interpretations affirmed the Board's conclusion, based upon an analysis of the comments and the Equal Credit Opportunity Act, that the rules in Regulation B apply to all creditors, whether they evaluate creditworthiness judgmentally or through a credit scoring system.

The Board received almost 300 written comments on these proposals from members of Congress, federal and state agencies, industry, consumers, and academics. Generally, creditors (retailers, oil companies, financial institutions, and trade associations) claimed that a properly designed credit scoring system is an accurate, objective mechanism for determining creditworthiness. They suggested that to preserve the empirical and statistical character of such a system, a creditor should be allowed wide latitude to include in or exclude from a particular system the amount and sources of an applicant's income depending on whether those factors were related in a statistically significant way to creditworthiness as established by the creditor developing the system. They also advocated that wide latitude be given to determining the most appropriate way for selecting and disclosing the principal reason or reasons for an adverse credit decision.

Consumer commenters (including several members of Congress and a number of individual consumers) generally were concerned that the Board not reduce or eliminate what they perceived as the basic protections already afforded by the law. They were opposed to allowing creditors the degree of flexibility sought by the industry because of the belief that such flexibility might be used to mask illegally discriminatory practices.

Based on a review of the comments and its own analysis, the Board has redrafted the proposed interpretations. Before adopting them in final form, however, the Board wishes to provide an opportunity for comment on technical problems creditors might encounter in complying with the interpretations.

The Board also solicits comments on whether a period of time is needed for technical adjustments to existing credit scoring systems to comply with the interpretations. Because comments are only being solicited on the technical difficulties creditors would encounter in complying with the interpretations, the Board finds it is not necessary to follow the expanded rulemaking procedures set forth in the Board's policy statement of January 15, 1979 (44 FR 3957). Instead, the Board finds that a 30 day comment period is sufficient.

The first interpretation (§ 202.601) addresses several issues concerning consideration of income and income reliability. The interpretation clarifies that Regulation B applies to credit scoring systems as well as to judgmental systems. The interpretation also advises that income need not be considered, but that, if income is considered, protected income must be considered on an individual basis and not assigned a weight based on aggregate statistics.

The second interpretation (§ 202.901) sets forth several principles governing the selection and disclosure of reasons for adverse action. The interpretation advises creditors that the process used to select specific reasons for adverse action must identify the factors that were most significant in the applicant's failure to achieve a passing score in a credit scoring system. The interpretation also advises creditors that the reasons must be taken from those factors actually considered for that applicant. Finally, the interpretation advises creditors on proper use of the model form for disclosing reasons for adverse action.

(2) Regulatory flexibility analysis. The economic impact of either interpretation is unlikely to be large. Creditors currently using credit scoring systems which treat protected income in a manner that violates the first interpretation will have to modify their systems. This will entail the retraining of persons making loan evaluations and the probable expense of further statistical analysis. Most creditors have the tools needed for making such changes as part of their procedures for normal periodic updates of their systems. System modifications to conform to the interpretation, however, might require a system update earlier than would normally be performed. The economic impact of the second interpretation, governing the selection and disclosure of reasons for adverse action, is likely to be even smaller, as it should not require any new statistical analysis. The impact of either interpretation on users of judgmental systems should involve at most the expense of new forms and instructions for loan officers. Offsetting these costs, the clarifications provided by the interpretations will probably help both applicants and creditors. With more precise instructions on the proper treatment of protected income, creditors who previously may have been reluctant to use income in their credit systems may now do so. The benefits of the second interpretation will accrue primarily to applicants who are rejected because of incorrect information and to applicants who are unaware of their credit weaknesses.

List of Subjects in 12 CFR Part 202

Banks, banking; Civil rights; Consumer protection; Credit; Federal Reserve System; Marital status discrimination; Minority groups; Penalties; Religious discrimination; Sex discrimination; Women.

(3) Text of interpretations. Pursuant to the authority granted in § 703(a) of the Equal Credit Opportunity Act (15 U.S.C. 1691(a)), the Board proposes to adopt the following two interpretations of Regulation B (12 C.F.R. Part 202) to read as follows:

§ 202.601 Consideration of income.

