The Equal Credit Opportunity Act
Avoid the Pitfalls

The Equal Credit Opportunity Act (the “ECOA” or the “Act”) subtly pervades many aspects of American life and business. Many creditors are aware of the Act’s more visible manifestations while remaining in the dark about some of the Act’s less visible provisions. Perhaps most importantly, the majority of press and attention given to the ECOA focuses on the protections granted by the Act with respect to consumers. Many are unfamiliar with the protection provided by the Act to corporate or other non-consumer customers. A lack of knowledge of the specific requirements under the Act may leave sellers exposed to claims of discrimination by individual consumers, potential non-consumer buyers or, more importantly, from a class action filed against your company.

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In the February issue, we discussed what should be considered in designing or reviewing your current credit application. Each credit application, and all other means of obtaining information from a potential buyer, should also be evaluated to make sure that you are complying with ECOA requirements. Companies reviewing credit applications of their business customers are not immune from having charges made against them for ECOA violations. Many of these cases involve less visible ECOA provisions, such as its notification requirements. In a recent case brought in an Indiana federal court, the court found a bank liable under the Act for failure to provide a business applicant notice of an adverse action within 30 days.

The wide breadth of the ECOA causes it to affect many businesses that routinely evaluate the creditworthiness of their customers. For this reason it is important for all businesses involved in selling on credit, even those only tangentially connected, to have procedures in place and employees trained in those procedures in order to ensure effective compliance with the law. Congress wrote the ECOA in broad language and it is interpreted by Federal Regulation B in even more expansive terms. All businesses that deal with any type of credit transaction need to be aware of the Act’s provisions and be cognizant of simple steps they can take to avoid liability under the Act. The 10 questions and answers that follow are designed to give businesses involved in credit transactions a better understanding of the Act’s breadth.
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and the preventive measures they can take to help manage their liability risks.

**What Is the Equal Credit Opportunity Act?**
The ECOA is a subchapter of the Federal Consumer Credit Protection Act. Regulation B, issued by the Board of Governors of the Federal Reserve System, provides guidance regarding the interpretation and enforcement of the ECOA. The ECOA prohibits any creditor from discriminating against any applicant for credit with respect to race, color, religion, sex, marital status, age, participating in public assistance programs or for exercising his or her rights under the Act. A creditor is deemed to have discriminated under the Act if it treats an applicant or potential applicant less favorably based upon one of the above factors. In addition, under the ECOA, a creditor is liable for any statement, in advertising or otherwise, that might discourage on a prohibited basis a reasonable applicant or prospective applicant from applying for credit from the particular creditor. It is important to recognize that discrimination under the ECOA is measured by an “effects test” and is not simply based upon ill or malicious intent. Thus, even if a creditor does not intentionally mean to discriminate, it can be held liable under the Act if the effects of its action result in discrimination toward one of the above protected groups.

To establish a *prima facie* case under the ECOA, a plaintiff must establish four elements. First, it must establish that it is a member of a protected class. Second, it must demonstrate that it applied for and was denied credit. Third, the plaintiff must be denied credit. Finally, the creditor must continue to approve credit applications for applicants with qualifications similar to those of the plaintiff.

**Who Qualifies as a Creditor Under the ECOA?**
The ECOA defines a creditor as anyone who “regularly extends, renews or continues credit; any person who regularly arranges for the extension, renewal or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew or continue credit.”

Regulation B elaborates upon this definition and asserts that the term creditor under the ECOA was designed to include all persons who regularly make credit decisions including decisions regarding credit terms. The definition also includes persons who routinely refer applicants or prospective applicants to creditors. In addition, persons who select or offer to select creditors to whom requests may be made for potential applicants are also considered creditors under the ECOA.

The definition of creditor under the ECOA and Regulation B is very broad and encompasses many individuals and businesses who may not traditionally consider themselves creditors. It is important for all businesses to determine whether they fall within the definition of creditor as described in the Act and the Regulations, and then determine all aspects of their business where they are wearing their “creditor” hat in order to accurately assess which areas of their business place them at risk for liability under the ECOA.

**Who Does the ECOA Consider Applicants?**
The ECOA defines an applicant as “any person who applies to a creditor directly for an extension, renewal or continuation of credit, or applies to a creditor indirectly.” Under the Act the term person includes natural persons, corporations, governmental agencies and subdivisions, trusts, estates, associations, partnerships and cooperations. Regulation B specifies that this definition includes persons who may become contractually liable regarding an extension of credit. Additionally, guarantors, sureties and endorsers are also applicants under the ECOA.

Creditors need to be aware of the breadth of this definition and understand that potential applicants, as well as formal applicants, fall under the provision of the Act. Additionally, it is important for creditors to remember that indirect applications for credit also fall within the purview of the Act.

**How Broad Is the ECOA?**
The ECOA applies to credit transactions. The statute and Regulation B define the term “credit transaction” very broadly to encompass all aspects of a prospective applicant’s dealings with a potential creditor. Requests and requirements for information, the particular investigation procedures used by a creditor, a creditor’s standards of creditworthiness and terms of credit all fall under the term “credit transaction.” Similarly, the manner in which a creditor furnishes credit information to third parties is also subject to regulation under the Act, as well as a creditor’s collection procedures. Finally, a creditor’s revocation, alteration and termination of credit procedures also qualify as credit transactions under the ECOA.

A creditor’s preventive policies and training practices should reflect the breadth of this definition. Creditors must emphasize to employees the importance of impartiality in all aspects of dealing with potential applicants through all stages of a particular credit transaction.

**What Type of Information Can a Creditor Ask for Under the ECOA?**
Under the ECOA, a creditor may not ask for information regarding an applicant’s or potential applicant’s race, color, religion, national origin or sex unless the information is
Thus, if a decision is made not to sell on credit or to revoke credit terms, the decision should be recorded based upon the financial situation of the buyer/applicant.

It is important that companies train employees, particularly those who will be interviewing potential applicants or taking applications from potential applicants about what constitutes permissible and impermissible questions. What may seem like a harmless or “small talk”-type question to an employee may encroach upon forbidden ground under the Act’s strict provisions.

**What Constitutes an Adverse Action Under the ECOA?**

Under the statute, the term adverse action includes the revocation or denial of credit to an applicant, and change in the terms of a credit agreement already in existence, and/or a refusal on behalf of a creditor to grant credit in substantially the same amount or upon substantially the same terms as requested.

The term adverse action does not encompass a refusal to extend additional credit under an existing credit agreement, whether the requesting applicant is currently in default, otherwise delinquent, or a refusal to extend credit beyond a prior established credit limit. Thus, if a decision is made not to sell on credit or to revoke credit terms, the decision should be recorded based upon the financial situation of the buyer/applicant.

Regulation B specifies that changing the terms of an account with the express agreement of the applicant is permissible. Similarly, a creditor may refuse to extend credit to an applicant if a creditor does not offer the particular type of credit or the particular type of credit plan requested by a prospective applicant. A creditor may also act or forebear to act upon an account on the basis of inactivity, default or delinquency without fear that a court would characterize the action as an adverse action under the ECOA.

**What Notification Requirements Are Contained in the ECOA?**

The Act also specifies that generally within 30 days a creditor must provide an applicant against whom adverse action is taken with a statement detailing the reasons behind the adverse action. Creditors may satisfy this requirement by either regularly providing all creditors against whom adverse action is taken with written notifications explaining why such action was taken, or by providing written or oral notice of an applicant’s ability to request such an explanation within 30 days.

In contrast, to the above requirement, Congress adopted a more flexible notification requirement for business credit applicants with gross revenues of more than $1 million. For this class of business applicants, creditors must give notice of any adverse action within a “reasonable time.”

To avoid liability under the Act, it is a good idea to formalize and make routine notice practices. Employees should be trained in these procedures and steps should be taken to ensure that procedures are followed regularly.

**What Records Are a Business Required to Maintain Under the ECOA?**

Under the Act, creditors are required to retain records of any action taken on an application for a certain period of time. If the action pertains to a consumer, the creditor must maintain the record for 25 months. If the action pertains to a business, the creditor must generally retain the record for 12 months. If the business applicant had gross revenue of more than $1 million for the prior fiscal year, a creditor need only retain the records for 60 days.

The records required to be retained under the Act include the application received, any information used to make the decision, a copy of the notification given to the applicant, a statement describing the reasoning behind such action and any writing received by the creditor from the applicant alleging a violation of the statute or Regulation B.

**What Happens if a Creditor Violates the ECOA?**

A creditor who violates a provision of the ECOA is liable for all actual damages sustained by the applicant either as an individual or as a member of a class. In addition to actual damages, punitive damages are also available. For creditors other than a government or governmental subdivisions or agency, punitive damages are capped at $10,000 for an individual creditor and $500,000 for a class action (or 1% of the net worth of the creditor).

Courts consider several factors when determining whether to award punitive damages and when determining the proper amount of punitive damages for violations of the ECOA. These factors include “the amount of any actual damages awarded, the frequency and persistence of failures of compliance by the creditor, the resources of the creditor, the number of persons adversely affected and the extent to which the creditor’s failure of compliance was intentional.” Additionally, it is important to note that attorneys’ fees and costs are also available to plaintiffs in ECOA actions. In a recent Southern District of Indiana case, a plaintiff was awarded $10,000 in punitive damages and more than $55,000 in attorneys’ fees and
costs against a defendant creditor who failed to properly comply with the Act’s notice provisions. Therefore, it is important for companies to realize that once fees and costs are included, damages under the ECOA can be quite substantial.

How Can a Company Prevent Violations of the ECOA?

There are five practices that your company should adopt to make sure it limits liability under the Act. First, ensure that credit applications are worded neutrally and do not ask for any prohibited information. Second, make sure that the criteria used to determine the creditworthiness of a potential customer can be easily measured and documented. Request financial statements and financial references from the buyer which will assist you in making a credit decision, such as the customer’s bank or other trade creditors. Check reputable credit reports concerning the potential customer. Third, establish and maintain a systematic method of complying with the Act’s notification requirements. If your company determines that a customer is not creditworthy enough to buy from you on credit, make sure that you notify the potential buyer within the 30 days required under the Act. Similarly, if you have requested the guaranty of an individual, make sure that any denial of the guarantor is made timely. Incorporate into the notification a statement recording the date when the credit application was received and when notification was given. Fourth, develop a record retention policy that is in compliance with the Act, and fifth, make sure that your employees understand that your company does not discriminate and that each of them is required to comply with the notification and record retention policy.

Compliance under the ECOA is not difficult, but it does require a review of your company’s current procedures to make sure that you have effective procedures in place. Establishing these now will protect you in the event of a disgruntled customer down the road.

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