Equal Credit Opportunity Act

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I. INTRODUCTION

Almost four years after the effective date of the original Equal Credit Opportunity Act and three years since it was substantially amended and broadened, the legal and credit worlds are just beginning to see litigation patterns emerging under that Act. At the same time, there continues to be considerable regulatory activity by the Federal Reserve Board, some enforcement initiatives by the Federal Trade Commission, and a proposed set of uniform enforcement guidelines issued by the five federal agencies that supervise depository institutions.

The original Equal Credit Opportunity Act of 1974 (Act), effective in October 1975, prohibited discrimination in credit transactions on the basis of sex or marital status. Congress significantly expanded the Act in 1976, and those amendments (plus a wholly new implementing regulation, Regulation B) took effect on March 23, 1977. The 1976 amendments added a number of new protected categories of applicants. Credit discrimination is now barred on the basis of age (provided the applicant has the capacity to contract), race, color, religion, national origin, receipt of public assistance benefits, or good faith exercise of rights under the Consumer Credit Protection Act, as well as sex or marital status. The new Act and Regulation also expressly provide that applicants are entitled to learn the reasons for any adverse action taken against them.

Other provisions of the new Regulation B set forth: the information that may be solicited in credit applications; the rules applicable to the evaluation of credit applications; the limitations on the creditor’s requirements concerning name designations, nonapplicant signatures, and credit insurance; the creditor’s right to establish “special purpose” credit programs; the requirements applicable to furnishing credit histories for married persons; the record retention requirements; and the creditor’s duty to gather certain monitoring information about applicants for residential real property credit.
Since 1975, the Act has generated only a handful of reported cases, despite a fairly complex regulation and civil liability of up to $10,000 per violation. By contrast, the Truth in Lending Act has produced a flood of litigation. There are several reasons why there has not been, and may never be, a litigation explosion under the Act as there has been under Truth in Lending: (1) as part of Regulation B, the Federal Reserve Board spelled out in some detail the kinds of information that could, and could not, be asked of applicants or used to evaluate them;\(^5\) (2) the Board also published "approved" model application forms that creditors could adopt or adapt with little risk of technical violations;\(^6\) (3) the Act does not provide for minimum damages, as does Truth in Lending;\(^7\) and (4) the instances of discrimination are not likely to be overt in most cases, so that plaintiffs will often need to develop an "effects test" rationale to support their claim.

Since agency rulemaking and enforcement activities touch on some of the same aspects of the Act as have been raised in private litigation, both regulatory and judicial developments will be described together below.

II. THE APPLICATION PROCEDURE

Regulation B's general rule in section 202.5 permits a creditor to request any information about an applicant unless the request is specifically barred by the Regulation. Thus, a creditor cannot ask the applicant's race, color, religion or national origin, but may inquire about an applicant's immigration status. A creditor cannot request the sex of the applicant, must indicate that courtesy titles (Ms., Miss, Mr., or Mrs.) are optional, and cannot inquire about family planning practices or capabilities. Before inquiring about income derived from alimony, child support or similar payments, the creditor's application must indicate that such income need not be revealed unless the applicant is relying on it for the credit extension. Where community property is involved, or where the applicant applies for other than individual, unsecured credit, the creditor may directly request the applicant's marital status; but the creditor may request information about an applicant's present or former spouse only in certain enumerated situations: where the spouse will use or be liable on the account, where the applicant is relying on the spouse's income or on alimony, child support or similar payments from the spouse, or where community property is involved.

Only one reported case involved a creditor whose application forms were technically defective, and the case has little precedential value since it arose

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7. Under the Truth in Lending Act, the creditor is liable for a minimum of $100 and a maximum of $1,000 in addition to the consumer's court costs, legal fees and actual damages for any violation. 15 U.S.C. § 1640 (1976). Under § 706 of the Equal Credit Opportunity Act, there is no minimum recovery, but the consumer can always recover court costs, attorney's fees, and any actual damages.
under the pre-1977 version of Regulation B. In *Smith v. Lakeside Foods, Inc.* a grocery store credit application form failed to indicate the optional nature of courtesy titles and also failed to contain the "notice of rights" required in conjunction with all applications prior to March 23, 1977.