Regulation B prohibits creditors from discounting or excluding the income of an applicant (or the spouse of the applicant) from consideration because of a prohibited basis or because the income is derived from alimony, child support, separate maintenance, part-time employment, retirement benefits or public assistance ("protected income").1/ A creditor may consider, however, the probability of any income continuing in evaluating an applicant's creditworthiness, and may consider the extent to which alimony, child support or separate maintenance is likely to be consistently made. Regulation B applies equally to all methods of credit evaluation -- whether performed judgmentally or through the use of a credit scoring system.2/

Creditors need not consider income at all. However, creditors that do consider income should consider the amount of income as required in § 202.6(b)(5). A credit scoring system will not be deprived of its status as a "demonstrably and statistically sound, empirically derived" credit scoring system because it aggregates income (including a type of income which, by itself, would not be selected as a predictive characteristic).

Creditors have asked whether evaluating or deriving a point score for certain types of income (such as Social Security and alimony) during the development of the system constitutes "consideration" of that income for purposes of the regulation, enabling the creditor to discount or exclude such

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1/ Section 202.6(b)(5) states in relevant part:

> A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of the applicant because of a prohibited basis or because the income is derived from part-time employment, or from an annuity, pension, or other retirement benefit; but a creditor may consider the amount and probable continuance of any income in evaluating an applicant's creditworthiness. Where an applicant relies on alimony, child support, or separate maintenance payments in applying for credit, a creditor shall consider such payments as income to the extent that they are likely to be consistently made. Factors that a creditor may consider in determining the likelihood of consistent payments include, but are not limited to, whether the payments are received pursuant to a written agreement or court decree; the length of time that the payments have been received; the regularity of receipt; the availability of procedures to compel payment; and the creditworthiness of the payor . . . .

2/ The only differences in evaluation procedures for the two methods of judging creditworthiness sanctioned by the law relate to consideration of age and receipt of public assistance. (See § 202.6(b)(2)(ii) and (iii).)

income based upon these aggregate statistics. In the Board's view, the statute requires that evaluation of protected income be made on an individual basis, and not based upon aggregate statistical relationships such as those underlying credit scoring models. Thus, creditors may not use blanket rules which automatically deem a certain type of protected income to be unreliable. Nor may the average reliability of a particular type of protected income be used to predict the reliability of the same types of income for an individual applicant.

For creditors that do consider income, there are several acceptable methods under § 202.6(b)(5) which creditors using credit scoring systems may use for this purpose. First, creditors can score the amount of all income stated by the applicant without taking steps to evaluate the income. This method could be used in a system which is based on the income the applicant states; the creditor need not actually verify the amount. Second, based on an individual evaluation of each component of the applicant's income, the creditor may score reliable income separately from income that is not reliable. Alternatively, the creditor may include a portion or disregard a portion of income to the extent that it is not reliable, before aggregating and scoring all reliable income. Third, if the creditor does not evaluate all income components, any component of protected income that is not evaluated must be treated as reliable. In considering the separate components of an applicant's income, the creditor may not automatically discount or exclude from consideration any income of a type protected by § 202.6(b)(5).

Creditors have asked whether credit scoring systems may place values on the number of sources from which earned income is received without violating the regulation's prohibition against discounting income. The regulation does not prohibit consideration of the number of earned income sources for an individual applicant. For example, a creditor may take into account the fact that an individual applicant has more than one source of earned income -- a full-time and a part-time job, or two part-time jobs. Alternatively, a creditor might score an individual applicant's earned income from a second source differently than the applicant's earned income from a primary source. Creditors may not, however, treat as an adverse factor the fact that an individual applicant's only source of earned income is derived from a part-time job.

§ 202.901 Disclosure of reasons for adverse action.

The Board has been asked for an interpretation of § 202.9 of Regulation B regarding the selection and disclosure of the reasons for adverse action 1/ where a credit scoring system is used, alone or in conjunction with a judgmental evaluation. Although the issue has arisen in the context of credit scoring, as a general principle the provisions of Regulation B apply equally to both judgmental and credit scoring systems of credit evaluation. The reasons for adverse action disclosed under § 202.9(a)(2) and (b)(2) must relate to factors actually scored or reviewed by the creditor. The creditor must disclose the specific reason or reasons for the adverse action.

