



FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS
75265-5906

January 19, 1995

Notice 95-14

TO: The Chief Executive Officer of each
member bank and others concerned in
the Eleventh Federal Reserve District

SUBJECT

**Request for Public Comment on
Revisions to the Official Staff Commentary to
Regulation B (Equal Credit Opportunity)**

DETAILS

The Board of Governors of the Federal Reserve System has requested public comment on revisions to the official staff commentary to Regulation B (Equal Credit Opportunity). The proposed revisions to the commentary provide guidance on several issues including disparate treatment, special purpose credit programs, credit scoring systems, and marital status discrimination.

The Board must receive comments by February 15, 1995. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0865.

ATTACHMENT

A copy of the Board's notice as it appears on pages 67235-38, Vol. 59, No. 249, of the Federal Register dated December 29, 1994, is attached.

MORE INFORMATION

For more information, please contact Eugene Coy at (214) 922-6201. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

FEDERAL RESERVE SYSTEM**12 CFR Part 202**

[Regulation B; Docket No. R-0865]

Equal Credit Opportunity**AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Proposed rule; official staff interpretation.

SUMMARY: The Board is publishing for comment revisions to its official staff commentary to Regulation B (Equal Credit Opportunity). The commentary applies and interprets the requirements of Regulation B and is a substitute for individual staff interpretations. The proposed revisions to the commentary provide guidance on several issues including disparate treatment, special purpose credit programs, credit scoring systems, and marital status discrimination.

DATES: Comments must be received on or before February 15, 1995.

ADDRESSES: Comments should refer to Docket No. R-0865, and may be mailed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551. Comments also may be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or to the guard station in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time.

Comments received will be available for inspection in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's rules regarding the availability of information.

FOR FURTHER INFORMATION CONTACT: Jane Jensen Gell, Sheilah Goodman, or Natalie E. Taylor, Staff Attorneys, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at (202) 452-3667 or 452-2412; for the hearing impaired only, contact Dorothea Thompson, Telecommunications Device for the Deaf, (202) 452-3544.

SUPPLEMENTARY INFORMATION:**I. Background**

The Equal Credit Opportunity Act (ECOA), 15 U.S.C. 1691-1691f, makes it unlawful for creditors to discriminate in any aspect of a credit transaction on the basis of gender, marital status, age, race, national origin, color, religion, receipt of public assistance, or the exercise of rights under the Consumer Credit Protection Act. This statute is

implemented by the Board's Regulation B (12 CFR Part 202). The Board also has an official staff commentary (12 CFR Part 202 (Supp. I)) that interprets the regulation. The commentary provides general guidance to creditors in applying the regulation to various credit transactions, and is updated periodically to address significant questions that arise.

II. Summary of Proposed Revisions to Commentary

Section 202.2—Definitions

2(c)(2)(iii) Application To Increase Amount of Credit or Change Terms

Proposed comment 2(c)(2)(iii)-2 clarifies that the denial of an application to increase the amount of credit or change the terms for an existing account or loan, such as a business line of credit, is adverse action. As provided in section 202.2(c), however, action or forbearance taken in connection with inactivity, default, or delinquency for an account or loan is not adverse action. For example, a "workout" arrangement generally is not adverse action, unless the consumer submits an application that is denied by the creditor.

2(p) Empirically Derived and Other Credit Scoring Systems

Proposed comment 2(p)-3 clarifies that a creditor may acquire an empirically derived, demonstrably and statistically sound credit scoring system—or the data from which to develop such a system—from multiple credit grantors, as long as the creditor validates the borrowed system on its own data when data become available.

Proposed comment 2(p)-4 clarifies that credit scoring systems—even if "empirically derived, demonstrably and statistically sound"—are subject to review under the ECOA and Regulation B. (A system may include age as a predictive factor provided that the age of an elderly applicant is not assigned a negative factor or value, but no other prohibited basis may be used as a variable.) If a scoring system is used in conjunction with individual discretion, disparate treatment could still occur. In addition, a violation of the act and regulation could occur if there is a disparate impact on a prohibited basis, unless the practice is justified by a business necessity with no less discriminatory alternative available.

Section 202.4—General Rule Prohibiting Discrimination

Comment 4-1 would be revised to clarify the concept of disparate treatment. Creditors have asked for greater guidance about what actions

constitute discriminatory treatment under the regulation.

