

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551



CA-81-9

DIVISION OF CONSUMER
AND COMMUNITY AFFAIRS

October 23, 1981

TO OFFICERS IN CHARGE OF BANK EXAMINATIONS AND CONSUMER AFFAIRS SECTIONS

We recently sent you a Policy Statement and a Supervisory Enforcement Policy concerning the enforcement of the Equal Credit Opportunity and Fair Housing Acts that were recommended by the Federal Financial Institutions Examination Council (FFIEC) and approved by the Board. To date, all but one FFIEC agency, the Federal Home Loan Bank Board (FHLBB), have adopted the Policy Statement. The Enforcement Policy has been adopted by the Board, the Office of the Comptroller of the Currency, and the National Credit Union Administration. We have no indication what further action, if any, will be taken by the FHLBB on either document or by the Federal Deposit Insurance Corporation on the Enforcement Policy.

Because both the Statement and Policy allow for considerable agency discretion, we believe it is necessary to establish more specific procedures to assure uniform implementation of these documents on a System-wide and interagency basis. We also believe it is necessary to monitor the System's implementation so that uniform coordination can be achieved and consistent decisions made. This letter is to advise you of those procedures and establish the monitoring program.

Instructions - There are four specific areas we'd like to draw your attention to:

- a) Retroactive Correction Periods
- b) Agency Discretion
- c) Distribution
- d) Effective date

RETROACTIVE CORRECTION PERIODS

The retroactivity period for corrective action referred to in the policy is to be measured from the date of "discovery". This is considered to be the date the Reserve Bank sends written notice of the violation and need for corrective action to the bank; for example, in a report of examination, a transmittal letter, or other correspondence. The bank should, of course, be required to correct all violations that occurred during the retroactive period as well as those that occur from the date of discovery to the date the bank implements the corrective action.

AGENCY DISCRETION

The corrective action, both prospective and retrospective, outlined in the Enforcement Policy should be undertaken in virtually every appropriate case in order to implement the policy uniformly throughout the System. However, should you believe an exception is warranted, you should ask the bank to take alternative corrective action only after you have consulted with, and obtained the concurrence of, this Division. We believe this central coordination is essential to obtaining uniform implementation within the System and on an interagency basis. Furthermore, if problems develop that may have interagency implications, it may prove necessary for us to consult with the other FFIEC agencies in order to coordinate our actions.

Numbered paragraph 2 of Part II of the attached Statement of Enforcement Policy (Attachment A) sets forth specific steps for notifying the applicants and offering to reconsider their application when an application is improperly rejected. It is not specific, however, with regard to which loan terms are to be used when a loan is approved upon reconsideration of the application. Rather, it requires the agencies to make the determination on a case by case basis. Please discuss any such situations with this Division and obtain its concurrence before making such a determination. Until we have experience under this policy, we believe that these decisions require centralized coordination to assure uniform implementation.

DISTRIBUTION

The Policy Statement has been distributed in the form of a press release dated October 13, 1981. The Enforcement Policy, however, is primarily an examination instruction document and should be made available to the public only upon request. It will not be issued as a press release.

The copy attached to this letter reflects some changes made to the document sent to you earlier to reflect its character as a System document. It is this version that is to be distributed upon request. A camera ready copy will be sent to you under separate cover.

Both the Policy Statement and the Enforcement Policy will be incorporated in the FRS Administrative Manual and Compliance Handbook, as soon as possible.

EFFECTIVE DATE

The policy became effective upon adoption, October 7, 1981. Therefore, corrective action is required when any examination conducted as of that date, or afterward, reveals covered violations.

Monitoring Program - We would like to maintain records regarding the implementation of this policy along the same lines as the current Regulation Z Enforcement Policy. Until we can complete the data processing steps to do

this, please fill out the attached form (ATTACHMENT B) for each bank for which covered violations were discovered and forward them to this Division with the relevant report of examination.

If you have any questions, please contact the Compliance Section at (202) 452-3946. Your cooperation is appreciated.

Sincerely, .

A handwritten signature in cursive script, appearing to read "Glenn E. Loney".

