

The language of B2B credit: Understanding ECOA and FCRA regulations

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In business credit, a single word can carry a lot of weight. Wording in a contractual agreement, for instance, can mean the difference between getting paid and absorbing a loss. Even something as simple as a misspelling of a legal entity name can complicate the protection of a creditor.

When credit is denied, the phrasing matters just as much. For this, credit professionals must adhere to specific standards set by federal regulations when an adverse action is taken. Otherwise, they risk complicating their customer relationships and exposing their companies to potential legal and regulatory consequences.

Understanding ECOA and Regulation B

Since 1974, credit professionals have been required to abide by the Equal Credit Opportunity Act (ECOA), which has protected both individuals and small businesses from discrimination based on race, color, religion, national origin, sex, marital status, age, consumer rights under certain consumer protection laws and public assistance, including benefits like Social Security, Disability Insurance and the Supplemental Nutrition Assistance Program.

The ECOA is implemented by Regulation B, a federal rule that pertains to extensions of credit primarily for business or commercial purposes except for public utilities, securities and government credit. Issued by the Consumer Financial Protection Bureau (CFPB), Regulation B prohibits lenders from discriminating against credit applicants.

Language becomes important when following these regulations because the ECOA provides detailed guidelines and clarifications on how the term “creditor” should be interpreted and applied in various contexts. Moreover, Regulation B expanded the definition of “applicant” in 2022 to “express more succinctly the fact that the term includes both a person who requests credit and a debtor.”

Understanding FCRA

The Fair Credit Reporting Act (FCRA) is a federal statute that governs obtaining and using a consumer credit report. Where it gets complicated for some creditors is that under the FCRA, “consumer” is defined as “an individual.” “This very broad definition mandates that credit professionals must obey the FCRA anytime they wish to obtain or use a consumer credit report regarding an individual,” said Wanda Borges, Esq., member of Borges and Associates (Syosset, NY). “That individual may be a personal guarantor, the owner of a small business or a sole proprietor.”

Under the FCRA, a “Consumer Report” is “any written, oral or other communication of any information by a consumer reporting agency bearing on a consumer’s credit worthiness serving as a factor in establishing the consumer’s eligibility for:

- credit or insurance to be used primarily for personal, family or household purposes,

- employment purposes or
- any other purpose authorized under section 1681b of this title.”

Creditors are also required to provide a “Permissible Purpose” for obtaining or using the credit report. The ones most applicable according to the FCRA are:

- in response to the order of a court having jurisdiction to issue such an order, or a subpoena issued in connection with proceedings before a Federal grand jury,
- in accordance with the written instructions or permission of the consumer to whom it relates or
- in connection with a legitimate business need for the information.

When regulations overlap

In business-to-business credit management, the ECOA and FCRA overlap in several instances. For one, the FCRA takes its definition of “consumer” from the ECOA. “The most recent amendments to the Dodd-Frank Act require creditors who use credit scores to provide specific information to the credit applicant regarding those credit scores,” said Borges. “One of the most important opinions for credit professionals from the CFPB is this: Extending credit to an individual, a sole proprietor or a personal guarantor is a Permissible Purpose under the FCRA for obtaining and using a consumer credit report. In contrast, obtaining and using a consumer credit report on an individual who is merely an owner of a corporation or limited liability company is not a Permissible Purpose under the FCRA.”

Practical advice for compliance

When taking adverse action, creditors should provide the applicant with the requisite ECOA Notice, which is advised to be included in the credit application. As an example, it can read:

“The Federal Equal Credit Opportunity Act 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. The Federal agency that administers compliance with this law concerning this creditor is Federal Trade Commission, Consumer Response Center, 600 Pennsylvania Avenue NW, Washington, DC 20580.”

It’s important to notify the applicant within a reasonable time, verbally or in writing, that credit has been denied, terminated or reduced and to inform the applicant that they have the right to know the reasons for credit denial. Additionally, the credit application should stipulate that the undersigned is either a sole proprietor, a partner in a partnership, an individual who may be executing a personal guarantee in connection with the extension of credit to the applicant, or one of the principal stockholders of a corporation. In it, the applicant would grant permission to [the creditor] to obtain and utilize an individual credit report on them personally to determine their creditworthiness.

The bottom line: Credit professionals reserve the right to deny credit so long as they remain adherent to federal regulations. In accordance with the ECOA and FCRA, they are to be mindful of the words they use and how they use them when declining to extend credit.