Section 202.5a—Rules on Providing Appraisal Reports

5a(a) Providing Appraisals

Proposed comment 5a(a)-1 clarifies that section 202.5a applies to applications for credit to be secured by a consumer's dwelling, whether the credit is for a business purpose or a consumer purpose.

Proposed comment 5a(a)-2 provides that a request for renewal of an existing extension of credit secured by a dwelling is covered by the appraisal rules if the creditor obtains and uses a new appraisal report in evaluating the request. Section 202.5a applies to appraisal reports "used in connection with an application for credit." Under section 202.2(f), "application" includes an oral or written request for an extension of credit; section 202.2(q), in turn, defines "extension of credit" to include "the refinancing or other renewal of credit." Thus, a request for a renewal of credit is an application and covered by section 202.5a.

Proposed comment 5a(a)-2 also provides that if a consumer requests renewal of existing credit and the creditor does not obtain a new appraisal, section 202.5a does not apply.

5a(a)(2)(i) Notice

Proposed comment 5a(a)(2)(i)-1 provides that for credit involving more than one applicant, the notice under this section need only be given to one applicant, but it must be given to the primary applicant where one is readily apparent. This parallels the rule applicable to notices of action taken under section 202.9 in cases where there is more than one applicant.

5a(a)(2)(ii) Delivery

Proposed comment 5a(a)(2)(ii)-1 clarifies that in all cases creditors may be reimbursed for photocopy and postage costs incurred in providing the copy of the appraisal report, unless prohibited by state or other law. The comment further clarifies that if a consumer has already paid for the report—for example, as part of an application fee—the creditor may not seek additional fees (other than incidental photocopy and postage costs) prior to providing a copy of the report upon the applicant's request. And, if the creditor does not otherwise charge for the report, the creditor may not require payment solely from those consumers who request a copy of the report. The statute gives credit applicants the right to receive copies of appraisal reports

upon request; the Board believes imposing charges on applicants who exercise this right could have a chilling effect.

5a(c) Definitions

Proposed comments 5a(c)-1 and 5a(c)-2 address the scope of the term "appraisal report." Under the proposal, listings of valuations for dwellings that are publicly available, such as published home sales prices or mortgage amounts, are not covered. The appraisal rules guard against discriminatory evaluations of a dwelling's value. The Board believes that publicly listed reports of home sales prices or tax assessments, among others, are unlikely to be influenced by the type of subjectivity the law is intended to eliminate. If a creditor used this information as a factor in determining a value for the property, however, the document would be part of the appraisal report.

Section 202.6—Rules Concerning Evaluation of Applications

6(b)(1) Prohibited Basis—Marital Status

Comment 6(b)(1)-1 would be revised to clarify that if a creditor chooses to offer joint credit, the creditor generally may not take the applicants' marital status into account in credit evaluations.

Section 202.8—Special-Purpose Credit Programs

8(a) Standards for Programs

Two proposed comments clarify the requirements that for-profit organizations must meet to establish special-purpose credit programs under section 202.8(a)(3). Proposed comment 8(a)(3)-1 addresses how for-profit organizations can determine whether there is a need for a special-purpose credit program, and the type of information to rely upon in making that determination. Proposed comment 8(a)(3)-2 addresses the elements of the written plan that for-profit organizations are required to have when establishing a special-purpose credit program.

Section 202.9—Notifications

Proposed comment 9-5 addresses questions posed to the Board about when an adverse action notice is required for prequalification, preapproval and similar programs. The proposed comment clarifies that the guidance provided in the commentary to section 202.2(f) (addressing applications and inquiries) applies to all types of inquiries, including prequalification and preapproval programs. Thus, if a creditor—in giving

information to a consumer about a prequalification or preapproval program—decides it will not grant credit, and communicates this to the consumer, the creditor has treated the inquiry as an application (by virtue of having made a credit decision) and must comply with the notification rules in section 202.9.

Appendix C of Supplement I to Part 202—Sample Notification Forms

Proposed comment Appendix C-1 provides examples of additions that may be made to Model Form C-9.

III. Form of Comment Letters

Comment letters should refer to Docket No. R-0865. The Board requests that, when possible, comments be prepared using a standard courier typeface with a type size of 10 or 12 characters per inch. This will enable the Board to convert the text into machine-readable form through electronic scanning, and will facilitate automated retrieval of comments for review. Comments may also be submitted on computer diskettes, using either the 3.5" or 5.25" size, in any IBM-compatible DOS-based format. Comments on computer diskettes must be accompanied by a hard copy version.

