



October 8, 1997

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RE: Special Purpose Credit Programs

Dear []:

This responds to your July 11, 1997 letter in which you asked the Office of Thrift Supervision ("OTS") to treat a small business lending program [] (the "Association") is developing as a "special purpose credit program" and to authorize the Association to inquire as to the race, nationality, sex, and handicapped status of the principals of its small business loan applicants.

In brief, while we do not give prior approval or disapproval of proposed special purpose credit programs, we do provide guidance on how the Association may develop its program in conformity with applicable statutory and regulatory requirements. We have set forth our guidance below.

I. Background

Your letter explains the Association's laudable goal of designing a program involving the development of underwriting standards for small business lending to assist the Association in meeting the credit needs of underserved markets. You indicate that the program ultimately will be targeted toward making [] of the Association's small business loans to minority and disabled-owned businesses but "will not specifically favor or grant special dispensation to minorities, women or the disabled." You point out that the Association's proposed collection of data on the race, nationality, sex, and handicapped status of the principals of its small business loan applicants would enable the Association to determine the number and dollar volume of

small business loans that it originates to businesses owned by persons with certain common characteristics. You further explain that the Association is in the process of establishing its first set of underwriting standards for small business lending and thus, has no past record of its own to draw upon as to the operation of such standards.

II. Discussion

As your letter notes, Federal Reserve Board (“FRB”) Regulation B,¹ implements the Equal Credit Opportunity Act (“ECOA”).² Regulation B generally prohibits a creditor from inquiring about the race, color, religion, or national origin of an applicant or any other person in connection with a credit transaction, or inquiring about the sex of an applicant.³ Regulation B provides certain exceptions, however, including one for certain special purpose credit programs.⁴ One category of special purpose credit program is:

Any special purpose credit program offered by a for-profit organization or in which such an organization participates to meet special social needs, if:

(i) The program is established and administered pursuant to a written plan that identifies the class of persons that the program is designed to benefit and sets forth the procedures and standards for extending credit pursuant to the program; and

(ii) The program is established and administered to extend credit to a class of persons who, under the organization’s customary standards of credit worthiness, probably would not receive such credit or would receive it on less favorable terms than are ordinarily available to other applicants applying to the organization for a similar type and amount of credit.

12 C.F.R. § 202.8(a)(3) (1997).

¹ 12 C.F.R. Part 202 (1997).

² 15 U.S.C. §§ 1691-1691f.

³ 12 C.F.R. § 202.5(d)(3) and (5) (1997).

⁴ 12 C.F.R. §§ 202.5(b)(3) and 202.8 (1997).

It is OTS's policy and practice not to determine whether an individual proposed program qualifies as a special purpose credit program under Regulation B. The FRB follows the same policy.⁵ It follows that an association may initiate a special purpose credit program without the prior approval of the OTS or the FRB.

We are happy to provide general guidance on establishing such a program. You point out that your program would not provide "special dispensation to minorities, women or the disabled." We note that Regulation B provides that a program must meet "special social needs" to qualify under 12 C.F.R. § 202.8(a)(3). While Regulation B envisions that some programs will be limited by race, national origin, sex, or another characteristic that would otherwise be expressly prohibited from operating as an eligibility criterion, it clearly contemplates that other special purpose credit programs will not be limited in this way.⁶ Where one or more characteristics such as race, national origin, or sex are used to determine eligibility, the creditor may ask about the applicable characteristics. But where a special purpose credit program is not limited by race, national origin, or sex, no inquiry into these characteristics is permitted.

We also note that nothing in Regulation B appears to preclude a program from qualifying as a special purpose credit program merely because the program involves a type of lending that the institution has not previously offered. Regulation B requires that the program be established and administered pursuant to a written plan as described in 12 C.F.R. § 202.8(a)(3)(i), and that the program be established and administered to extend credit to persons who probably would otherwise be denied credit or receive it on less favorable terms.⁷ This does not mean, however, that unless an institution has previously applied underwriting criteria that operated to disadvantage persons with a common characteristic, it may not establish a special purpose credit program. The FRB's commentary on Regulation B clearly contemplates that a special purpose credit program may be established even where the institution lacks experience of its own in the type of lending to be covered by the program. The commentary states:

⁵ See 12 C.F.R. Part 202, Supp. I at 60 (1997) ("The Board does not determine whether individual programs qualify for special purpose credit status, or whether a particular program benefits an 'economically disadvantaged class of persons.' The agency or creditor administering or offering the loan program must make these decisions regarding the status of its program.").

⁶ See 12 C.F.R. § 202.8(c) (1997).

⁷ 12 C.F.R. § 202.8(a)(3)(ii) (1997) and 12 C.F.R. Part 202, Supp. I at 60 (1997).

5. *Determining need.* In designing a special-purpose program under § 202.8(a), a for-profit organization must determine that the program will benefit a class of people who would otherwise be denied credit or would receive it on less favorable terms. This determination can be based on a broad analysis using the organization's own research or data from outside sources including governmental reports and studies. For example, a bank could review Home Mortgage Disclosure Act data along with demographic data for its assessment area and conclude that there is a need for a special-purpose credit program for low-income minority borrowers.

12 C.F.R. Part 202, Supp. I at 60 (1997) (emphasis added).

An institution that has not previously engaged in the type of lending to be covered by a special purpose credit program could substantiate the need for the program with data from outside sources. In the case of small business lending, the Small Business Administration may be one possible source of such information on particular locales.

Regulation B also does not specify any minimum size for a program to qualify as a special purpose credit program. For example, Regulation B appears to allow pilot programs involving a limited dollar volume and/or number of loans to qualify as special purpose credit programs if the requirements of 12 C.F.R. § 202.8 (1997) are satisfied. Nor does Regulation B prohibit an institution from including in its written plan for the program procedures and standards that are flexible and readily changed as additional data and experience is obtained on the operation of the program. Thus, Regulation B does not appear to preclude a limited pilot program with procedures and standards that can evolve over time and that can include race, sex, or national origin if those characteristics are part of the program eligibility requirements.

Finally, with regard to inquiries concerning the handicapped status of principals, we note that ECOA does not prohibit discrimination based on handicap. However, such discrimination is prohibited by the Americans with Disabilities Act of 1990 ("ADA").⁸ Since the Department of Justice is the agency responsible for interpreting

⁸ 42 U.S.C. § 12101 et seq.

and enforcing the applicable provisions of the ADA,⁹ you may wish to consult that agency to see if it has any concerns regarding such inquiries.

We hope that this information will be of assistance to you. We look forward to working with you as you develop your approach to small business lending. If you have any questions regarding this matter, please feel free to contact Richard Bennett, Counsel (Banking and Finance), at (202) 906-7409 or Tim Burniston, Director, Compliance Policy, at (202) 906-5629.

Very truly yours,

/s/

Carolyn J. Buck
Chief Counsel

cc: Nicolas P. Retsinas

⁹ 42 U.S.C. §§ 12186(b) and 12188(b).