Allegations of impermissible information requests have been made in several cases as part of an effects test claim, but there is no reported private litigation in which the creditor was held to have violated the Regulation B strictures on permissible inquiries. The Federal Trade Commission, however, has taken a consent cease-and-desist order from a Chicago mail-order house, in which the respondent, Alden’s Inc., agreed to stop requesting the name of the applicant’s spouse where the applicant applied for personal, unsecured credit. In addition, the Federal Reserve Board staff has issued an Official Interpretation permitting sellers of religious books, for marketing purposes, to inquire about a customer’s religion so long as such information is not considered in making the credit decision. The staff letter also cautions the creditor about its possible exposure to allegations that it has misused the information.

An aspect of the application process that continues to be troublesome is the question of the creditor’s freedom to draw a credit report on the applicant’s spouse. This is clearly an Equal Credit Opportunity Act question since Regulation B limits inquiries concerning nonapplicant spouses; but it is also a Fair Credit Reporting Act question since that act limits the purposes for which credit reports may be obtained on consumers. Regulation B does not directly address the specific question of credit reports. The Federal Trade Commission has finally settled on an Interpretation of the Fair Credit Reporting Act that permits the creditor to draw a credit report on the non-applicant spouse in four instances: where the spouse will use the account, where the spouse is contractually liable, where community property laws apply or where the applicant relies on the spouse’s income. This Interpretation proceeds on the theory that, for Fair Credit Reporting Act purposes, there is in fact a legitimate business transaction—an extension of credit—involving the nonapplicant.

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13. See 12 C.F.R. § 202.5(b)(1) note 4 (1978), which provides that the general authorization in that subsection (to “request any information” in connection with an application) “is not intended to limit or abrogate any Federal or State law regarding privacy, privileged information, credit reporting limitations, or similar restrictions on obtainable information.”
This recently finalized Interpretation comes after almost a year of Federal Trade Commission hesitation over the final justification for obtaining a credit report on the nonapplicant spouse—i.e., where the applicant relies on the spouse's income. The staff's view is that the creditor may fairly assume that a permissible purpose exists under the Fair Credit Reporting Act unless the creditor has reason to know that the applicant is not acting as the spouse's agent or that the doctrine of necessaries does not bind the nonapplicant spouse. The Interpretation provides, however, that the creditor may not obtain a credit report on a nonapplicant who is paying alimony or child support, since no "involvement" in the credit transaction by that spouse or former spouse can be presumed. This Federal Trade Commission interpretation, of course, is advisory and not necessarily binding on the courts; and it may leave creditors in a dilemma in states like California where the state Constitution protects the privacy of individual credit reports.  

**III. THE CREDIT-GRA NTING DECISION**

In evaluating a credit application, section 202.6 of Regulation B generally permits the creditor to consider any information that is available to it, so long as it is not used to discriminate on a prohibited basis. This general authorization is subject to a number of qualifications. For example, the creditor may consider the applicant's age in a sound credit scoring system (provided elderly applicants are not assigned negative values), or in determining a pertinent element of creditworthiness, or in order to favor elderly applicants. Similarly, the creditor cannot indulge in assumptions about childbearing, or consider whether there is a telephone listing in the applicant's name, or discount part-time or nonwage income. Probably the most ominous language in all of Regulation B is footnote 7 to section 202.6 which notes that the legislative history of the Act indicates congressional intent to have an "effects test" concept apply to alleged credit discrimination. This notion, borrowed from the employment discrimination field, generally means that a plaintiff makes out a prima facie case of discrimination by showing through statistical evidence that some standards used by the creditor have a decisive and disproportionately adverse impact on a protected class. The creditor then has the burden of showing that its system is justified by business necessity. The plaintiff then has a further opportunity to show that some other standards will satisfy the business necessity equally well, and without the discriminatory effect.