List of Subjects in 12 CFR Part 202

Aged, Banks, banking, Civil rights, Credit, Federal Reserve System, Marital status discrimination, Penalties, Religious discrimination, Reporting and recordkeeping requirements, Sex discrimination.

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR part 202 as set forth below:

(Certain conventions have been used to highlight the proposed changes to the staff commentary. New language is shown inside bold-faced arrows, while language that would be removed is set off with brackets.)

PART 202—EQUAL CREDIT OPPORTUNITY (REGULATION B)

1. The authority citation for part 202 would continue to read as follows:

Authority: 15 U.S.C. 1691-1691f.

2. In Supplement I to Part 202, Section 202.2 Definitions, is amended as follows:

a. Under Paragraph (2)(c)(2)(iii), a new paragraph 2. is added; and

b. Under 2(p), the paragraph heading for 2(p) is revised and new paragraphs 3. and 4. are added.

The additions read as follow:

Supplement I to Part 202—Official Staff Interpretations

* * * * *

Section 202.2 Definitions

* * * * *

Paragraph (2)(c)(2)(iii)

* * * * *

►2. *Application to increase amount of credit or change terms.* The denial of an application for an increase in the amount of credit (or for a change in the terms) for an existing account or loan is adverse action.◄

* * * * *

(2)(p) *Empirically derived and other credit scoring systems.*

* * * * *

►3. *Pooled data scoring systems.* A scoring system or the data from which to develop such a system may be obtained from either a single credit grantor or multiple credit grantors. The resulting system will qualify as an empirically derived, demonstrably and statistically sound credit scoring system as long as the criteria set forth in paragraph (p)(i) through (iv) are met.

4. *Disparate impact.* An empirically derived, demonstrably and statistically sound credit scoring system may include age as a predictive factor (provided that the age of an elderly applicant is not assigned a negative factor or value). No other prohibited basis may be used as a variable. Generally, credit scoring systems treat all applicants objectively and thus avoid problems of disparate treatment. In cases where a credit scoring system is used in conjunction with judgmental override, disparate treatment could still occur. In addition, credit scoring systems that employ neutral factors could violate the act or regulation if there is a disparate impact on a prohibited basis, unless the practice is justified by business necessity with no less discriminatory alternative available.◄

* * * * *

3. In Supplement I to Part 202, under Section 202.4—General Rule Prohibiting Discrimination, two new sentences are added at the end of paragraph 1. to read as follows:

* * * * *

Section 202.4—General Rule Prohibiting Discrimination

1. *Scope of section.* * * * ►Disparate treatment on a prohibited basis is illegal whether or not it results from a conscious intent to discriminate. Disparate treatment would be found, for example, if:

i. A minority applicant is required to provide greater documentation to obtain a loan than is required of a similarly situated nonminority applicant.

ii. Credit standards are waived or relaxed for a nonminority applicant but not for a similarly situated minority applicant.◄

* * * * *

4. In Supplement I to part 202, a new Section 202.5a is added to read as follows:

* * * * *

►Section 202.5a—Rules on Providing Appraisal Reports

5a(a) Providing appraisals.

1. *Coverage.* This section covers applications for credit to be secured by a lien on a consumer's dwelling, whether the credit is for a business purpose (for example, a loan to start a small business) or a consumer purpose (for example, a loan to finance a child's education).

2. *Renewals.* If an applicant requests that a creditor renew an existing extension of credit, and the creditor obtains a new appraisal report to evaluate the request, this section applies. This section does not apply to a renewal request if the creditor uses the appraisal report initially obtained in connection with the decision to grant credit.

5a(a)(2)(i) Notice.

1. *Multiple applicants.* When an application that is subject to this section involves more than one applicant, the notice about the appraisal report need only be given to one applicant, but it must be given to the primary applicant where one is readily apparent.

5a(a)(2)(ii) Delivery.

1. *Reimbursement.* Creditors may charge for photocopy and postage costs incurred in providing a copy of the appraisal report, unless prohibited by state or other law. If the consumer has already paid for the report—for example, as part of an application fee—the creditor may not require additional fees (other than photocopy and postage costs) for the appraisal. Similarly, if the creditor does not otherwise impose a fee for appraisal reports, as in the case of "no closing cost" loans, the creditor may not require repayment from those consumers who request a copy of the appraisal report.

5a(c) Definitions.