Many credit systems contain features that call for automatic adverse action because of one or more negative factors in the applicant's record (such as the applicant's previous bad credit history with that creditor, a declaration of bankruptcy, or the fact that the applicant is a minor) that cannot be offset by other factors. When a creditor takes adverse action because of an automatic factor, the creditor must disclose that specific factor.

If the creditor does not automatically reject the application, and bases the decision on a credit scoring system, the reasons disclosed must relate only to those factors actually scored in the system, not to factors that are not included in the credit scoring system. Similarly, in a judgmental system, the reasons disclosed must relate to the factors in the applicant's record actually reviewed by the person making the decision and must accurately describe the reasons for adverse action. If the credit evaluation system employs both judgmental and credit scoring components, the factors to be disclosed will be determined by whether the final decision resulted from the judgmental or the scoring system assessment of the application. Thus, if the creditor initially credit scores an application and takes adverse action as a result of that scoring, the reasons for adverse action must relate only to the factors actually scored in the system. If the application passes the credit scoring stage successfully but the creditor then takes adverse action based on the judgmental assessment, one or more of the reasons disclosed must relate to the factors in the applicant's record that were reviewed judgmentally.

1/ Section 202.9(a)(2) states in relevant part:

> Any notification given to an applicant against whom adverse action is taken shall be in writing and shall contain...a statement of specific reasons for the action taken.

Section 202.9(b)(2) states in relevant part:

> A statement of reasons for adverse action shall be sufficient if it is specific and indicates the principal reason(s) for the adverse action. A creditor may formulate its own statement of reasons in check list or letter form or may use all or a portion of the sample form printed [in this subsection], which, if properly completed, satisfies the requirements of subsection (a)(2)(i). Statements that the adverse action was based on the creditor's internal standards or policies or that the applicant failed to achieve the qualifying score on the creditor's credit scoring system are insufficient.

The regulation does not require that any one method be used for selecting reasons for the adverse credit decision, nor does it mandate that a specific number of reasons be disclosed. However, disclosure of more than four reasons is not likely to be helpful to the applicant. The Board recognizes that there may be a number of valid methods for selection of reasons for denial which meet the requirements of Regulation B. One method, for example, would be to identify those factors for which the applicant's score fell furthest below the average score for each of those factors achieved by applicants whose total score was at or slightly above the minimum passing score.2/

Creditors may identify reasons for adverse action by mathematical or manual selection. No factor or factors may be arbitrarily excluded from the pool of factors subject to disclosure. The creditor must disclose reasons actually considered (such as "age of automobile") even if the relationship of that factor to predicting creditworthiness may not be clear to the applicant.

Creditors have also asked about proper use of the sample form set forth in § 202.9(b)(2) when providing reasons for adverse action. The sample form is illustrative and may not be appropriate for all creditors. It was designed to disclose those factors which creditors most commonly consider. Some of the reasons listed on the form could be misleading when compared to the factors actually scored. In such cases, it is improper to complete the form by simply checking the closest identifiable factor listed. For example, a creditor that considers only bank references (and disregards finance company references altogether) should disclose "insufficient bank references" (not "insufficient credit references"). Similarly, a creditor that considers bank references and other credit references as separate factors should treat the two factors separately in disclosing reasons. The creditor should either add those other factors to the form or check "other" and include the appropriate explanation.

2/ For example, if a scoring system with a maximum score of 300 points has a cut-off score of 200 points, the creditor could use applicants whose total scores fall between 200 and, for example, 205 points to determine the average score for those factors.