Glenn E. Loney
Assistant Director

Enclosure

Supervisory Enforcement Policy for the
Equal Credit Opportunity Act and the Fair Housing Act

PART I

This document supplements and expands upon the Equal Credit Opportunity and Fair Housing Acts (the "Acts") Enforcement Policy Statement recommended by the Federal Financial Institutions Examination Council (F.F.I.E.C.) on August 10, 1981 and adopted by the Board of Governors of the Federal Reserve System.

The Policy Statement was issued by the Federal Reserve Board to the institutions they supervise to remind them of the seriousness of certain violations of the Acts and to inform them that such violations will be dealt with by the agencies retrospectively as well as prospectively. The purpose of this document is to give Reserve Bank staff guidance by describing various actions for correcting the following substantive violations:

- o discouraging applicants on a prohibited basis;
- o using credit criteria in a discriminatory manner in evaluating applications;
- o imposing different terms on a prohibited basis;
- o requiring cosigners, guarantors and the like, on a prohibited basis;
- o failure to maintain and furnish separate credit histories;
- o failure to provide proper adverse action notification.

Those actions described in Part II of this document should be used, as appropriate, to correct the conditions caused by the violation. However, if different corrective action is believed to be more appropriate, this policy does not preclude the Federal Reserve System's discretion to use it.

This policy provides guidance for correcting both the conditions and practices resulting from violations of the Acts. When violations of the Acts addressed by the policy statement are discovered, the institution should be required to adopt a written compliance program to ensure that such violations will not recur. The program normally should include employee training in the requirements of the Acts and establishment of an internal controls program. The institution optionally may be required to include a written loan policy or written appraisal standards in the compliance program should the violations of the Acts so warrant.

Part III of this document contains three examples of how this policy might be implemented.

Part II

1. Discouraging Applicants on a Prohibited Basis in Violation of the Fair Housing Act, or § 202.4 or 202.5(a) of Regulation B.

When this violation is discovered the institution should be directed to adopt, in consultation with the Reserve Bank, a program to reverse and overcome the effects of those practices by the institution which have limited participation in its credit programs by the discouraged group. Each program should normally be tailor-made and should be designed to increase applications from the discouraged group.

The program should include an in-house training program and such marketing techniques as are necessary to encourage or solicit applications from the discouraged groups. Among the techniques which have proven successful are: advertising in appropriate media, particularly through the depiction of members of the discouraged group as successful applicants; establishing new business relationships with real estate brokers, automobile dealers, or other

arrangers of credit who generally service the discouraged group; direct mailings to members of disfavored classes; contacts with representative community groups; hiring members of the discouraged groups to be employed in the credit evaluating process; and sponsoring of credit education programs.

If specific individuals have been identified who have been discouraged on a prohibited basis from applying for credit, the institution should be required to send to all such discouraged applicants a notice which contains:

- (a) the solicitation of an (new) application; and,
- (b) a disclosure that the applicant has 60 days in which to (re)apply.

2. Using Credit Criteria in a Discriminatory Manner in Evaluating Applications in Violation of the Fair Housing Act or Sections 202.4 through 202.7 of Regulation B.

When this violation is discovered the institution should be required to identify all applicants affected by the discriminatory standard(s) within the 24 month period prior to discovery of the violation and send to them a notice that includes:

- (a) the solicitation of a new application by the institution;
- (b) a disclosure that the applicant has 60 days in which to reapply; and
- (c) a description of the conditions under which any refund or reimbursement will be made.

In addition to the above customer notification requirements, the institution should be instructed to notify any party it previously informed of the rejection and inform that party to correct the applicant's credit history by deleting the previously reported rejection.

The institution should be required to offer to refund any fees or costs associated with submitting or processing the original application in the notice. This refund offer should include, at a minimum, application, appraisal, prepaid, and credit check fees. Upon re-application, the institution should not be allowed to require applicants to pay fees or costs associated with submitting or processing the new application. Such fees may be charged, however, if the application is approved. The sum of those fees must be the lesser of the total currently being charged or the total in effect at the time of original application.

In evaluating borrowers' applications, the institution should be directed to use the creditworthiness standards in effect at the time of the original applications, absent any discriminatory elements, or those currently in effect, whichever are more favorable to an applicant. If the new applications are approved and *are* for credit other than open-end, the terms offered will be those currently in effect or those in effect at the time of the original applications, whichever the agency deems most appropriate.