1. *Appraisal reports.* Examples of appraisal reports are:

i. A report prepared by an appraiser (whether or not a licensed or certified appraiser), including written comments and other documents submitted to the creditor in support of the appraiser's estimate or opinion of value.

ii. A document prepared by the creditor's staff which assigns value to the property, if a third-party appraisal report has not been used.

iii. A document reflecting a creditor's valuation that is different from a valuation in a third party's appraisal report (or different from valuations that is publicly available or valuations such as manufacturers' invoices for a mobile home), such as an internal review document indicating that the value assigned by the third-party appraiser (or by the other valuation) is incorrect.

2. *Other reports.* The term "appraisal report" does not apply to all documents relating to the value of the applicant's property. Examples of reports not covered are:

i. Internal documents, if a third-party appraisal report was used to establish the value of the property.

ii. Governmental agency statements of appraised value.

iii. Valuations lists that are publicly available (such as published sales prices or mortgage amounts, tax assessments, and

retail price ranges) and valuations such as manufacturers' invoices for mobile homes. ◀

* * * * *

5. In Supplement I to Part 202, under *Section 202.6—Rules Concerning Evaluation of Applications*, under Paragraph 6(b)(1), three new sentences are added at the end of paragraph 1 to read as follows:

* * * * *

Section 202.6—Rules Concerning Evaluation of Applications

* * * * *

Paragraph 6(b)(1)

1. *Prohibited basis—marital status.* * * *

▶ Except to the extent necessary to determine rights and remedies for a specific credit transaction, a creditor that offers joint credit may not take the applicants' marital status into account in credit evaluations. Because it is unlawful for creditors to take marital status into account, creditors are barred from applying different standards in evaluating married and unmarried applicants. In making credit decisions, creditors may not treat joint applicants differently based on the existence, the absence, or the likelihood of a marital relationship between the parties. ◀

* * * * *

6. In Supplement I to Part 202, under *Section 202.8—Special Purpose Credit Programs*, under 8(a) *Standards for programs.*, new paragraphs 5. and 6. are added to read as follows:

* * * * *

Section 202.8—Special Purpose Credit Programs

(8)(a) *Standards for programs.*

* * * * *

▶ 5. *Determining need.* In designing a special-purpose program under section 202.8(a), a for-profit organization must determine that the program will benefit a class of people who would otherwise be denied credit. This determination can be based on a broad analysis using the organization's own research or data from outside sources including governmental reports and studies. For example, a bank could review its Home Mortgage Disclosure Act data along with demographic data for its delineated community and conclude that there is a need for a special-purpose credit program for low-income minority borrowers.

6. *Elements of the program.* The written plan must contain information that supports a need for the particular program. In addition, the plan should specify the period of time that it will be in effect, at the end of which time the need for the program will be reevaluated. The plan should be designed to increase access to credit, but should not have the effect of depriving people who are not part of the class of rights or opportunities they otherwise would have. ◀

* * * * *

7. In Supplement I to Part 202, under *Section 202.9—Notifications*, a new paragraph 5. is added to read as follows:

* * * * *

Section 202.9—Notifications

* * * * *

▶ 5. *Prequalification and preapproval programs.* Whether an adverse action notice must be provided for a prequalification or preapproval request depends on the creditor's response to the request, as discussed in the commentary to section 202.2(f). For instance, a creditor may treat the request as an inquiry if the creditor provides general information such as loan terms and the maximum amount a consumer could borrow under various loan programs, explaining the process the consumer must follow to submit a mortgage application and the information the creditor will analyze in reaching a credit decision. On the other hand, a creditor has treated a consumer's request for prequalification as an application for credit if, after evaluating information, the creditor decides that it will not approve the request and communicates that decision to the consumer. For example, if in reviewing a request for prequalification, a creditor tells the consumer that it would not approve an application for a mortgage because of a bankruptcy in the consumer's record, the creditor has denied an application for credit. ◀

* * * * *

8. In Supplement I to Part 202, a new Appendix C is added at the end to read as follows:

* * * * *

▶ Appendix C—Sample Notification Forms

Form C-9. Creditors may design their own form, or add to or modify the model form, to reflect their individual policies and procedures. For example, a creditor may want to add:

- i. A telephone number that applicants may call to leave their name and the address to which an appraisal report should be sent.
- ii. A notice of the cost the applicant will be required to pay the creditor for the appraisal or a copy of the report. ◀

By order of the Board of Governors of the Federal Reserve System, December 20, 1994.

William W. Wiles,

Secretary of the Board.

[FR Doc. 94-31715 Filed 12-28-94; 8:45 am]

BILLING CODE 6210-01-P