Many in the industry find themselves rejecting more applicants than they have in a long time. This issue of Dispatches from the Trenches provides an outline of the Equal Credit Opportunity Act and the requirements it imposes on finance companies in such situations.

The Equal Credit Opportunity Act (ECOA) is a great example of the slippery slope where consumer protection laws begin creeping into the commercial leasing industry. As will be explained in more detail, although ECOA is clothed as a consumer protection statute, it is part of the Consumer Credit Protection Act, it applies to commercial transactions as well.

The stated purpose of ECOA is: to promote the availability of credit to all creditworthy applicants without regard to race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract) . . . by prohibit[ing] creditor practices that discriminate on the basis of any of these factors [and] requir[ing] creditors to notify applicants of action taken on their applications; to report credit history in the names of both spouses on an account; to retain records of credit applications; to collect information about the applicant’s race and other personal characteristics in applications for certain dwelling-related loans; and to provide applicants with copies of a appraisal reports used in connection with credit transactions.

ECOA protects all applicants including those that are natural persons, corporations, governments, governmental subdivisions or agencies, trusts, estates, partnerships, cooperatives or other associations.

ECOA regulates all creditors and this term includes brokers, originators and funders. The term is defined as: a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit. The term creditor includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of [this Act], the term creditor also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made.
In addition, a broker, originator or funder can, in some circumstance, be liable for the acts of those third parties with whom they do business if they have knowledge that such third parties are violating ECOA. This liability is established within the definition of creditor which also states that a person is not a creditor regarding any violation of the Act or this regulation committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction.

As is fairly common with Federal statutes such as these, the legislature delegated authority to a federal institution to proscribe regulations to carry out the purpose of the title. In these case the Federal Reserve Board (the Board) was granted such authority.

Despite the fact that ECOA is part of the Consumer Credit Protection Act, the statute itself is drafted broadly to include commercial and consumer transactions. However, the statute specifically acknowledges that some commercial transactions may be such that ECOA rules should not apply. In particular, the Act allows the Board to exempt from the provisions of ECOA any class of transactions that are not primarily for personal, family, or household purposes, or business or commercial loans made available by a financial institution.

The Board used this opportunity by distinguishing business credit from consumer credit in the regulations. However, this distinction only lessens certain record keeping and notice requirements. The general prohibition created by ECOA with respect to discrimination still applies to all commercial credit transactions.

Part of ECOA’s regulations require all business creditors to notify credit applicants that the creditors comply with the Act. Many creditors in the industry comply with this standard by adding language to their credit applications stating that ECOA prohibits creditors from discriminating against credit applicants on the 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. Such a notice must also provide the name and address of the federal agency that administers compliance by the particular creditor. The identity of this agency varies based on the geographic location of the creditor as well as the type of entity it is— for example, whether it is a national bank, state member bank, nonmember insured bank or a finance company which doesn’t meet any of the foregoing classifications or other classifications in Act.

ECOA also requires creditors to provide certain notices of adverse action to applicants. With respect to business credit transactions, the Board has lessened the requirements somewhat. The standard applied depends upon the size of the applicant, measured by the applicant’s gross revenue. The Board establishes two types of business credit applicants (a) business credit applicants with gross revenues of $1 million or less in their preceding fiscal year, and (b) business credit applicants with more than gross revenues of $1 million in their preceding fiscal year.

With respect to applications from a business that had gross revenues of $1 million or less in its preceding fiscal year, a business credit grantor must notify the applicant either orally or in
writing within 30 days of receiving a completed application concerning the approval of, counteroffer to, or adverse action taken.

If adverse action is taken, within 30 days, the creditor must provide a statement about the action taken that includes either: (i) a statement of specific reasons for the action taken, or (ii) a disclosure of the applicant’s right to a statement of the reasons for an adverse action. However, this disclosure of the applicant’s right to a statement of the reasons may be given either at the time the adverse action is taken or at the time the application is submitted, provided that the disclosure is in a form the applicant may retain and contains the required ECOA notices.

Many creditors in the industry comply with this standard by adding language to the application which basically says that if the applicant is denied business credit, the applicant has the right to a written statement of the specific reasons for the denial and provides contact information where the applicant can request such a statement.

With respect to applications for business credit from a business with gross revenues in excess of $1 million in its previous fiscal year, the creditor must notify the applicant either orally or in writing within a reasonable time of the action taken. If the applicant makes a written request for the reasons of the adverse action within 60 days, the creditor must give the applicant a written statement of the specific reasons for the action and the ECOA notice. Language used to comply with the requirements for applicants with gross revenues of $1 million or less can generally be used to comply with the requirements applicable to larger applicants.

Regardless of the size of the applicant, most creditors are required to provide a written statement with reasons for the credit declination if the applicant requests the additional details. The is an exception for small volume creditors, defined to be those that did not receive more than 150 applications during the preceding calendar year. For those creditors, the notification of action can be oral, including the statements of specific reasons.

Given the decreased supply of credit for many applicants, creditors would be wise to review their current ECOA policy. Obviously, creditors should not discriminate on the basis of race, color, religion, national origin, sex, marital status, or age (provided the applicant has the capacity to contract). Any call from an angry applicant who has been denied credit and who mentions these characteristics should raise a red flag. Creditors receiving such calls should make sure the file is accurately documented to show the legitimate reason for the declination.

The ECOA policy should also be reviewed to make sure it properly addresses the technical notice and response requirements of ECOA. Creditors should verify whether their forms have the proper ECOA notice and that it lists the correct Federal Agency as the party which regulates the particular creditor’s compliance with the Act. The credit application should also contain the optional language which can satisfy certain disclosure requirements relating to the applicant’s right to a statement for reasons of the declination. In addition, the creditor should have a proper system in place to receive and process any requests from rejected applicants for a detailed list of the reasons for the declination.
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