If applicants reapply and new applications are approved, but the applicants have obtained alternative credit in lieu of the credit denied on a prohibited basis, consideration should be given to requiring the creditor to refund fees and costs required by subsequent creditors to pay off the alternative credits. As in the case of applicants who have not obtained alternative credit, the costs for submitting and processing new approved applications should be the lesser of the total currently being charged by the institution or the total in effect at the time of the original applications.

The institution should be allowed to terminate the reapplication offer if it does not receive a reapplication within 60 days.

3. Imposing More Onerous Terms on a Prohibited Basis in Violation of the Fair Housing Act or Section 202.4 or 202.6(b) of Regulation B.

When this violation is discovered the institution should be required to identify all such loans and notify consumers within 60 days of the corrective action. The institution should be required to offer to substitute non-discriminatory terms for any terms illegally required and reimburse applicants for any money illegally required.

Where the institution has improperly imposed a higher annual percentage rate, higher finance charges, insurance, or other loan fees such as points on a real estate loans, the institution should be instructed to reimburse to consumers the money illegally required.

Where the institution has imposed other more onerous terms, such as requiring higher downpayments, shorter maturities, or more strict collateral requirements, it should be instructed to offer to change the account from the terms illegally required to the terms for which applicants should have qualified. The institution should be instructed that no fees for processing such changes may be assessed, and that the offers must state that fact.

The method for reimbursement to applicants should be the lump sum or the lump sum/payment reduction method, at the institution's option. In the case of a loan which is in default status, the institution should be instructed to reduce the balance of the loan with any monies illegally required.

4. Requiring Cosigners on a Prohibited Basis in Violation of Section 202.7(d) of Regulation B.

When this violation is discovered the institution should be instructed to identify all affected applicants and release additional parties where appropriate.

The institution should be instructed to absorb any cost associated with the illegal requirements, such as recording or filing fees, or fees for consumer reports, imposed on applicants by the institution or by any third party in connection with the illegal requirement.

If an applicant was individually creditworthy but a cosigner, guarantor, or other additional party was required in violation of the Act, the institution should be directed to notify all parties that the additional party will be released unless other instructions *are* received within 30 days from the parties to the debt. The notice of release should be sent to all contractually liable parties.

If an additional party was necessary to support the extension of credit requested, but the institution restricted the applicant's choice of parties on a prohibited basis, the institution should be directed to include in the notice sent to all parties that the applicant may substitute a creditworthy party to provide the necessary support to maintain the extension of credit. The notice should also state that the additional party originally required will be informed of the effective date of the release, provided a suitable substitute is found. The institution should be instructed to allow the offer to accept another party on the obligation to remain in effect for at least 60 days after notification to the applicant.

If an applicant was individually creditworthy but was rejected because of inability or unwillingness to furnish a cosigner, guarantor, or other additional party required by the institution in violation of the Act, the appropriate remedy is provided in No. 2 above.

If an additional party was necessary to support the extension of credit requested and the applicant offered a financially responsible party but was

rejected because of inability or unwillingness to furnish an alternative party or a particular additional party specified by the institution in violation of the Act, the appropriate remedy is also provided in No. 2 above.

If any changes to the account are made regarding the cosigner, guarantor, or other additional parties, the institution should be directed to report the changes to the appropriate consumer reporting agency.

5. Failing to Furnish Separate Credit Histories for Married Persons in Violation of Section 202.10 of Regulation B.

When this violation is discovered the institution should be instructed to identify all affected applicants and take the following corrective actions as appropriate within 30 days: 1) designate joint accounts to reflect the participation of both spouses and comply with the requirements of section 202.10(a)(2) and (3), 2) notify consumer reporting agencies to which it has improperly or incorrectly furnished credit information of the separate credit histories and request them to amend their records to reflect such histories properly and 3) notify the account holder that this information was not reported correctly, that it may have been the cause of a credit denial from other creditors, and that if credit was denied on the basis of an insufficient or nonexistent credit history or credit file, the applicant may want to reapply.

If the institution has failed to obtain sufficient information for accounts held by married persons, the institution should be directed to request the necessary information it lacks within 30 days. Upon receipt of the information the institution should be instructed to take the reporting and notification actions specified in the preceding paragraph.

6. Failing to Provide Notices of Adverse Action in Violation of Section 202.9 of Regulation B.

If the institution has failed to send notices of adverse action to applicants against whom adverse action has been taken, the institution should be directed to identify such applicants and send adequate adverse action notices.