By order of the Board of Governors of the Federal Reserve System, May 25, 1982.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board

[SEAL]

STATEMENT OF CREDIT DENIAL, TERMINATION, OR CHANGE

DATE _____

Applicant's Name: _____

Applicant's Address: _____

_____

Description of Account, Transaction, or Requested Credit: _____

_____

Description of Adverse Action Taken:

_____

_____

PRINCIPAL REASON(S) FOR ADVERSE ACTION CONCERNING CREDIT

___ Credit application incomplete
___ Insufficient credit references
___ Unable to verify credit references
___ Temporary or irregular employment
___ Unable to verify employment
___ Length of employment
___ Insufficient income
___ Excessive obligations
___ Unable to verify income
___ Inadequate collateral
___ Too short a period of residence
___ Temporary residence
___ Unable to verify residence
___ No credit file
___ Insufficient credit file
___ Delinquent credit obligations
___ Garnishment, attachment, foreclosure, repossession, or suit
___ Bankruptcy
___ We do not grant credit to any applicant on the terms and conditions you request.
___ Other, specify: _____

_____

DISCLOSURE OF USE OF INFORMATION OBTAINED FROM AN OUTSIDE SOURCE

___ Disclosure inapplicable
___ Information obtained in a report from a consumer reporting agency
Name: _____

_____

_____

Street address: _____

_____

Telephone number: _____

___ Information obtained from an outside source other than a consumer reporting agency. Under the Fair Credit Reporting Act, you have the right to make a written request, within 60 days of receipt of this notice, for disclosure of the nature of the adverse information.

Creditor's name: _____

Creditor's address: _____

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Creditor's telephone number: _____

Federal Reserve System

12 CFR Part 202

[Reg B; Docket No. R-0185]

EQUAL CREDIT OPPORTUNITY

Proposed Withdrawal of Proposed Amendments

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed withdrawal of proposed amendments.

SUMMARY: The Board proposes to withdraw amendments to the business credit provisions of Regulation B which it published for comment in October 1978. The Board specifically solicits comment, however, on whether creditors should be required to give business credit applicants a written notice of adverse action in certain loan transactions under $100,000. The amendments to the business credit rules would have (1) eliminated the partial exemption that currently exists with respect to record keeping and adverse action notification requirements in certain loan transactions under $100,000; (2) subjected business credit to the general bar in the regulation against asking an applicant's marital status; and (3) incorporated official staff interpretation EC-0009 into the regulation to make clear that creditors must give business applicants some notice, oral or written, of action taken on an application within a reasonable time. The amendments would have affected only the mechanical requirements of the regulation and their withdrawal will not affect the substantive provisions of the Equal Credit Opportunity Act and Regulation B which will continue to prohibit discrimination on the basis of sex, marital status, race, etc. in any aspect of a business credit transaction.

DATE: Comments must be received on or before July 1, 1982.

[NOTE: The remainder of this notice may be obtained from the Federal Reserve Board or the Federal Reserve Banks.]

Federal Reserve System

12 CFR Part 202

[Reg B; Docket No. R-0185]

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DATE: Comments must be received on or before July 1, 1982.

ADDRESS: Comments may be mailed to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washington, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m. All material submitted should refer to Docket No. R-0185.

FOR FURTHER INFORMATION CONTACT: Claudia J. Yarus, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-3667).

SUPPLEMENTARY INFORMATION: (1) Introduction. Regulation B (12 CFR Part 202) prohibits discrimination, in any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex, marital status, age, receipt of public assistance, or the exercise of rights under the Consumer Credit Protection Act. The regulation applies to all credit transactions, including business credit.

The regulation sets certain mechanical requirements that creditors must follow with regard to applications that they receive. Sections 202.9 and 202.12(b) of Regulation B provide, respectively, that a creditor must give the applicant notice of the action taken on an application and retain, for 25 months, the records regarding the application. When the creditor rejects a credit application it must give an "adverse action" notice consisting of a written statement of reasons (or of the right to request the reasons) for the credit denial, together with a short summary of the applicant's rights under the Equal Credit Opportunity Act.

Because of the specialized nature of the business credit application process, Section 203.3(e) of Regulation B provides a partial exemption for business credit transactions from these notification and record keeping requirements. An applicant for business credit may request written notice of reasons for adverse action, but does not receive the written notice automatically. The business applicant may also request to have records of the application retained for 25 months. If there is no such request, the creditor may discard its records of the application 90 days after it rejects the credit request.