Sex and marital status have been "prohibited bases" longer than the others, and most of the litigation concerning the credit granting activities of creditors has dealt with those categories. In *Markham v. Colonial Mortgage Service*

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15. See n. 13 *infra*, and n. 5 to the FTC Interpretation. In a recent case, a wife crossed out "Mr." on an application sent to her husband, typed in "Mrs." but left his first name, and the creditor then obtained a report on the husband. The court found no violation, since his was the only available name. The court also suggested that the creditor would have violated the Act if it had done otherwise. Harbaugh v. Continental Ill. Nat'l Bank, ___ F.Supp. ___ (N.D. Ill. 1978).
Co., Associates, Inc.? the plaintiffs, a lawyer and his fiancee, were rejected for a mortgage loan. They alleged that the creditor’s denial of credit was due to its refusal to combine their incomes, as was done for married couples, and thus constituted discrimination on the basis of their unmarried status. In an unreported order, the trial judge rejected the plaintiffs’ contention, asserting without citation that:

The Act . . . does not compel creditors to ignore the special legal ties created between two people by the marital bond . . . Defendant in this case had a right to be concerned that plaintiffs’ unmarried status might make the continuity of their pooled income less certain, and the enforceability of their joint obligation less feasible.

The decision appears clearly wrong, both under the earlier version of Regulation B that was applicable, and under the current Regulation. Both versions of Regulation B provide that a creditor may not discount the income of an applicant on the basis of marital status, yet this is clearly what the defendant in Markham was alleged to have done. The court’s reasoning in relating marital status to income continuity is unpersuasive. The plaintiffs were co-applicants, they would be jointly liable on the obligation, and there was no suggestion that either of them was in danger of becoming unemployed. The “continuity” of the plaintiffs’ income simply does not depend on whether they are married.

The Federal Trade Commission also dealt with what was apparently overt discrimination in its consent order in the Alden’s case, mentioned above. The respondent agreed, without admitting a violation, to stop automatically rejecting any applicant whose occupation was “waitress” while not applying a similar policy to waiters.

Allegations have been made in a number of cases that ostensibly innocent criteria used by creditors was violative of the Act because application of the criteria had the unjustifiable effect of discriminating against protected categories of applicants. So far, none of these claims has succeeded. In Carroll v. Exxon Co., U.S.A., for example, the plaintiff was an unmarried female. She objected to inquiries about the number of her dependents, claiming that it is unusual for an unmarried person to have dependents with the result that Exxon’s credit scoring system effectively discriminates on marital grounds. The court rejected the argument, finding that the plaintiff had not made out the requisite prima facie case of discrimination. More recently, in Lawner v. Central Charge Service, Inc., the plaintiff asserted that the card issuer’s length-of-employment criterion had the effect of discriminating against women. The plaintiff voluntarily dismissed the suit, however, when an analysis

of the card issuer's applications failed to produce any statistically significant evidence of sex bias.

Both of these cases confirm the place that the effects test will likely occupy in Equal Credit Opportunity Act litigation. Absent the use of an obviously discriminatory system, an applicant must proceed by demonstrating that some otherwise permissible system in fact results in disproportionate rejections of some protected class.\textsuperscript{20} One easy example of the effects test idea is built into Regulation B itself—the prohibition against considering the existence of a telephone listing in the applicant's name\textsuperscript{21} that clearly adversely impacts on married women. Beyond this, the Regulation merely mentions the judicially-created effects test in a footnote citing the Act's legislative history.\textsuperscript{22} The early returns from the courts indicate it will not be an easy standard for rejected applicants to satisfy.

IV. REASONS FOR ADVERSE ACTION

Probably the most hotly contested provisions in the original versions of Regulation B and in the 1976 amendments to the Act were those which gave rejected applicants the right to learn the reasons for the creditor's adverse action. While the original version of Regulation B merely provided that the creditor "shall provide each applicant who is denied credit . . . the reasons for such action, if the applicant so requests,"\textsuperscript{23} the statutory rule enacted in 1976 contains a more elaborate mechanism in which the creditor, either on request or on his own initiative, must give the "specific reasons"\textsuperscript{24} for any adverse action. According to section 202.9 of the new Regulation, the creditor's first responsibility is to notify the applicant of the action taken, and this must be done either within 30 days after the adverse action is taken, or within 90 days after an unaccepted counteroffer. The creditor then has an option: he may either include the "specific reasons" for adverse action in the original notice of that action, or he may disclose the applicant's right to a statement of the reasons within 30 days after the applicant, acting within 60 days of the adverse action notice, requests such a statement.

Only one reported case involves outright dereliction by the creditor in providing the reasons for credit denial. In the Exxon case discussed above,\textsuperscript{26} Ms. Carroll was advised that her credit application was denied and no reason

\textsuperscript{20} Similar allegations of effects test discrimination have been lodged in other cases without definitive resolution. Wilke v. Montgomery Ward Co., ___ F. Supp. ___ (N.D. III. 1977); Deselles v. J.C. Penney Co., No. 78-1495 (E.D. La. 1978). The Civil Aeronautics Board, however, has entered an order against Delta Airlines on the ground that its ticket-by-mail program had the effect of restricting credit to racial groups and young adults. Order 78-8-101, Docket No. 33219 (1978).
\textsuperscript{21} 12 C.F.R. § 202.6(b)(4) (1978).
\textsuperscript{22} 12 C.F.R. § 202.6(a) note 7 (1978).
\textsuperscript{23} 12 C.F.R. § 202.5(m)(2) (1975).
\textsuperscript{25} 434 F. Supp. 557 (E.D. La. 1977).
was given. She wrote to Exxon requesting the reason and received the following form letter reply:

The credit bureau we contacted in your case did not respond adversely, but unfortunately it could furnish little or no definitive information regarding your established credit.26

The court found that Exxon's response was an unsatisfactory explanation of the credit denial. Although the case arose before the effective date of the 1976 amendments to the Act, the court quoted extensively from the legislative history of those amendments to support its conclusion that Exxon's response "fail(ed) to achieve the informative purposes legislated in the ECOA."

At the surface level, even though the court draws on inapplicable and largely irrelevant legislative history it is difficult to question the decision, since Exxon's purported explanation was singularly uninformative. But the case may not be dismissed that easily. Presumably Exxon was trying to tell Ms. Carroll that she was an unknown quantity on whom the local credit bureau simply had no record of a credit history. If so, the case poses the question of whether a creditor satisfies its obligation to give "specific reasons" for a turndown when it tells the applicant that the lack of any credit history, good or bad, disqualifies the applicant. The best available authority, the current version of Regulation B, indicates that a creditor complies with the law by checking off a line indicating "no credit file" or a line indicating "insufficient credit file." 27 The Exxon case may be an omen of the willingness of courts to impose their own sense of what are adequate reasons, and could signal a running battle between the courts and the Federal Reserve Board as to compliance with the Act, similar to the battle that has been waged under the Truth in Lending Act.28

The "reasons for adverse action" requirement poses problems in several other settings as well. One of these problem areas is point-of-sale turndowns. For example, assume that a credit cardholder attempts to make a purchase at a store, but the transaction is not authorized by the card issuer's service center. The refusal of that transaction may be because the purchase would run the customer's balance over the established credit limit, or it may be for the lack of adequate identification, or because the transaction is sufficiently unusual to trigger security features in the creditor's system. The Act itself specifies that the first of these—exceeding an established credit limit—is not adverse action, and the 1977 version of Regulation B reflects the statutory language almost verbatim.29 The Federal Reserve Board first tried to deal with

26. The court held that this cryptic statement also violated the Fair Credit Reporting Act for failure to identify the credit reporting agency.

27. These designations are part of the sample statement of reasons set out in 12 C.F.R. § 202.9(b)(2) (1978).


other point-of-sale turndown problems by an Official Staff Interpretation, but eventually amended the regulatory definition itself. As of March, 1978, the definition of adverse action excludes:

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

This version clearly exempts the creditor from an obligation to reveal the security system that causes the turndown, but it reinstates the obligation to give reasons if the creditor "pulls" the customer's card, lowers the credit limit, or refuses a formal point-of-sale application for a higher limit. It leaves somewhat up in the air a turndown based on an undisclosed credit limit. In this case, prudent counseling would dictate that the creditor disclose the limit.

Another dilemma in connection with the reasons for adverse action is how a creditor who utilizes an empirically derived scoring system can identify the "specific reasons" for a rejection. The Regulation clearly forbids the creditor from saying, "we use a credit scoring system and you did not get a passing score." But how is the creditor to translate to the applicant that the applicant's failure to get higher scores in several of the categories, rather than some fatal flaw in, the applicant's character, led to the denial? In O'Quinn v. Diner's Club, the court used the restriction in the new Regulation B provision to find a violation in a pre-1977 statement of reasons that merely noted that the plaintiff did not have sufficient points in the scoring system.

More significant guidance on this question may be found in the Federal Trade Commission's consent order in the Alden's case. Alden's agreed to disclose the four characteristics in its system that produce the greatest spread between the points that the applicant actually obtained and the number of points that the applicant could have obtained. Fewer characteristics may be disclosed if they would cause denial regardless of scores on others. That this approach is likely to reflect an administrative enforcement policy is already confirmed by a consent judgment entered in Ohio in November 1978: U.S. v. Federated Department Stores followed the Alden's formula. While these

32. 12 C.F.R. § 202.9(b)(2) (1978) provides, in pertinent part: "Statements . . . that the applicant failed to achieve the qualifying score on the creditor's credit scoring system are insufficient."
33. In re Alden's, Inc., supra n. 9.
34. In re Alden's, Inc., supra n. 9.
35. — F. Supp. (S.D. Ohio 1978). The defendant also agreed to pay a $50,000 penalty and to recontact previously rejected applicants.
settlements provide a measure of certainty and feasibility to creditors using scoring systems, one cannot help wondering how long it will be before a court, or Congress, refuses to accept as a sufficient statement of "reasons" for denial that a customer is a carpenter, lives in an apartment, has two department store credit cards and drives a large car.

V. SIGNATURE PROBLEMS

Section 202.7(d) of Regulation B imposes significant limitations on the creditor’s freedom to require a spouse’s signature, either on the credit instrument itself or on collateral documents. Although these limitations have not yet appeared in the reported cases under the Act, they are troublesome to creditors and to those who counsel creditors, and they are among the most frequent violations detected in bank examinations according to Federal Reserve Board reports.

Of course the creditor may always require the signatures of joint applicants, whatever their relationship to each other. At the other extreme, if a creditworthy applicant applies for individual credit, the creditor may never insist on the signature of a spouse or other third-party on the note or instrument obligating the applicant to pay. If the applicant would not be creditworthy in an individual capacity, a cosigner or other surety may be required, but the creditor cannot insist that it be the spouse.

Whether he takes a formal security interest or not, if the creditor relies on property to determine creditworthiness, the nonapplicant’s spouse may be required to execute the documents in certain circumstances. For example, if an individual applicant seeks unsecured credit, the creditor may rely on the applicant’s joint interest in certain real estate in agreeing to extend the credit. The creditor might properly require the nonapplicant spouse to consent to the sale of the real property without partition if the creditor reasonably thought that such a sale would be necessary to assure a full market value return on the property at an execution sale. Similarly, where a married applicant seeks unsecured credit on the strength of community property and the state law denies that applicant the power to control enough community property to satisfy the creditor’s standards, the creditor may require the spouse’s signature on a waiver, assent or similar instrument that the creditor feels is necessary to make the community property accessible to satisfy the indebtedness. When a creditor takes an application for secured credit, the creditor may require a spouse or other third party to execute whatever instruments are necessary to make the collateral available to the creditor on default—"for example, any instrument to create a valid lien, pass clear title, waive inchoate rights, or assign earnings."[36]

Two things are of particular importance in analyzing the signature requirements. First, the nonapplicant spouse can never be required to become a

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primary obligor on the credit instrument if the applicant applies for the credit in the applicant's own right. Second, the right of the creditor to require third-party signatures on ancillary documents affecting property relied on by the creditor depends on a careful assessment of state law affecting joint ownership or community property rights.