If the institution has failed to provide an adequate notice of adverse action or has failed to provide an accurate statement of the reasons for denial to applicants against whom adverse action has been taken, the institution should be directed to send an adequate adverse action notice to all affected applicants.

The corrective action time period for violations of this section is six months prior to the discovery of the violation.

PART III

The following are case studies that illustrate the application of the foregoing corrective actions to specific situations.

Case I:

The examination revealed that some, but not all, loans to minority groups were made with more onerous terms than the creditor's average loan for any given time period. These applications were submitted to the loan committee with a stated rate 1/4 point above those for non-minorities. In five cases, the applications involved an extra point, upon the recommendation of the loan officer. These loans were traced to two of the creditor's 12 loan officers. Both worked in the same branch office. The examiner reported that the creditor received few applications from minorities living in the area served by the branch.

1. To prevent recurrence of the violation , the creditor was required to:

Sign a written agreement which described the violations and specified the corrective action the creditor would take.

Issue a memorandum to employees describing the problem and directing

that loan applications should be taken for the same terms, regardless of the identity of the applicant(s).

Revise the written underwriting standards to incorporate the instructions issued to employees.

The creditor was further required to conduct training for all loan officers to assure that they are familiar with the Acts and with the creditor's nondiscriminatory underwriting policies.

2. Because this practice, limited to one branch, may have presented a discriminatory impression to the area served by the branch, the creditor was also required to take the following actions to correct this perception:

Place advertisements, including the current terms at which credit is available, in local newspapers, especially any having circulation in the community served by the branch, which solicit applications for credit.

Inform real estate brokers who regularly deal with the adversely affected groups of the lender's credit and underwriting standards.

Conduct a credit education course in the community, to include information on how to qualify for credit and how to prepare a credit application.

3. To correct conditions caused by the violation, the creditor was required to:

Identify the individuals affected by this policy and advise them that their rates were adjusted.

Correct the loan contracts to eliminate the higher interest rate, with no charge to the borrowers for this action.

Reimburse the five individuals for the extra point they had been charged and refund the overcharges resulting from the higher interest rate.

Case II:

The examination showed that the creditor required cosigners of all single applicants for car loans without regard to whether or not the individual met the creditor's credit standards without the cosigner. The creditor's written instruction to loan officers did not mention cosigners or the circumstances in which one would be required.

1. To prevent recurrence of the violation the lender was required to:

Sign a written agreement which described the violation and the corrective action the lender would take.

Circulate a memorandum to all employees advising them of the revised procedure.

Amend the written procedures to provide instructions on how single applicants are to be evaluated and when cosigners should be requested, consistent with the Acts.

Conduct a half-day staff meeting with all loan processors to discuss evaluation of applications under the Acts and how the new procedures apply.

2. To notify the public of the current nondiscriminatory practices, the creditor was required to:

Direct several advertisements toward single individuals with the message that they can qualify for credit without a cosigner.

3. To correct the conditions caused by the violation, the creditor was required to:

Remove any illegally required cosigner, or, if a cosigner was needed, offer to allow the borrower to substitute a qualified cosigner of his or her choice.

Case III :

The examiner reported that the creditor converted all applications for Charge Card to the name of the male applicant and filed and reported the credit history under his name only . Women had to request their credit history under the male co-owner's name.

1. The creditor was required to take the following action to prevent the violation from recurring:

Sign a written agreement which identified the violation and specified the corrective action the creditor will take.

Revise all instructions to employees correcting the procedures for reviewing, recording and reporting credit.

Develop new written procedures for processing credit applications.

2. To correct the conditions caused by the practice , the lender was required to:

Identify all affected individuals and notify them of the changes which would be made to their accounts to correct the violation, including an offer to change the names in which the account was held .

Notify consumer reporting services, to which the lender had reported the credit, of the changes, requesting them to correct the credit history.

3. To assure compliance, a special limited examination was scheduled to be conducted after six months to review the creditor's progress under **the** corrective action agreement.

DSBB #	Name of Bank	Examina
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For each violation indicate the following:

Cite:

Number Found:

Description:

Cause:

Describe the corrective action, prospective and retroactive, required and the date which it is expected to be completed: