

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8193]
October 6, 1977

PROPOSED AMENDMENTS TO REGULATION B
Definition of Adverse Action by Creditors

To All Member Banks, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement issued October 3 by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today proposed for public comment two alternative amendments to its Equal Credit Opportunity Regulation B affecting the definition of adverse action which requires notification to the customer that an application for credit had been refused.

The Board requested comment by November 15, 1977.

Regulation B requires that when adverse action occurs the creditor must send the applicant a written notice within 30 days, including a statement of the creditor's specific reasons for taking the action, or notification of the customer's right to have such a statement.

Regulation B sets forth three circumstances in which it defines a refusal to extend credit as adverse action, and it specifically excludes five circumstances. One circumstance that is excluded from the definition of adverse action is the case in which the credit requested at a point of sale would exceed a previously established credit limit for the account.

Questions have arisen whether all refusals of credit that do not exceed the established limit for the account are adverse actions requiring notification. In response, the Board's staff issued an official staff interpretation stating that refusal or failure to authorize the use of an open end (credit card) account at the point of sale, or to make a cash advance is not adverse action.

In response to requests for reconsideration of this interpretation, the Board offers for comment two alternative revisions of Regulation B:

A. This proposal would provide that adverse action has occurred at the point of sale when (1) the creditor refuses to increase the credit limit for the account in accordance with procedures established by the creditor, or (2) the action terminates the account, or (3) the action makes an unfavorable change in the terms of an account that does not affect all or most other such accounts.

B. This alternative proposal would provide that all refusals of credit at the point of sale would be adverse actions except when the refusal is (1) occasioned by the customer's failure to present a credit card or required identification, or (2) because the customer presents an expired credit card, or (3) because the credit card authorization center is closed or known to the merchant to be out of order.

The staff interpretation mentioned above remains in effect until final action is taken on these proposals.

Printed below is the text of the proposed amendments. Comments on the proposals should be submitted by November 15 and may be sent to our Consumer Affairs Division.

PAUL A. VOLCKER,
President.

FEDERAL RESERVE SYSTEM
[12 CFR Part 202]
[Reg. B; Docket No. R-0117]
Equal Credit Opportunity

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: In response to requests for clarification of the definition of adverse action, the Board proposes to amend that definition. A number of creditors and two government agencies have raised the question of whether some or all point of sale or loan refusals or failures to authorize an extension of credit that would not exceed the account limit are adverse action and therefore require notice to the customer. The Board is seeking public comment in order to determine what

regulatory course best implements the Equal Credit Opportunity Act.

DATE: Comments must be received on or before November 15, 1977.

ADDRESS: Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551. All comments should refer to docket number R-0117.

FOR FURTHER INFORMATION CONTACT: Anne Geary, Manager, Equal Credit Opportunity Section, Division of Consumer Affairs, Board of Governors of the Federal Reserve System, Washington, D.C. 20551 (202-452-3946).

SUPPLEMENTARY INFORMATION: The Equal Credit Opportunity Act and Regulation B require that notification be given to an applicant when adverse action occurs. Section 202.2(c) of Regulation B provides that adverse action occurs in three instances. First, it occurs when there is a refusal to grant credit in substantially the amount or on substantially the terms requested by an applicant, unless the applicant uses or expressly accepts the amount or terms that the creditor offers.

Second, adverse action occurs if there is a termination of an account or an unfavorable change in its terms that does not affect all or a substantial portion of a classification of the creditor's accounts. Third, it occurs when there is a refusal to increase the amount of credit available to an applicant who has requested the increase in accordance with the creditor's procedures for that type of credit.

The regulation specifically excludes five events from the definition of adverse action, including a creditor's refusal to extend credit at point of sale or loan because the credit requested would exceed a previously established credit limit on the account. Therefore, no notice of adverse action need be given when the use of a credit card would exceed the limit on the account. However, the Act and regulation are not explicit as to whether adverse action occurs and, thus, whether notice must be given, when the attempted use would not exceed the credit limit on the account.

In response to requests for clarification of this ambiguity, an official staff interpretation of § 202.2(c) was issued (EC-0008, 42 FR 21605, April 28, 1977). The interpretation states that a creditor's refusal or failure to authorize the use of an open-end account when such use would not exceed the account limit does not constitute adverse action and, therefore, does not require that the applicant be notified of the reasons for the refusal. The staff of the Federal Trade Commission and the Justice Department have asked for reconsideration of this interpretation.

The Board proposes to amend § 202.2(c) in order to resolve this ambiguity in the definition of adverse action. Board staff's official interpretation, EC-0008, remains in effect in the interim.

Two proposals are offered for comment. Proposal A would amend § 202.2(c) to provide that a refusal or failure to authorize the use of an account at a point of sale or loan is not adverse action unless such refusal or failure: (1) occurs in connection with a request to increase the credit limit on the account in accordance with the procedures established by the creditor, (2) is a termination of the account, or (3) is an unfavorable change in the terms of an account that does not affect all or a substantial portion of a classification of a creditor's accounts. In addition, the term "application" would be substituted for "applicant" in subsection (1) (i) of the current definition, and language would be inserted to emphasize that § 202.2(c)(2) takes precedence over § 202.2(c)(1). The effect of adopting this proposal would be that all point of sale or loan refusals or failures to authorize use of an account are not adverse action, except in the three cases described immediately above.

Proposal B, on the other hand, would amend § 202.2(c)(2) to provide that a refusal or failure to authorize the use of an account at point of sale or loan would not be adverse action if occasioned by the customer's failure to present a credit card or required identification, the customer's presentation of an expired credit card, or the fact that the authorization center was

closed or known to the merchant to be malfunctioning. All other point-of-sale refusals of credit would be adverse action requiring notice. The effect of adopting proposal B would be to limit the events that would not require a notice to those specifically exempted. Notices would still be required, for example, when an applicant presents a card reported lost or stolen, when an applicant attempts to use an account on which that applicant has disclaimed responsibility, or when the equipment at point of sale is malfunctioning. Similarly, a notice would be necessary if the use of the card did not fit into the applicant's previous pattern of card use or if the use of the card exceeded the credit limit for cash advances, for a particular kind of purchase, or for a geographic area. These are generally considered security control mechanisms.

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The following proposed amendments are published pursuant to the Board's authority under § 703(a) of the Equal Credit Opportunity Act (15 USC 1691(b)).

Proposal A

SECTION 202.2—DEFINITIONS AND RULES OF CONSTRUCTION

* * *

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

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

* * *

(2) The term does not include:

* * *

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

* * *

(3) When a particular action falls within the definitions of both subsections (c)(1) and (c)(2), the provisions of subsection (c)(2) control.

Proposal B

SECTION 202.2—DEFINITIONS AND RULES OF CONSTRUCTION

* * *

(c) **Adverse action.**

* * *

(2) The term does not include:

* * *

(vi) a refusal to extend credit because an applicant fails to present a credit card or presents an expired credit card; or

(vii) a refusal to extend credit because an applicant fails to present the required identification; or

(viii) a refusal to extend credit because the credit card issuer's authorization center is closed or known to the merchant to be malfunctioning.

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