



**Aldrich & Bonnefin, PLC**  
*Counsel to Bankers' Compliance Group® presents*

# Consumer Lending Bootcamp: Mastering Regulation B Applications and Adverse Action Requirements

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**ALDRICH  
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# Objectives

- Understand
  - When Regulation B applies
  - What is a prohibited basis of discrimination
  - What is an application under Regulation B
  - What information may be requested from an applicant
  - What is adverse action under Regulation B
  - When an Adverse Action Notification must be sent
  - What are the contents of an Adverse Action Notification



# ECOA/REG B BASICS



# ECOA/Reg B Basics

- Congress passed ECOA in 1974 to prohibit creditors from discriminating on the basis of
  - Sex and marital status
- Amended the statute in 1976 to ban discrimination on the basis of
  - Race, color, religion, national origin, age, receipt of public assistance income
  - Consumer's good faith exercise of rights under Consumer Credit Protection Act
- ECOA meant to ensure that credit is extended with fairness, impartiality, and without discrimination



# ECOA/Reg B Basics

- Reg B implements ECOA
- CFPB has rulemaking authority
- Reg B applies to
  - All types of applicants
  - All types of credit



# ECOA/Reg B Basics

- Reg B applies to the entire credit process, from start to finish:
  - Advertising and marketing
  - Application process
  - Underwriting & documenting
  - Servicing the loan
  - Collecting on the loan



# General Rule

- A creditor may not discriminate
  - Against an applicant
  - On a prohibited basis
  - In any aspect of a credit transaction



# Reg B's Prohibited Bases

- Race
- Color
- National origin
- Religion
- Sex
- Marital status
- Age . . . .



# Reg B's Prohibited Bases

- That all or part of the applicant's income derives from any public assistance program
- Applicant has in good faith exercised any right under the Consumer Credit Protection Act (TILA, FCRA, ECOA, etc.)



# Rule Against Discouraging Applications

- Creditors may not
  - Make any statement
  - In advertising or otherwise
  - To prospective applicants
  - That would discourage on a prohibited basis
  - A reasonable person from applying



# TAKING APPLICATIONS AND QUESTIONS YOU CAN (AND CANNOT) ASK



# Applications

- Definition of “Application”
  - Oral or written request
  - For an extension of credit
  - Made in accordance with lender’s procedures
  - For type of credit requested



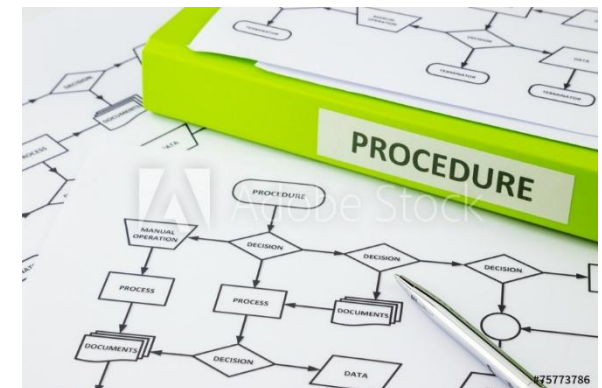
# Applications

- Examples of “applications”
  - Latitude to establish own application process and decide type and amount of information required
  - Completed, signed & submitted application forms
  - Business or personal financial statements
  - Signed letter of intent with a deposit



# Actual Practices

- “Procedures”=
  - Actual practices &
  - Stated application procedures



# Actual Practices - Example

- Creditor's stated policy is to require all applications to be in writing on the creditor's application form. However, the creditor also makes credit decisions based on oral requests.

On these facts, are the creditor's "procedures" to accept:

- ☐ Written applications (on its own application form)
- ☐ Oral applications
- ☐ Both of the above



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# Inquiries

- “Inquiry”
  - Providing general information to customer
  - Focus is on how institution responds to questions from applicant



# Applications v. Inquiry

- Provide basic loan terms = inquiry
- Communicate credit decision (such as denial) = application
  - Adverse action notice required if decision is to deny credit
  - The inquiry-into-application rule trumps your procedures' definition of application



# Exercise #1



# Exercise #1

Homer walks into Springfield ACE Bank and asks the bank's loan officer, Flanders, questions about the bank's mortgage loans.

The bank needs help figuring out whether Flanders' responses to Homer's questions turned Homer's inquiry into an "application" for purposes of Reg B.



# Scenario #1

|                                                                                                                                                                                                                       | Inquiry | Application |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|-------------|
| 1. Flanders told Homer about the maximum LTV and DTI ratios for the bank's mortgage loans.                                                                                                                            |         |             |
| 2. In order to tell Homer the applicable APR, Flanders asks for information about the home Homer is looking to buy (property address, sale price, etc.). Thereafter, Flanders tells Homer the rate will be 4.00%.     |         |             |
| 3. Homer tells Flanders he filed for bankruptcy last year after having a notably disappointing season. In response, Flanders tells Homer that he won't qualify for the mortgage loan so he shouldn't bother applying. |         |             |
| 4. Same as #3, but Flanders says, "While we normally view bankruptcies, negatively, we encourage you to apply so we can evaluate your entire financial picture."                                                      |         |             |



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# Practical Steps with Inquiries

- Conclude every inquiry with an invitation for the consumer to apply
- Keep detailed telephone logs that document every inquiry



# What Can You Ask an Applicant?



# General Rule

- You can ask for any information as part of an application
- Unless it concerns a prohibited basis
- But there some exceptions. . .



# Common Exception #1

- Can request info about non-applicant spouse
  - If applicant resides in a CP state (such as CA)
  - Property on which applicant is relying as a basis for repayment of credit requested is located in a CP state
  - Applicant is relying upon alimony, child support, or separate maintenance payments from spouse or former spouse
  - Spouse will be permitted to use account
  - Spouse will be contractually liable on account



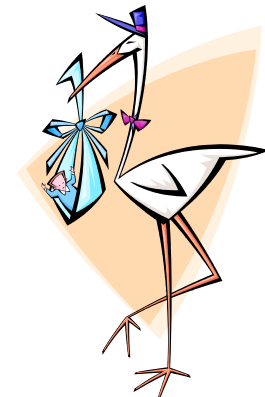
# Common Exception #2

- Marital status
  - OK to ask in CP states
  - OK to ask in non-CP states if:
    - Secured credit or
    - Loan is subject to HMDA/Reg C
  - Required terms: Married, Unmarried or Separated
  - OK to define unmarried as single, divorced or widowed (but don't ask)



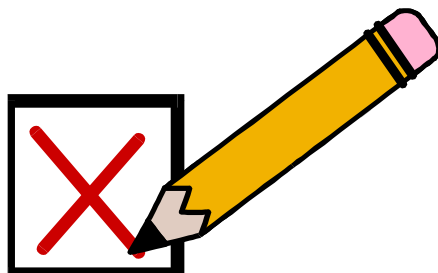
# Common Exception #3

- Alimony, child support & separate maintenance income
  - Must be preceded by disclaimer
  - Model clause on p. 7



# Common Exception #4

- Sex
  - You can ask the applicant to indicate a title (Ms., Miss, Mr. or Mrs.)
  - But you have to indicate that its optional
  - Must ask applicant's sex if application is subject to HMDA/Reg C reporting



# Common Exception #5

- Age
  - OK to ask about in order to determine legal ability to contract
  - 18 in most states (including CA)



# Common Exception #6

- Information about children
  - Asking about dependents or dependent related expenses = OK
  - But not OK to ask about
    - Applicant's pregnancy status
    - Childbearing intentions



# Common Exception #7

- Permanent residency status & immigration status
  - OK to ask about under Reg B
  - Careful about Unruh Act!



# Common Exception #8

- Race, ethnicity & sex
  - When Reg B or HMDA requires the collection of such information or
  - Creditor is conducting a self-test that qualifies under Reg B Section 1002.15 self-testing privilege





# NOTIFICATION OF THE CREDIT DECISION (ADVERSE ACTION)



# General Rules

- Rule #1 - “Completed applications” must notify applicant of credit decision
- Rule #2 - If credit denied, must send Adverse Action Notice (AAN)



# Four Steps

- **Step One:** Inquiry phase
- **Step Two:** Have you received an “application”?
- **Step Three:** If it’s an incomplete application, make it complete.
- **Step Four:** Now that application is complete, make a decision!



# Step One – Inquiry Phase



# Credit Inquiries

- May trigger AAN
- Depends on creditor's response
  - Basic loan info  $\neq$  AAN
  - “Here's an application”  $\neq$  AAN



# Credit Inquiries

- AAN triggered when creditor:
  - Evaluates consumer's info
  - Decides to decline request
  - Communicates decline
- Even if you haven't received an application
- "Inquiry Rule"



## Step Two – Have You Received an “Application”



# Basic Rule

- Apart from Inquiry Rule
- Receipt of an “application”
- Starts Reg B’s notice time frames



# “Application” Defined

- Oral or written request
- For an extension of credit
- Made in accordance with procedures creditor uses
- For type of credit requested



# “Application” Defined

- Tons of latitude here
- Creditors get to decide
  - Type & amount of info
  - It wants from credit applicants



## **Step Three – If it's an Incomplete Application, Make it Complete**



# Incomplete Applications

- Complete Application =
  - Creditor has received all info
  - It regularly obtains and considers
  - In evaluating applications
  - For amount and type of credit requested



# Incomplete Applications

- You've received
  - An “application”
  - But not a “completed application”
- Notice depends on whether you can or can't make a decision



# Can Make a Credit Decision

- You may
  - Evaluate application &
  - Notify applicant of action taken
- Source of missing info irrelevant
- Credit denied → Send AAN



# Can't Make a Credit Decision

- Depends upon who's supposed to provide missing info
  - Creditor obtains: appraisals, credit reports, etc.
  - Applicant supplies: tax returns, pay stubs, etc.



# Info Creditor to Obtain

- Must act with reasonable diligence to make application complete
  - Request info from third parties promptly after receiving application
  - For example: order the credit report or appraisal promptly after receiving application



# “Pending” Applications

- Sometimes you wait a long time for info from third parties
  - Appraisals, title reports, flood certs
  - Not a technical Reg B term, but application is “pending”



# “Pending” Applications

- What to do
  - Keep applicant up-to-speed & log this
  - You do not have to deny credit application



# Info Applicant to Provide

- Creditor's options:
  - Orally request info
  - But must do one of following within 30 days of receiving incomplete application
    - Deny incomplete application & send AAN
    - Send NOI



# Option #1 – Deny Incomplete Application

- Timing:
  - Deny w/in 30 days of receiving incomplete application
  - Notify w/in 30 days of deciding to deny incomplete application
- Reason for denial on AAN: “Credit application incomplete”



# Option #2 – Send NOI

- Notify w/in 30 days of receiving incomplete application
- Here's a sample form . . .



# Option #2 – Send NOI

Creditor's Name  
Creditor's Address  
Telephone Number

Date

Dear Applicant:

Thank you for your application for credit. The following information is needed to make a decision on your application: \_\_\_\_\_.

We need to receive this information by \_\_\_\_\_ (date). If we do not receive it by that date, we will regrettably be unable to give further consideration to your credit request.

Sincerely,



## Option #2 – Send NOI

- If applicant **doesn't** respond by deadline
  - Nothing further a creditor must do



## Option #2 – Send NOI

- Do not revise NOI to state that application will be considered “withdrawn”
  - Applicant must expressly withdraw the application



## Option #2 – Send NOI

- If applicant expressly withdraws:
  - No further obligations under AAN rules
  - Document withdrawal in file
- Know the difference between withdrawn application and closed for incompleteness



# Option #2 – Send NOI

- Applicant **does** respond by deadline
  - Follow completed application rules
  - We'll discuss those rules in a moment



## Exercise #2



## Exercise #2

For their unsecured consumer credit product, Springfield ACE Bank requires an application form and a copy of the consumer's most recent paystub. Today, Bart submits an incomplete application to the lender.

Also today, the lender calls Bart and informs him that his application is incomplete and tells him what information the lender needs to make the application complete (his paystub).

Three weeks have passed and Bart has yet to send the lender the paystub.



## Exercise #2

1. What must lender do within 30 days of today (the day lender received incomplete application)?
  - ☐ Send a notice of incompleteness
  - ☐ Deny loan
  - ☐ Either of above



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## Exercise #2

2. If lender denies incomplete application, it must mail AAN to Bart within \_\_\_\_ days from deciding to deny incomplete application.



## Exercise #2

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# Step Four – Now That the Application is Complete, Make a Decision!



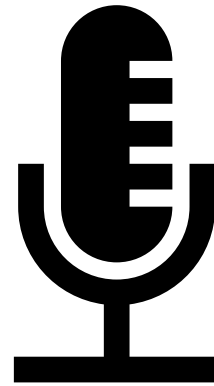
# General Rule

- Creditor must notify applicant
- Of creditor's
  - Approval
  - Counteroffer OR
  - Adverse action
- w/in 30 days of receiving a completed application



# Approve Complete Application

- Easy – communicate approval orally or in writing



# Counteroffer

- Example
  - Consumer applied for particular terms
  - Creditor offers less favorable terms (such as a higher rate, or loan amount is less than applied for)
- Less favorable terms = adverse action unless borrower expressly accepts or uses credit offered
- Two options . . .



# Counteroffer Option #1

- Send only a counteroffer
- But:
  - Must send an AAN w/in 90 days of CO
  - If applicant does not expressly accept or use credit offered
- So, Option #1 requires some work



# Counteroffer Option #2

- Send combined counteroffer/AAN

Date \_\_\_\_\_

Dear Applicant:

Thank you for your application for \_\_\_\_\_.  
We are unable to offer you credit on the terms that you requested for the following reason(s): \_\_\_\_\_.

We can, however, offer you credit on the following terms: \_\_\_\_\_

If this offer is acceptable to you, please notify us within [amount of time] at the following address: \_\_\_\_\_

[ECOA notice & FCRA AAN contents]



# Counteroffer Option #2

- More popular option because:
  - Do not have to worry about sending a subsequent AAN
  - No further action if applicant doesn't accept CO



# Avoiding Counteroffers

- Consumer applies for credit on general terms
  - Any approval is consistent with request
  - No AA
- Don't include blanks in applications for consumer to specify interest rate, credit limit, etc.



# Adverse Action #1

- Refusal to grant credit
  - In substantially the amount or
  - On substantially the terms requested
  - Unless (as we discussed a moment ago)
    - Lender makes a CO &
    - Borrower accepts or uses credit offered



## Exercise #3



## Exercise #3

1. Marge applies for a \$50,000 line of credit and the creditor refuses to offer the line of credit because Marge does not qualify.

The creditor:

- ☐ has OR
- ☐ has not taken adverse action



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The creditor:

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## Exercise #3

2. Change of facts. The creditor makes Marge a counteroffer for a \$25,000 line of credit. The creditor tells Marge she has 45 days to accept the counteroffer.



## Exercise #3

- a. The creditor sends a standalone counteroffer.
  - (1) If Marge accepts the counteroffer within 45 days, the creditor ☐ has to OR ☐ does not have to send an AAN.
  - (2) If Marge does not accept the counteroffer within 45 days, the creditor ☐ has to OR ☐ does not have to send an AAN (in this case, by the 90th day from making the counteroffer).



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## Exercise #3

- b. The creditor sends a combined counteroffer/AAN.
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  - (2) If Marge does not accept the counteroffer within 45 days, the creditor ☐ has to OR ☐ does not have to send an AAN.
  - (3) In other words, the creditor ☐ does OR ☐ does not have to take any further action if Marge does not accept counteroffer.



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# Adverse Action #2

- Includes:
  - Refusal to increase credit limit
  - On borrower's revolving credit line
  - When borrower has applied for an increase



# Adverse Action #3

- Also includes:
  - Termination of an account or
  - Unfavorable change in account terms
  - That does not affect
    - All or
    - Substantially all
  - Of a class of creditor's accounts



# Adverse Action #3

- Also includes:
  - Termination of an account or
  - Unfavorable change in account terms
  - That does not affect
    - All or
    - Substantially all
  - Of a class of creditor's accounts



# Adverse Action #3

- Substantially all =
  - Creditor's action must affect
  - Overwhelming majority of accounts
  - In a designated class
- No AA when creditor's action not based on individual credit characteristics
- Example
  - Creditor terminates all CC accounts because it no longer offers a credit card product



# Adverse Action #3

- Counterexample
    - Creditor terminates O/E credit accounts
      - That have low credit limits
      - Keeps open accounts with higher credit limits
- = Adverse action
- ∴ Send AAN to terminated account holders



# Adverse Action #4

- Includes:
  - Refusal to refinance or extend the term
  - Existing business or other loan
  - If applicant applied for it in accordance with creditor's procedures



# What is not adverse action?

- Change in account terms expressly agreed to by applicant
  - Includes any sort of mutually agreed-to loan modification
- Any action or forbearance taken with respect to inactive, defaulted or delinquent accounts
  - Example: account freeze based on account delinquency



# What is not adverse action?

- Creditor does not offer requested credit product
  - Example: Credit Cards
- However, if applicant applies for credit and the creditor does not offer the credit terms the applicant requested
  - Examples: interest rate, length of maturity, collateral, amount of down payment
- A denial of the application for that reason is adverse action, triggering AAN
- Unless creditor makes a CO applicant accepts



# What is not adverse action?

- Applicable law prohibits creditor from extending credit requested
  - Example: applicant is listed on the Treasury's Specially Designated Nationals and Blocked Persons List
  - Creditor must deny the applicant's credit request



# Reg B AANs – Consumer Loans

- For copies of the sample notification forms, refer to Appendix C of Regulation B



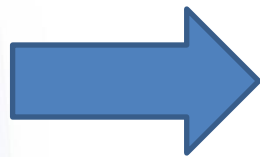
# Reg B AANs – Consumer Loans

- Description of adverse action taken
  - Written statement of creditor action
  - Examples:
    - “Credit has been denied”
    - “Your application has been denied”



# Reg B AANs – Consumer Loans

- Sample form:



Date: \_\_\_\_\_

Applicant's Name: \_\_\_\_\_

Applicant's Address: \_\_\_\_\_

Description of Account, Transaction, or Requested Credit \_\_\_\_\_

Description of Action Taken: \_\_\_\_\_

# Reason(s) for Denial

- Creditor must disclose
  - Specific
  - Principal reasons
  - For taking adverse action
- Model forms lists common reasons



# Reason(s) for Denial

**Part I-PRINCIPAL REASON(S) FOR CREDIT DENIAL, TERMINATION, OR OTHER ACTION TAKEN CONCERNING CREDIT.**

This section must be completed in all instances:

- |                                                                                    |                                                                             |
|------------------------------------------------------------------------------------|-----------------------------------------------------------------------------|
| <input type="checkbox"/> Credit application incomplete                             | <input type="checkbox"/> Unable to verify credit references                 |
| <input type="checkbox"/> Unacceptable type of credit references provided           | <input type="checkbox"/> Unable to verify employment                        |
| <input type="checkbox"/> Temporary or irregular employment                         | <input type="checkbox"/> Income insufficient for amount of credit requested |
| <input type="checkbox"/> Length of employment                                      | <input type="checkbox"/> Unable to verify income                            |
| <input type="checkbox"/> Excessive obligations in relation to income               | <input type="checkbox"/> Temporary residence                                |
| <input type="checkbox"/> Length of residence                                       | <input type="checkbox"/> No credit file                                     |
| <input type="checkbox"/> Unable to verify residence                                | <input type="checkbox"/> Poor credit performance with us                    |
| <input type="checkbox"/> Limited credit experience                                 | <input type="checkbox"/> Collection action or judgment                      |
| <input type="checkbox"/> Delinquent past or present credit obligations with others | <input type="checkbox"/> Garnishment or attachment                          |
| <input type="checkbox"/> Bankruptcy                                                | <input type="checkbox"/> Foreclosure or repossession                        |
| <input type="checkbox"/> Number of recent inquiries on credit bureau report        | <input type="checkbox"/> Value or type of collateral not sufficient         |
| <input type="checkbox"/> Insufficient number of credit references provided         | <input type="checkbox"/> Other, specify                                     |



# Reason(s) for Denial

- OK to add/delete inapplicable reasons
- Check actual reason(s), not just closest one
- Up to four
- Reasons checked must:
  - Relate to & accurately describe
  - Factors creditor actually considered



# Reason(s) for Denial

- Alternative (right to receive reasons):

Dear Applicant:

Thank you for applying to us for \_\_\_\_\_

After carefully reviewing your application, we are sorry to advise you that we cannot [open an account for you/grant a loan to you/increase your credit limit] at this time.

If you would like a statement of specific reasons why your application was denied, please contact [our credit service manager] shown below within 60 days of the date of this letter. We will provide you with the statement of reasons within 30 days after receiving your request.

Creditor's name: \_\_\_\_\_

Address: \_\_\_\_\_

Telephone number: \_\_\_\_\_



# Always Include ECOA Notice

NOTICE: The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in Appendix A of Reg B).



# Small Business Applicants

- \$1MM or less gross revenues in preceding fiscal year
- Includes start-ups in 1<sup>st</sup> year of operation
- Creditor may rely on applicant's confirmation as to business revenue
- Sole props → Consider SP's revenue to determine which rules govern
- Two options . . .



# Small Business Applicants: Option #1

- Treat small business like a consumer
  - State denial reasons (Model Form C-7)

OR

- Don't state denial reasons (BCG Form)



# Small Business Applicants: Option #2

- An “upfront” notice at time of application
  - Model Form C-8
  - Thereafter notify applicant either orally or in writing



# Large Business Applicants

- We're talking about applications
  - For credit incident to factoring arrangements and similar types of business credit, or
  - From businesses with revenues exceeding \$1 million



# Large Business Applicants

- Option #1
  - Treat them like small businesses or consumers
- Option #2
  - Treat them like a large business
    - Notify applicant of credit decision orally or in writing
    - Within a reasonable time
    - Don't have to tell them about their right to statement of reasons



# Large Business Applicants

- May request written statement of reasons
  - Must be made w/in 60 days after notice of AA
  - Same rule for consumer applicants, but no need to disclose



ANY  
QUESTIONS  
?

# We're adjourned!

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