In October 1978 the Board published for comment proposed changes to these business credit provisions (43 FR 49987). The proposed amendments would have applied to direct loan applications in which the aggregate of any amount already owed to a creditor and the amount applied for is less than $100,000. Creditors would have been required in such cases to give written notification of adverse action to the applicant, and to retain the records of the application for 25 months.

The proposed rulemaking was in response to petitions from the President's Interagency Task Force on Women Business Owners and the staff of the Federal Trade Commission. The Interagency Task Force and the FTC staff both expressed concern about effective enforcement of the act in business credit transactions. With regard to the adverse action notice, they contended that unless a creditor gives notice, women and minority group members who own small businesses may not realize that the act applies to business credit. The FTC staff also suggested that subjecting business credit applications to record retention would ensure the availability of documentary evidence to both private litigants and enforcement agencies.

Another proposal related to marital status inquiries. Regulation B generally prohibits creditors from inquiring about an applicant's marital status except in the case of applications for secured credit. Section 202.3(e)(1) of Regulation B provides, however, that a creditor who receives an application for business credit is not subject to this restriction. The Interagency Task Force on Women Business Owners expressed concern that the current exemption may dilute the protection of the act for women business owners. The Board published for comment a proposed amendment that would have eliminated the exemption, making business credit subject to the general information bar against marital status inquiries.

Based on a review of the comments received and its own analysis, the Board proposes to withdraw the proposed amendments. Because of the time that has elapsed since the amendments were published, however, the Board is soliciting comment specifically on whether there have been intervening developments which suggest that creditors should be required to give business credit applicants a

written notice of adverse action for direct loans in which the aggregate of any amount already owed to a creditor and the amount applied for is less than $100,000. The Board understands that some creditors automatically provide a written notice of adverse action to their business credit applicants and that this is useful to the applicants. The Board is particularily interested in learning what impact, if any, the requirement of an adverse action notice would have on current creditor practices if the Board should decide to adopt this part of the amendment proposed in 1978. Therefore, the Board finds that it is not necessary to follow the expanded rulemaking procedures set forth in the Board's policy statement of January 15, 1979 (44 FR 3957). Instead, the Board finds that a 30 day comment period is sufficient.

The Board's proposed withdrawal of the business credit amendments is based on a number of factors. In the intervening years since the amendments were proposed, little or no concrete evidence of the specific problems that these amendments were intended to alleviate (and no general evidence of widespread problems) has been brought to the attention of the Board. In light of the costs and burdens that would be associated with the implementation of these amendments, their adoption appears unwarranted at this time. The regulation already provides that business credit applicants may receive written notice and have records retained on request, and any existing problems could be handled, for example, through educational efforts. The likely benefits of prohibiting inquiry about an applicant's marital status also appear to the Board to be rather limited. Because most applications for business credit are for secured credit, creditors would in most cases continue to be able to inquire about marital status.

The proposal published by the Board also would have codified within the text of the regulation an official staff interpretation, EC-0009, which was issued on November 2, 1977. That staff interpretation requires creditors to give business applicants some notice, either oral or written, of action taken on an application within a reasonable time. Official staff interpretation EC-0009 will remain in effect even if the Board withdraws the proposed amendments.

Creditors are also reminded that the proposed amendments which the Board proposes to withdraw would have affected only the mechanical requirements of the regulation. The substantive provisions of the Equal Credit Opportunity Act and Regulation B continue to prohibit discrimination on the basis of sex, marital status, race, etc. in any aspect of a business credit transaction.

(2) Regulatory flexibility analysis. In 1981 the denial rate at commercial banks for business credit applicants desiring to start a new business was estimated to be approximately 50 percent. The denial rate estimated for existing businesses was 27 percent.1/ Many of these denials would have required

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1/ Survey of Commercial Bank Lending to Small Business, February 1982, Cynthia Glassman and Peter Struck. The denial rate is an estimate of the proportion of written credit applications turned down by all federally insured commercial banks that had at least $1 million in commercial and industrial loans in their portfolios on December 31, 1980. These figures do not include informal applications and may reflect unusually weak credit demand caused by high interest rates. Thus, the number of rejected applications subject to the proposed amendments may be much larger. Estimates in the survey reflect the banks' perceptions of their small business lending, not the perceptions of the small business community.

written "adverse action" notification and record retention for 25 months under the proposed amendments. At the 1981 level of denials, the annual compliance cost of the proposed amendments to the banking industry as a whole could be substantial. Although the impact on after-tax profits would likely be minimal for virtually all banks, many of the relatively small short-term loans that are currently available to small businesses could become unprofitable. Many banks find it difficult to provide affordable credit to their small business customers during periods of high interest rates. The proposed amendments could only aggravate the credit problems of small businesses, because the cost of compliance would ultimately be passed on to borrowers as increased cost of credit and reduced credit availability.

Small banks would likely be affected more than other banks by the proposed amendments. Their business loans tend to be exclusively to small business. Small banks' loan portfolios contain relatively few loans over $100,000, and their average loan size is less than that for other banks. Therefore, the amendments would likely result in a greater cost per dollar of loan for small banks and their customers.

The potential negative impact of the proposed amendments on cost and availability of relatively small short-term small business loans would affect all creditors subject to the act, not only commercial banks.

The potential benefits of the proposed amendments appear to be limited. Survey evidence shows that small business credit is more costly and less accessible to some groups protected by the act,2/ but evidence suggesting that the disparity is caused by unlawful discrimination rather than a legitimate evaluation of risk is meager. Furthermore, it is unlikely that the proposed amendments could effectively uncover any unlawful discrimination that may exist. The business credit process is complex, and the multitude of factors considered in approving or denying business credit make such discovery difficult.

(3) Text of 1978 proposal. For the convenience of commenters the text of the 1978 proposal is included in this material. At that time, the Board proposed to amend Section 202.3(e) by deleting paragraph (1), by renumbering existing paragraphs (2), (3), and (4) as paragraphs (1), (2), and (3), respectively, and by revising the paragraphs renumbered (1) and (3):

SECTION 202.3 - SPECIAL TREATMENT FOR CERTAIN CLASSES OF TRANSACTIONS

* * * * *

(e) Business credit. The following provisions of this Part shall not apply to extensions of credit of the type described in subsection (a)(4):

(1) Section 202.9(a) relating to notifications, except that:

2/ Federal Monetary Policy and Its Effect on Small Business, H.R. Report of the Committee on Small Business, 1980.

(i) This exemption is not available regarding applications for or existing extensions of direct loans where the aggregate of the amounts owed by the applicant to the creditor and any amount applied for is less than $100,000; and

(ii) In the case of any application or account where this exemption is available, the creditor nevertheless shall notify the applicant, orally or in writing, within a reasonable time of any action taken regarding the application or account; and if the applicant, within 30 days after a notification of adverse action is given, requests in writing the reasons for such action, the creditor shall furnish a written statement of specific reasons for the adverse action and the ECOA notice within 30 days of such a request, in accordance with section 202.9(b);

(2) Section 202.10 relating to furnishing of credit information; and

(3) Section 202.12(b) relating to record retention, except that:

(i) This exemption is not available regarding applications for or existing extensions of direct loans where the aggregate of the amounts owed by the applicant to the creditor and any amount applied for is less than $100,000; and

(ii) In the case of any application or account where this exemption is available, the creditor nevertheless shall comply with section 202.12(b) if the applicant, within 90 days after adverse action has been taken, requests in writing that the records relating to the application or account be retained.

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List of Subjects in 12 CFR Part 202

Banks, banking; Civil rights; Consumer protection; Credit; Federal Reserve System; Marital status discrimination; Minority groups; Penalties; Religious discrimination; Sex discrimination; Women.

(4) Authority. 15 U.S.C. § 1691

By order of the Board of Governors of the Federal Reserve System, May 25, 1982.

(signed) William W. Wiles
William W. Wiles
Secretary of the Board

[SEAL]