VI. BUSINESS CREDIT

The Act is not limited to transactions involving consumers. The key definition of the term "applicant" includes "any person" who requests or receives credit. Thus, the antidiscrimination provisions of the Act and Regulation B clearly apply to credit transactions between business entities, for business purposes. Section 202.3(e) of Regulation B does, however, accord special treatment to business transactions. Creditors in such transactions are free to inquire about marital status, need not automatically notify applicants of action taken or of their right to a statement of reasons for adverse action, need not maintain separately accessible spousal account records, and need retain account records for more than 90 days only on the applicant's request.

At the urging of the Federal Trade Commission staff and the President's Interagency Task Force on Women Business Owners, the Federal Reserve Board has proposed amendments to Regulation B that would modify three of these four special rules: inquiries about marital status would be barred in business credit transactions as in consumer transactions, notifications of action taken and of reasons for adverse action would be reinstated for direct business loans under $100,000; and, in the case of direct business loans under $100,000, the creditor would be required to retain transaction records for the usual 25 months.

VII. ENFORCEMENT OF THE ACT

Administrative enforcement of the Act is assigned to the same agencies as those involved in enforcing the Truth in Lending Act and the other titles of the Consumer Credit Protection Act—principally to the agencies regulating depository institutions and to the Federal Trade Commission. The Department of Justice may also bring "pattern and practice" suits, either on its own initiative or on referral from other enforcement agencies. In addition, section 706 of the Act affords aggrieved applicants a private cause of action in which the remedy may include actual damages, a penalty of up to $10,000, plus costs and attorney's fees. For class actions, there is a ceiling recovery on punitive

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39. It is now apparent that the Department of Justice intends to use its authority to bring "pattern and practice" suits, as several are known to have been filed, including the action against Federated Department Stores noted above. See n. 35 supra. In another recent consent decree, a Kentucky bank agreed to take into account the joint income of married couples, and, in the case of women applicants, income from alimony, child support and public assistance payments. U.S. v. Citizens Bank & Trust Co., C.A. No. 79-1, (E.D. Ky. 1979).
damages of $500,000 or 1 per cent of the creditor’s net worth, whichever is less.

Whether courts will enter substantial judgments against creditors without proof of actual damages is an open question. In O'Quinn v. Diners Club, no damages were awarded despite the finding of a violation, although plaintiff did receive costs and attorney's fees. In Smith v. Lakeside Foods, Inc., the court observed that even without proof of actual damages the plaintiff may be entitled to declaratory or injunctive relief, or punitive damages. The matter of actual and punitive damages in the Exxon case was referred to a magistrate.

A significant regulatory development is imminent with respect to all creditors who are depository institutions—banks, thrifts and credit unions. The federal regulatory agencies for these creditors—the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Federal Home Loan Bank Board and the National Credit Union Administration—have issued proposed uniform enforcement guidelines for the Equal Credit Opportunity Act and the Fair Housing Act. These guidelines commit the agencies to ordering corrective action, as opposed to conventional cease and desist orders, against institutions violating those acts. The forms of corrective action may include “affirmative advertising” where applications have been discouraged on prohibited bases, reevaluation of applications where discriminatory policies were previously applied, reimbursements or adjustments where more onerous terms were imposed on protected categories of applicants, and the release of unnecessary co-signers.

The Federal Reserve Board also has under consideration a proposed amendment to section 202.2(1) of Regulation B to expand the definition of “creditor” to include those who “arrange for the extension of credit.” This would confirm the coverage of real estate brokers and similar intermediaries under the general anti-discrimination provisions of the Act, although they are not subject to some of the mechanical rules such as giving reasons for adverse action. The notion that “arrangers” are subject to the law has been in the Act and Regulation B from the beginning, and it is curious that the Board should only now incorporate it expressly into the Regulation. One can only hope that expanding the definition at this point will not be the cause of more confusion than clarification.

45. Act § 702(e).
46. Section 202.2 of Regulation B defines “creditor” as one who “regularly participates in the decision of whether or not to extend credit.” Brokers or other arrangers are therefore presumably covered when they have a role in the credit decision. The proposed definition of arranger might be read to include those who merely do preliminary paper work but have no control over the credit transaction. This would be an undesirable extension of the arranger concept. See generally Maltz & Miller, The Equal Credit Opportunity Act and Regulation B, 31 Okla. L. Rev. 1 (1978).