Meeting the Equal Credit Opportunity Act's Specificity Requirement: Judgmental and Statistical Scoring Systems

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MEETING THE EQUAL CREDIT OPPORTUNITY ACT’S SPECIFICITY REQUIREMENT: JUDGMENTAL AND STATISTICAL SCORING SYSTEMS

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INTRODUCTION

Consumer credit has become an accepted fact of American life. It continues to grow at a phenomenal rate as more and more buyers seek to improve their standard of living by utilizing various financing arrangements. Virtually all home purchases involve some form of mortgage agreement and approximately two-thirds of all consumer automobile purchases are made on an installment payment basis. In addition, many large department stores report that at least half of their business depends on their closed-end credit plans. Total installment credit has risen 68% in the last five years, with consumer installment debt rising by a record $44 billion in 1978.

Americans who are constantly encouraged to become more dependent on credit need to be reminded that credit is available to them as a privilege, not as a legal right. Everyone who wants or needs credit cannot obtain it; each creditor devises its own method of separating those who will receive credit from those who will...
not. The decision to grant or deny credit is usually based on an evaluation of the applicant's creditworthiness, a process which generally involves evaluating a person's ability and willingness to repay the creditor.

Prior to 1974 there was virtually no federal regulation of the credit evaluation process. Most creditors looked to the proverbial "three C's" of credit—capacity, character, and collateral—for guidance in screening applicants. However, use of this selection criteria precipitated the complaint that female applicants were being denied credit because of their sex or marital status rather than because they failed to meet the "three C's" standard. The problems created by denying credit to women for reasons other than their individual creditworthiness were formally brought to the attention of Congress by women's groups and by a report from the National Commission on Consumer Finance. Congressional hearings fur-

4. Whether credit remains a "privilege" rather than a "right" is debatable. Most people view credit as a privilege for the deserving. However, recent laws greatly curtail a creditor's freedom to determine to whom this privilege will be extended. See National Comm'on on Consumer Finance, Consumer Credit in the United States 151 (1972) [hereinafter cited as National Comm'on on Consumer Finance].

5. The "Three C's of Credit" have been defined in the following manner: "Capacity reflects an individual's earning power and provides a measure of his ability to repay. Collateral is some form of tangible asset owned by the individual which is offered for security against the loan. Character... refers to the person's moral qualities, particularly the individual's ethical resolve to repay the loan." Churchill, Nevin & Watson, Credit Scoring: Why and How, The Credit World, March 1977, at 3 [hereinafter cited as Credit Scoring: Why and How].

6. The following women's groups were instrumental in directing Congressional attention to credit discrimination against women: Women in Equity Action League (WEAL); Center for Women Policy Studies; [National Women's Lobby] National Organization for Women (NOW); American Association of University Women (AAUW); National Council of Jewish Women; National Federation of Business and Professional Women's Clubs; League of Women Voters; and the Washington Council of Women Businesswomen. According to one Congressman: "Without the input of women activists pushing for credit reform, there would be no Equal Credit Opportunity Act." Gelb & Pally, Women and Interest Group Politics, A Case Study of the Equal Credit Opportunity Act, 5 Am. Pol. Q. 331, 335 (1977) [hereinafter cited as Women and Interest Group Politics].

7. The National Commission on Consumer Finance highlighted these problems in its 1972 report to the President and Congress. It identified the following as among the major problems faced by women seeking credit:

1) Single women have more trouble obtaining credit than single men.

2) Creditors generally require a woman upon marriage to reapply for credit, usually in her husband's name. Similar reapplication is not asked of men when they marry.

3) Creditors are often unwilling to extend credit to a married woman in her own name.
ther explored these problems and substantiated the need for immediate legislative action to correct them. Recognizing this need, Congress concluded that this legislation was necessary "to insure that the various financial institutions and other firms engaged in the extensions of credit exercise their responsibility to make credit available with fairness, impartiality, and without discrimination on the basis of sex or marital status." Accordingly, on October 28, 1974 Congress passed the Equal Credit Opportunity Act (ECOA) affirmatively requiring that "financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers without regard to sex or marital status." The ECOA was viewed as the first major step toward the elimination of discrimination problems unique to female credit applicants. Congress perceived the law as a mandate to creditors to objectively exercise their discretionary credit-granting powers, disregarding sex and marital status.

Congress soon recognized that the problem of discrimination resulting from the consideration of factors other than individual creditworthiness was not unique to women. After thorough inves-

4) Creditors are often unwilling to count the wife's income when a married couple applies for credit.

5) Women who are divorced or widowed have trouble reestablishing credit. Women who are separated have a particularly difficult time, since accounts may still be in the husband's name.

National Comm'n on Consumer Finance, supra note 4, at 152-53.


12. As originally proposed, the ECOA prohibited discrimination on the basis of race, color, religion, national origin, and age, as well as sex and marital status. However, the Equal Credit Opportunity Act of 1974 was limited to discrimination based on sex or marital status because (1) the classifications other than sex and marital status could not be carefully studied before the close of the 93rd Congress, and (2) they raised different questions which
tigation, the ECOA was amended in 1976\textsuperscript{13} to expand its coverage and prohibit discrimination in the granting of credit based on consideration of race, color, religion, national origin, age, receipt of public assistance income, or the exercise in good faith of the rights guaranteed under the Consumer Credit Protection Act.\textsuperscript{14} This expansion was believed necessary to protect others from the same subjective denials of credit that women had experienced prior to the passage of the 1974 Act; specifically, denials based on reasons other than the applicant’s ability and willingness to repay.\textsuperscript{15}

The ECOA has a broad scope as indicated by its applicability to “any aspect of a credit transaction.”\textsuperscript{16} The Federal Reserve Board has the responsibility of establishing implementation guidelines and otherwise ensuring creditor compliance with the Act.\textsuperscript{17} They have responded with Regulation B\textsuperscript{18} which contains both pre-application and post-application guidelines; its provisions can be reduced to five basic components. The first component prohib-
its creditors from discouraging applicants for reasons that are discriminatory under the ECOA. For example, creditors are generally prohibited from making any inquiries regarding the applicant's childbearing and birth control intentions or capabilities, or from discouraging pregnant applicants. This prohibition effectively thwarts pre-Regulation B application requirements such as the infamous "baby letter." The first component of Regulation B also limits inquiries about the applicant's marital status. Unless a resident of a community property state or dependent on property located in such a state, an applicant applying for individual, unsecured credit cannot be asked questions concerning marital status. Similarly, a creditor is denied access to information concerning an applicant's spouse if the applicant does not intend that the spouse will use the contemplated account, be contractually liable for it, or repay the loan with personal income. This provision allows an individually creditworthy, married, female applicant to receive credit independently of her spouse, an uncommon occurrence before Regulation B. The second component of Regulation B concerns post-application evaluation restrictions. It prohibits creditors from considering the likelihood that female applicants will have children and leave the labor market permanently. Also, while allowing creditors to consider age and source of income, Regulation

21. The "baby letter" is a physician's statement which discloses the birth control method practiced by a couple or states that the couple is unable to have children. One Washington, D.C. mortgage lending company required a couple to submit not only the standard physician's statement on birth control, but also affidavits signed by both the husband and wife in which they each agreed to abortion and/or vasectomy should their method of birth control fail. Joint Economic Comm. Hearings, supra note 8, at 548-49.
22. Community property states have special laws concerning married persons' property ownership rights. The complexity of these ownership rights and their effect on a creditor's accessibility to assets in the event of default necessitates the community property exception. The eight community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington.
24. See id. at § 202.7(d)(1).
25. Before Regulation B, most married women were granted credit only after their husbands' creditworthiness was considered. This often resulted in credit denial to married women with sufficient income whenever their husbands were unemployed or otherwise without a reliable income source. See generally 119 Cong. Rec. 24061 (1973) (remarks of Sen. Brock).
B forbids disqualifying or penalizing an applicant because of age\textsuperscript{27} or because income is derived from annuity, pension, retirement benefits or public assistance.\textsuperscript{28} Although the creditor cannot arbitrarily deny credit because the applicant's income is derived from one or more of these sources, he may consider the probability that such payments will continue.\textsuperscript{29} Third, the regulation mandates that creditors assess the applicant's \textit{individual} characteristics in determining his creditworthiness.\textsuperscript{30} If the applicant is deemed individually creditworthy, he cannot be denied an account for any of the prohibited reasons,\textsuperscript{31} nor can he be required to have a co-signor or guarantor.\textsuperscript{32} Fourth, Regulation B refers to the notification process, and requires that when a creditor denies a loan or otherwise takes adverse action,\textsuperscript{33} he must inform the applicant of this decision, send an ECOA notice,\textsuperscript{34} and state specific reasons for the denial.\textsuperscript{35}

\begin{enumerate}
\item \textsuperscript{27} \textit{Id.} at § 202.6(b)(2). \textit{See generally} notes 68-73 \textit{infra} and accompanying text.
\item \textsuperscript{28} \textit{Id.} at § 202.6(b)(2)(5).
\item \textsuperscript{29} \textit{Id.}
\item \textsuperscript{30} \textit{Id.} at § 202.7.
\item \textsuperscript{31} \textit{Id.} at § 202.7(a).
\item \textsuperscript{32} \textit{Id.} at § 202.7(d)(1). This rule, however, has exceptions. For example, a creditor may require the signature of a co-owner of property if such property is used to support the loan application. Additionally, in a community property state, unless both spouses have equal management and control over the community assets, or the applicant alone has enough separate, non-community property to support the loan's repayment, both spouses can be required to sign the loan agreement. \textit{Id.} at § 202.7(d)(2), (3), and (4). If the applicant is not creditworthy, the creditor clearly may require a co-signer, but he cannot require that the co-signer be the applicant's spouse. \textit{Id.} at § 202.7(d)(5).
\item \textsuperscript{33} Adverse action is defined as (1) a refusal to grant credit in substantially the amount or on substantially the terms requested by an applicant unless the creditor offers to grant credit other than in substantially the amount or on substantially the terms requested by the applicant, and the applicant uses or expressly accepts the credit offered; (2) a termination of an account or an unfavorable change in terms of an account that does not affect all or a substantial portion of a classification of a creditor's accounts; or (3) a refusal to increase the amount of credit available to an applicant when the applicant requests an increase in accordance with procedures established by the creditor for the type of credit involved. \textit{Id.} at § 202.2(c)(1).
\item \textsuperscript{34} Regulation B contains the following sample ECOA notice:

\begin{quote}
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, or age (provided that 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 exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is (name and address as specified by the appropriate agency listed in Appendix A of Regulation B).
\end{quote}
\end{enumerate}
Finally, the regulation addresses record retention, penalties and liabilities under the Act, the ECOA's relationship to state law, and enforcement provisions. Creditors are required to retain all records pertinent to an application for 25 months. Generally, where state law conflicts with the ECOA or Regulation B on recordkeeping or any other area, the federal law will prevail unless the state law is more favorable to the consumer. The intent is to provide consumers with the maximum protection. This is further illustrated by the liberal damages provision of Regulation B, under which an aggrieved applicant may sue for punitive damages of up to $10,000 in an individual suit and may, in a class action suit, sue for the lesser of $500,000 or one percent of the creditor's net worth. Enforcement of these provisions is primarily vested in the Federal Trade Commission. Additionally, the Attorney General is

Id. at § 202.9(b)(1).
35. Id. at § 202.9(b)(2).
36. Id. at § 202.12(b)(1).
37. Regulation B sets forth five instances in which the federal act would prevail over an inconsistent state law. They include instances where state law:
   (i) requires or permits a practice or act prohibited by the act or its Regulations;
   (ii) prohibits the individual extension of consumer credit to both parties to a marriage if each spouse individually and voluntarily applies for such credit;
   (iii) prohibits inquiries or collection of data required by the ECOA or its Regulations;
   (iv) prohibits asking age or considering age in a demonstrably and statistically sound, empirically derived credit system to determine a pertinent element of creditworthiness, or to favor an elderly applicant; or
   (v) prohibits inquiries necessary to establish or administer a special purpose credit program as defined in Regulation B, § 202.8.

Id. § 202.11(b)(1).
39. While the Federal Trade Commission is responsible for the general enforcement of the ECOA, other federal agencies and the Attorney General can enforce Regulation B in certain situations. These other agencies are: the Federal Deposit Insurance Corporation for banks that are not members of the Federal Reserve System; the Federal Home Loan Bank Board for FSLIC-insured savings institutions; the National Credit Union Association for federal credit unions; the Comptroller of Currency for national banks; the Federal Reserve Banks for state member banks; the Civil Aeronautics Board for creditors subject to the Board; the Interstate Commerce Commission for creditors subject to the Commission; the Small Business Administration for small business investment companies; the Packers and Stockyard Administration for creditors subject to the Packers and Stockyards Act; the Securities and Exchange Commission for brokers and dealers; and the Farm Credit Administration for federal land banks, federal land bank associations, federal intermediate credit banks and production credit associations. 15 U.S.C. § 1691(o) (Supp. V 1975). The Attorney
given enforcement authority so that its experience in other areas of discrimination can be utilized. 40

Many of the ECOA's general requirements are worthy of further discussion and analysis. This article, however, focuses on the requirement that creditors give rejected applicants "specific" reasons for credit denial, and examines the reasons given rejected applicants by creditors to determine whether these reasons substantively or technically violate the ECOA specificity requirement. 41

Before proceeding further, one point merits clarification: a finding that a reason is "specific" does not necessarily eliminate the possibility that discrimination has occurred. Conversely, failure to give a specific reason does not automatically prove discrimination. The utility of the statement of reason is that one may infer from the reason given, whether discrimination has occurred; the more specific the reason, the easier it is to make that determination. However, whether discrimination has actually occurred is not the question addressed in this article; rather, this article examines whether the creditors are giving specific reasons consistent with Congressional intent and, if they are not, whether they are capable of giving reasons which comport with Congressional policy objectives. The article will further examine whether the Federal Reserve Board's guidelines effectively implement these Congressional objectives and the major problems of compliance these regulations

40. According to the Senate Committee on Banking, Housing and Urban Affairs, the Attorney General is given enforcement authority because "that office's experience in the enforcement of other civil rights legislation can be effectively expanded and built on to achieve maximum compliance with the antidiscrimination policies on the Equal Credit Opportunity Act." S. Rep. No. 589, 94th Cong., 2d Sess. 13 (1976). On February 21, 1978, the Justice Department publicly announced the establishment of a special twelve attorney unit to investigate ECOA complaints and to take legal action against creditors who illegally discriminate in their lending practices. Letter from Walter Gorman, Justice Dep't, to author (Feb. 21, 1978).

41. References to the "specificity requirement" hereinafter mean the ECOA requirement that creditors give rejected applicants specific reasons for credit denial. "Statement of reasons requirement" and "specificity requirement" will be used interchangeably throughout this article.
have caused the various types of credit evaluation systems. Finally, in light of the problems presented, the practicality of revising the specificity requirement will be evaluated.

I. THE SPECIFICITY PROBLEM

The goal of insuring credit availability without discrimination is not easily achieved. Antidiscrimination legislation is of minimal benefit if those it is designed to protect do not know or cannot prove that they were discriminated against. The nation’s civil rights cases are replete with examples of the difficulties presented in detecting and establishing discrimination.42

Applicants denied credit prior to the passage of ECOA, even if they suspected discrimination, had little basis upon which to challenge the denial. The 1975 version of Regulation B attempted to remedy this situation by requiring that: “[A] creditor shall provide each applicant who is denied credit or whose account is terminated the reasons for such action, if the applicant so requests.”43 The Federal Reserve Board believed that this requirement would significantly aid in insuring private and administrative enforcement of the Act. Moreover, it was hoped that the statement of reasons “would greatly assist consumers in determining whether they have been discriminated against.”44 While this legislative effort helped protect consumers, the new requirement was nevertheless criticized by consumers because it did not go far enough to protect them. First, they noted that creditors were not required to inform applicants of their right to receive the “reasons,” and few creditors gratuitously provide this information. Second, consumers complained that the “reasons” when given were often ambiguous or inapplicable to a given applicant’s situation. For example, often the creditor would simply state that denial was based on the applicant’s failure to meet the creditor’s “internal policies.” Third, the vague reasons

42. See generally Comment, A Last Stand on Arlington Heights: Title VIII and the Requirement of Discriminatory Intent, 53 N.Y.U. L. Rev. 150 (1978); see also Comment, supra note 1, at 208-10. In comparing the ECOA with the Truth-in-Lending Act, the Senate Committee on Banking, Housing and Urban Affairs noted that “[d]iscriminatory practices, unlike violations of Truth-in-Lending, are not apparent from the face of particular documents or contracts.” S. Rep. No. 589, 94th Cong., 2d Sess. 14 (1976).


often left the rejected applicant not knowing how to meet the credit standards.\textsuperscript{45}

The 1976 congressional amendments to the ECOA addressed these consumer concerns with the following provision:

Each applicant against whom adverse action is taken shall be entitled to a statement of reasons for such action from the creditor. . . . A statement of reasons meets the requirement of this section only if it contains the specific reason for the adverse action taken.\textsuperscript{46}

For the first time, federal legislation afforded rejected credit applicants an automatic right to discover why adverse action was taken.\textsuperscript{47} A creditor satisfied this requirement by either automatically giving an applicant against whom adverse action was taken a statement of specific reasons, or by informing the applicant of his right to receive such a statement if a timely request is made.\textsuperscript{48} The Senate Committee on Banking, Housing and Urban Affairs considered the "specific reasons" requirement to be "among the most significant parts of the [amendment]"\textsuperscript{49} because it is "a strong and

\textsuperscript{45} Feminist groups were among those who felt that the provision requiring creditors to give reasons for denial needed strengthening. They were particularly concerned that creditors were not required to inform an applicant about the right to such a statement. These groups also anticipated an enforcement problem if creditors gave their statements orally. \textit{Women and Interest Group Politics}, supra note 6, at 348.


\textsuperscript{47} \textit{See supra} note 33, for the Regulation B definition of "adverse action."

\textsuperscript{48} If the creditor discloses in the written notice of adverse action that the applicant has a right to receive a statement of reasons, the applicant must also be informed that he will receive the reasons within 30 days after receipt by the creditor of a request made within 60 days of such notification. Additionally, the creditor must provide the name, address and telephone number of the person or office from which the reasons can be obtained. Oral statements of reasons may be given if the adverse action notification includes a disclosure of the applicant's right to have the oral statement of reasons confirmed in writing within 30 days after a written request for confirmation is received by the creditor. \textit{Equal Credit Opportunity Act Amendments of 1976}, 15 U.S.C. §§ 1691-1691(f) (1976).

\textsuperscript{49} S. Rep. No. 239, 94th Cong., 2d Sess. 7 (1976). The new specificity requirement's significance is best illustrated by comparing the "statement of reasons" in the original Regulation B to the statement required by the amended version. The original Regulation B required creditors to give a statement of reasons for denial only if the applicant so requested. Original Regulation B, 12 C.F.R. § 202.5(m)(2) (1975). Additionally, there was no express requirement that "specific" reasons be given. Thus, a creditor, while required to give reasons under limited circumstances, was not expressly required to give specific reasons for denial. The amendments to Regulation B, requiring that creditors automatically provide rejected credit applicants with statements of "specific reasons" explaining the denial, or notice of their right to receive the reasons, give more protection to the consumer.

The ECOA's legislative history does not explain why the word "specific" was added to
necessary adjunct to the antidiscrimination purpose of the legislation, for only if creditors know they must explain their decisions will they effectively be discouraged from discriminatory practices." Furthermore, in enacting this requirement Congress fulfilled a broader need: consumer education. Rejected credit applicants can learn where and how their credit status is deficient, instead of merely learning that they do not meet a particular creditor's standards. Knowing that the reason for the denial is their short residence in the area, or their recent change of employment, or their already over-extended financial situation not only allows credit applicants the opportunity to correct problems with their fiscal situation, but also affords them the opportunity to bring to the creditor's attention errors caused by misinformation or inadequate information. The creditor therefore is required to give the rejected applicant an accurate reason for denial and meaningful information to aid the applicant in becoming an acceptable credit risk. Previously used reasons such as failure to meet the creditor's "internal standards," or failure to achieve the "qualifying score" now expressly violate the specificity requirement.

The fundamental purpose of the specificity requirement, however, was not consumer education, but consumer protection from discrimination. By requiring the creditor to provide "specific reasons," Congress provided both a check on creditor discrimination and an evidentiary tool if creditors disregarded their mandate. In addition, the requirement benefits creditors by establishing a valuable communicative network and by improving relations between creditors and the public.

An understanding of the purposes underlying the promulgation of the specificity requirement does not necessarily lead to an understanding of what degree of specificity satisfies the ECOA. The Federal Reserve Board has the primary responsibility of determining the degree of specificity that suffices, and Congress has provided guidelines to aid the Board in their determination. The lawmakers felt that a statement of reasons in long, detailed, per-

the 1976 provision. Congress may have viewed the reason for its inclusion as obvious; it may be that the logical implication of including "specific" was to further describe and clarify the kinds of reasons which would satisfy the requirement.

51. Id.
52. 12 C.F.R. § 202.9(b)(2) (1980).
sonal letter form was unnecessary, and instead sanctioned a "checklist" format, with the proviso that the checklist give a concise indication of the application's deficiencies.\textsuperscript{53} Accordingly, the Federal Reserve Board prepared a sample checklist statement of reasons as a model for creditors to follow.\textsuperscript{54} If the Board's form is

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{53} S. Rep. No. 589, 94th Cong., 2d Sess. 8 (1976). The legislative history states that the Federal Reserve Board's regulations may suggest formats for the statements of reasons. During the ECOA hearings the Senate Banking, Housing and Urban Affairs Committee was presented with model letters by various witnesses. The Committee acknowledged the brevity of these letters but did not completely endorse any of them. \textit{Id.} at 8-10, \textit{reprinted in} [1976] \textit{U.S. Code Cong. & Ad. News} 410, 411.
\item \textsuperscript{54} Section 202.9(b)(2) of Regulation B contains the sample form and generally relates to the statement of specific reasons requirement. It provides a creditor with the option of formulating his or her own statement, or adopting, in whole or in part, the one prepared by the Board. The sample form provides as follows:

\textbf{PRINCIPAL REASON(S) FOR ADVERSE ACTION CONCERNING CREDIT:}
\begin{itemize}
\item [ ] Credit application incomplete
\item [ ] Insufficient credit references
\item [ ] Unable to verify credit references
\item [ ] Temporary or irregular employment
\item [ ] Unable to verify employment
\item [ ] Length of employment
\item [ ] Insufficient income
\item [ ] Excessive obligations
\item [ ] Unable to verify income
\item [ ] Inadequate collateral
\item [ ] We do not grant credit to any applicant on the terms and conditions you request
\item [ ] Too short a period of residence
\item [ ] Temporary residence
\item [ ] Unable to verify residence
\item [ ] No credit file
\item [ ] Insufficient credit file
\item [ ] Delinquent credit obligations
\item [ ] Garnishment, attachment, foreclosure, repossession, or suit
\item [ ] Bankruptcy
\item [ ] Other specify: ______
\end{itemize}

\textbf{DISCLOSURE OF USE OF INFORMATION OBTAINED FROM AN OUTSIDE SOURCE}
\begin{itemize}
\item [ ] Disclosure inapplicable
\item [ ] Information obtained in a report from a consumer reporting agency
\end{itemize}

\textbf{Name:}
\textbf{Address:}
\textbf{Telephone Number:}
\begin{itemize}
\item [ ] Information obtained from an outside source other than a consumer reporting agency. Under the Fair Credit Reporting Act, you have the right to make a written request, within 60 days of receipt of this notice, for disclosure of the nature of the adverse information.
\end{itemize}
\textbf{Creditor's name:}
\end{itemize}
\end{footnotesize}
properly used, a creditor is insulated from violation of the specificity requirement;55 if the creditor drafts his own form, he does so at the risk of violating Regulation B. Unfortunately, Regulation B does not provide a procedure which allows creditors to have their individual forms approved. Consequently, most creditors use the model form prepared by the Federal Reserve Board.56 However, consumers are often dissatisfied with the information they receive from the model form.57 Some applicants complain that the checklist format itself does not fulfill Congressional objectives because it fails to accurately inform them of the specific reasons for denial and because it fails to give them adequate information on credit standards so they may work toward meeting those standards.58 Additionally, others claim that some creditors substantively violate the ECOA by failing to give reasons consistent with those in the

Creditor's address: ____________________________________________________________

Creditor's telephone number: ________________________________________________

[Add ECOA Notice]


56. In the fall of 1977, the author made an informal survey of a cross section of judgmental creditors in the Madison, Wisconsin area, and almost all of those surveyed responded that they used the model form in giving reasons for denial. The ECOA Compliance Manuals prepared by the Credit Union National Association and the American Bankers Association recommend the model form. Conversations with representatives from both groups revealed that the overwhelming majority of banks and credit unions who use judgmental evaluation systems use the model form. Additionally, the author's survey of the F.T.C.'s ECOA complaint files and the Wisconsin's Office of Commissioner of Banking (OCB) consumer complaint files revealed that most judgmental creditors rely on the model form. See note 54 supra.

57. The data revealing this dissatisfaction was collected from Wisconsin's OCB consumer complaint files and the F.T.C.'s ECOA complaint files. In the fall of 1977, the author conducted a study on the consumer complaint handling process followed by the Wisconsin OCB. Eighteen complaints alleging credit discrimination based on sex or marital status and the adequacy of the complaint handling process were examined. A major aspect studied was whether creditors who denied credit gave specific reasons to the rejected applicants. More than half of the complaints received by the OCB from March 1, 1976 through February 28, 1977 questioned whether the creditor's reasons for denial sufficiently complied with the requirements of the ECOA.

In January 1978, the author visited the F.T.C. offices and reviewed its ECOA complaint files to determine the number of consumers who complained that the reasons they received for credit denial lacked specificity. A random sample was obtained from the 1,186 complaints received by the F.T.C. between March, 1977 and January, 1978. The complaints of approximately one-third of the sample related to reasons for denial. Of this one-third, approximately one-third related to whether specific reasons were being given. Thus, approximately one of every three complaints received by the F.T.C. relating to reasons for denial raised the specificity question.

58. See text accompanying notes 50-52 supra.
Board's checklist. Thus, some creditors are challenged for using the checklist format and others are challenged for failing to use it. The kind of challenge made primarily depends upon the type of credit evaluation system used by the creditors.

II. JUDGMENTAL & STATISTICAL SCORING SYSTEMS

Creditors use two types of evaluation systems in deciding whether to grant credit: the judgmental scoring system, and the statistical scoring system, both of which appraise each new applicant as a credit risk. In order to understand and appreciate the problems creditors face in complying with the ECOA specificity requirement, it is first important to understand how judgmental and statistical scoring systems operate.

Judgmental scoring, the older and more frequently used system,\(^5\) involves a subjective process whereby a credit manager looks at the applicant's personal characteristics and other information and evaluates the applicant's ability and willingness to repay. Typically, information such as home ownership, income, length of employment and credit references is relied upon. The credit manager evaluates the character, capacity and collateral of the applicant in light of the application information. Thereafter, the manager makes a professional judgment to grant or deny credit, relying in part on his past experiences as a credit risk evaluator.\(^6\) The following hypothetical indicates one possible application of the judgmental system. Assume applicant A, age 25, owns a home, is married, and has an annual income of $15,000; applicant B, age 19, is single, rents and has an annual income of $9,600. Applicant A is granted a loan, and applicant B is denied the same loan. The decision to grant credit to applicant A and deny it to applicant B may be explained by noting that, in the eyes of the judgmental creditor, a married person is less of a risk than a single person; a 25-year old is more stable than a 19-year old; one who owns a home is a better credit risk than a renter; and $15,000 is an adequate income to support the loan while $9,600 is not. Under Regulation B, the creditor's explanation for granting credit to applicant A while denying

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it to applicant B is unacceptable because the Federal Reserve Board sanctions the use of judgmental systems only if no discrimination on the prohibited bases results. In the above hypothetical, the assumption that a single person is less likely to repay a loan discriminates on the basis of marital status, which the ECOA expressly prohibits. Furthermore, although the creditor is free to determine how income and housing status will be evaluated, Regulation B specifically prescribes how creditors who use a judgmental system may evaluate age. A creditor may consider the applicant's age only for the purpose of determining a "pertinent element of creditworthiness," which the regulation defines as information about the applicant which the creditor considers to have a demonstrable relationship to the determination of creditworthiness. In other words, age may be considered only if it is manifestly related to the question of whether the applicant will repay. Thus, a creditor may not arbitrarily deny loans to 19 year old applicants, but may consider their age in assessing the significance of their length of employment or residence; for example, a young applicant may have just entered the job market or may have just recently established a residence. Similarly, under Regulation B, elderly applicants, who have often been the objects of unfavorable credit determinations and have generally been viewed negatively by creditors, may not be disfavored simply because of their age.

62. Id. at §§ 202.4, 202.2(u).
63. Information regarding income level and housing status does not relate directly to a prohibited basis. The information cannot be used, however, to violate the "effects test" concept of the ECOA. Id. at § 202.6(a) note 7; see notes 198-204 infra and accompanying text.
65. Id. at § 202.2(y).
67. For example, prior to the promulgation of Regulation B, many creditors regarded all retired persons as unacceptable credit risks and refused to grant them credit. Others refused to make certain types of loans, such as mortgages to elderly applicants, regardless of the likelihood of repayment. Regulation B expressly prohibits these arbitrary considerations. Creditors may, however, consider the length of time to retirement of an applicant to ascertain whether the applicant's retirement income will support the extension of credit until the loan matures. Creditors may also consider the adequacy of any security offered if the duration of the loan will exceed the applicant's life expectancy. For example, an elderly applicant might not qualify for a five-percent down, 30-year mortgage because the loan's duration exceeds the applicant's life expectancy and the cost of realizing on the collateral might exceed the applicant's equity, although the same applicant might qualify with a larger downpayment and a shorter loan maturity. 12 C.F.R. § 202.6(b)(2)(iii) note 9 (1977).
68. A creditor may, however, always use age to an elderly applicant's favor. Id. at §
The other credit evaluation system, credit or statistical scoring,\textsuperscript{69} employs empirical techniques to statistically predict the probability that the applicant will repay.\textsuperscript{70} Typically, certain financial and nonfinancial characteristics are rated by a series of point scores; for example, points are given for income, length of employment, occupation and home ownership. The point values for each applicant are accumulated, and the credit decision is made by comparing the total score to a statistical sampling of applicants with similar credentials. If the applicant scores higher than the predetermined cutoff score, credit is granted.\textsuperscript{71} The basic assumption underlying this system is that an individual's personal characteristics can be employed to predict his or her character or probability of repayment.\textsuperscript{72} Because scoring systems use an objective standard to evaluate applicants, many (including Congress) believe that they are more accurate and effective than the subjective judgmental systems.\textsuperscript{73}

The Federal Reserve Board sanctions the use of a credit scoring system if it is \textit{empirically derived} and \textit{demonstratively and statistically sound}. A scoring system is considered to be empirically derived if it evaluates creditworthiness primarily by allocating points to key applicant attributes,\textsuperscript{74} with the points being derived from an empirical comparison of the creditor's creditworthy and noncreditworthy applicant population, and with the applicant's entire score, either alone or in conjunction with other information, determining his creditworthiness.\textsuperscript{75} A scoring system is demonstratively and statistically sound if it "is developed for the purpose of predicting the creditworthiness of applicants with re-

\begin{itemize}
    \item \textsuperscript{69} The terms "statistical scoring" and "credit scoring" will be used interchangeably throughout this article.
    \item \textsuperscript{70} \textit{See generally} Haia, \textit{Credit Scoring and the Equal Credit Opportunity Act}, 30 Hastings L.J. 371 (1978).
    \item \textsuperscript{71} \textit{Id.} For a more detailed analysis of how scoring systems operate, \textit{see ECOA Hearings, supra} note 15, at 441.
    \item \textsuperscript{72} \textit{Credit Scoring: Why and How,} \textit{supra} note 5 at 3.
    \item \textsuperscript{74} 12 C.F.R. § 202.2(p)(1) (1977).
    \item \textsuperscript{75} \textit{Id.} at § 202.2(p)(ii). \textit{See also} Haia, \textit{supra} note 70.
\end{itemize}
spect to the legitimate business interests of the creditor utilizing the system, including, but not limited to, minimizing bad debt losses and operating expenses in accordance with the creditor’s business judgment. . . .”76 In order to be considered demonstratively and statistically sound, a scoring system must meet three statistical standards.77 First, the system must be based on “accurate developmental data,” that is, the data used to develop the system must consist of either the whole applicant population, including both accepted and rejected applicants, or a proper sample drawn from the whole applicant population.78 Second, the scoring system must be “validated.” The validation process tests the degree of accuracy of the scoring system’s ability to predict the creditworthiness of an arbitrarily chosen applicant79 by running an independent check to see if the system predicts creditworthiness in the manner for which it was designed. Also, the scoring system must be able to separate creditworthy and noncreditworthy applicants at a “statistically significant rate,”80 which means that the system’s predictive accuracy should be better than a completely random process.81 Third, the system must periodically be revalidated by using an applicant sample that represents the creditor’s most recent applicant population.82 If revalidation reflects a change in the applicant population that produces a decline in the scoring system’s predictive ability, the system must be adjusted to reestablish its predictive accuracy.83

Unlike the creditor using a judgmental system, the creditor employing a demonstrably and statistically sound, empirically derived scoring system is allowed to use an applicant’s age as a predictive variable.84 The only limitation under Regulation B is that applicants 62 years of age or older must receive the same number of points as anyone under age 62,85 this implies that young appli-

77. See generally Hsia, supra note 70.
81. See Hsia, supra note 70, at 379.
83. Id.
84. Id. at § 202.6(b)(2)(ii).
85. Id.
cants can be assigned fewer points in the age category if the distinction can be statistically supported. Moreover, unlike judgmental systems, there is no requirement that scoring systems only consider age if it is manifestly related to the applicant's ability to repay. Thus, scoring systems are given greater flexibility than judgmental systems in using age as a predictive variable.

Although the ECOA specificity problems faced by judgmental and statistical scoring creditors bear some similarity, for the most part they are very different. For this reason, it is now necessary to separate discussion of the two systems in order to analyze the problems related to each. Based on this analysis it will then be possible to suggest solutions to these specificity problems.

III. MEETING THE ECOA SPECIFICITY REQUIREMENT — JUDGMENTAL CREDITORS

A. Inadequacies in Present Practices

Since the use by a judgmental creditor of the Federal Reserve Board's checklist reasons raises an irrebuttable presumption of compliance with the specificity requirement, the overwhelming majority of judgmental creditors rely on the model checklist statement when giving reasons to applicants who are denied credit.\(^8^6\) Despite the Board's pronouncement that the model checklist is unquestionably specific,\(^8^7\) the form's terse responses do not necessarily meet the consumer's need for specific explanations.

This need for specificity can be seen by examining consumer criticism of several checklist reasons. The "insufficient credit references" reason has been severely criticized by rejected applicants because it fails to tell them how they can meet the creditor's requirements. The statement only raises the question of what "sufficient" is, and without further explanation, an applicant is left to speculate as to what will meet the creditor's standards. Consumers have also complained about the vagueness of the "insufficient income" checklist reason.\(^8^8\) An applicant who believes his income is

86. See note 54 supra.
88. Illustrative of consumer dissatisfaction with the checklist reasons is a complaint received by the Wisconsin Office of the Commissioner of Banking in which the complainant alleged she was not given a specific reason when a bank denied her loan application. The reasons given for the denial were "insufficient income" and "inappropriate credit references." According to her complaint, these reasons left her "puzzled as to the dollar amount I
“sufficient” to justify granting him credit would encounter major
difficulties in attempting to prove this or in attempting to prove
that the denial was discriminatory without first knowing the credi-
tor’s definition of “sufficient”. Many consumer complaints assert
that, at a minimum, the ECOA legislative history indicates a Con-
gressional intention that this type of crucial information be given
to rejected credit applicants.89

Similarly, the Congressional purpose would seem only to be
fulfilled when denials based on “too short a period of residency,”
also informed the consumer of how long a period is necessary to
satisfy the creditor’s standards. The applicant being fully informed
can then concede that the creditor is acting reasonably in requiring
a longer period, correct misinformation the creditor used in mak-
ing his decision or file a discrimination complaint. Therefore, for
specificity purposes, the creditor should inform the applicant of ex-
actly what period of residency is required.

Problems also arise when “temporary or irregular employ-
ment” is cited as a reason for denial. For example, are migrant or
other seasonal workers considered to be “temporarily or irregu-
larly” employed? Does it make a difference if these workers have
been employed during harvest season for ten consecutive years?
What about construction workers and Comprehensive Employ-
ment Training Act (CETA)90 employees? Are they temporary or
permanent workers? The creditor’s requirements and standards of
evaluating an applicant’s employment should be made known to
the applicant.

Another criterion presently used is the “credit application in-
complete” reason. Standing alone, this statement does little to ex-
plain the actual basis for denial. Where is the application incom-
plete? What defects are fatal? Did the applicant fail to give critical

must earn and the references I must have to qualify for a card.” The applicant felt that if
the specificity requirement had been met, she would not have been baffled by the creditor’s
requirements because the reasons for denial would have stated them clearly.

89. See note 49 supra. Congress placed great emphasis on getting specific information
to the applicant in order to enable him to correct any deficiency in the application.

90. The CETA program was established to provide training and employment opportu-
nities for unemployed, economically disadvantaged and under-employed persons. The pro-
grams which provide the training or employment experience are government funded. Typi-
cally, the funds are allocated for one year or less, without any commitment to fund the
program during the next fiscal year. Because future employment is in jeopardy until govern-
ment budgeting and fiscal allocations are announced, it is unclear whether CETA employees
are permanent or temporary workers. See generally 29 U.S.C. §§ 801, 802 (1978).
information, such as income, or merely forget to fill in the zip code? Perhaps the Federal Reserve Board recognized potential problems with the “credit application incomplete” reason because they included in Regulation B the requirement that: “[W]here an application is incomplete, a creditor shall make reasonable efforts to notify the applicant of the incompleteness and shall allow the applicant a reasonable opportunity to complete the application.” By giving the applicant an opportunity to correct the deficiency, this provision transforms the uninformative “credit application incomplete” statement into a meaningful explanation of the reason for denial.

Unfortunately, Regulation B does not require a similar effort on the creditor’s part to assist applicants in understanding vague checklist reasons or in correcting inaccurate information. For example, a person denied credit because of “insufficient credit references” is not given an opportunity to list, prior to denial, references available to him which may be sufficient. The same situation arises when an applicant is rejected because of “inadequate collateral.” Similar complaints are often registered about the model checklist reasons that relate to the applicant’s credit history, such as “insufficient credit references,” “insufficient file” and “no credit file.” If the creditor obtains negative information regarding an ap-

91. At one time, zip code was considered minor information on the application form. Recently, however, zip code has become a crucial consideration to some creditors who engage in the practice of credit card “red-lining” by giving lower point ratings to applicants who reside within certain regions of the country or within specific zip codes within these regions. Evaluating zip codes in this manner results in credit denial to persons who are otherwise acceptable on the basis of where they live. To prevent this type of discrimination, Senator Carl Levin (D.-Mich.) has introduced a bill (S. 15) which would amend the Consumer Credit Protection Act to prohibit discrimination in the issuance of credit cards on the basis of geography. The Senate Banking, Housing & Urban Affairs Committee conducted hearings on the bill in June 1979. A similar bill, H.R. 157, which prohibits discrimination on the basis of residence, has been referred to the House Committee on Banking, Finance, and Urban Affairs.


93. Almost one-third of all reasons complained of to the Wisconsin Office of the Commissioner of Banking relate to credit history. See note 57 supra and accompanying text. These reasons include: “insufficient credit data,” “credit references inappropriate,” “no satisfactory credit history,” “information received from the credit bureau,” “terrible credit,” “unable to verify credit references,” and “no established credit rating.” The author’s survey of the F.T.C. ECOA complaints also revealed that most reasons complained of related to credit history. Among them were: “information from credit bureau,” “previous pay record,” “insufficient credit history information,” “unfavorable report from credit bureau,” and “credit report did not contain sufficient information.”
plicant from a credit reporting agency, he is required to list the name and address of the credit bureau issuing the negative credit report, but he need not list the specific credit reference he found to be unsatisfactory.\textsuperscript{94} Therefore, the applicant is left to surmise which reference the creditor found unfavorable.\textsuperscript{95}

Because the specificity requirement is so new, few courts have had an opportunity to decide whether the various checklist reasons presently used are in compliance with it. However, two decisions seem to indicate that the courts will carefully examine the reasons given to determine whether they meet the Congressional objective of providing consumers with reliable and useful credit information. The cases point out that merely saying to an applicant that some deficiency exists or may exist in the application is insufficient to satisfy the ECOA requirement that the precise reasons for denial be given. In \textit{Carroll v. Exxon Company},\textsuperscript{96} a federal district court held that Exxon violated the specificity requirement when it denied credit to a single working woman and gave its reason as being that the credit bureau it had contacted could furnish "little or no information" regarding the applicant's established credit.\textsuperscript{97} While this was true, the court found that Exxon's decision to deny credit was based on several factors.\textsuperscript{98} However, the only reason for denial that Exxon had communicated to the plaintiff was that the report received from the credit bureau was insufficient. The court rea-
soned that Exxon’s failure to disclose all its reasons for denying credit prevented the applicant from obtaining accurate and reliable information concerning her credit status. Citing the legislative history of the specificity requirement, the court held that “Exxon’s responses to plaintiff’s request for specific reasons for the credit denial fail to achieve the informative purposes legislated in the ECOA.” 99 Similarly, in Berg v. Amoco Oil Co., 100 the plaintiff’s application for a credit card was denied for the stated reason that the company was “unable to obtain sufficient information to justify the establishing of a credit account at this time.” 101 The court concluded that this statement was inadequate because it left the applicant in the dark as to why the information obtained from the credit bureau was not “sufficient.” Furthermore, the court noted that Regulation B “must be construed to require that the statement of reasons be intelligible to the applicant and that it provide him or her with the opportunity to evaluate whether the impediment is one which can be removed.” 102 As a result, Amoco was found in violation of the specificity requirement and Mr. Berg received $1,000 in damages, plus attorney’s fees. 103 Interestingly, the

99. Id.
101. Id. slip op. at 2. After making several requests for a specific reason for denial, the plaintiff received the following letter:

Dear Customer:

Thank you for your recent credit card information. After checking with the credit bureau serving your area, we were unable to obtain sufficient information to justify the establishing of a credit account at this time. Our investigation was conducted with:

Credit Bureau of:
24 N. Carroll St.
Madison, Wisconsin

We are sorry if this inconveniences you.

Yours truly,
NEW ACCOUNTS CENTER
Letter from plaintiff’s attorney Steven A. Bach of Cassidy, Wendell, Center & Lipman, Madison, Wisconsin to author.
103. It should be remembered that a court is given great latitude in assessing damages for ECOA violations. One single violation triggers the damages provision, which allows an individual plaintiff to recover up to $10,000 in punitive damages, plus actual damages and court costs. 12 C.F.R. § 202.1(c), citing 15 U.S.C. § 1691(e) (1977). It is conceivable that a court might award a successful plaintiff the $10,000 maximum for a creditor’s failure to provide specific reasons for credit denial. Also, in class actions, creditors can lose up to the lesser of 1% of their net worth or $500,000. Id. Regulation B’s stiff penalty clause further underscores the need to be sure that creditors clearly understand what type of reasons for
reason rejected by the Berg court as inspecific would probably have been acceptable to the Federal Reserve Board.¹⁰⁴

A careful reading of various complaints made to the F.T.C. and Wisconsin's OCB,¹⁰⁵ along with court opinions that address the specificity issue, suggests that creditors using judgmental systems can satisfactorily meet the objectives of the specificity requirement if they make their minimum standards of creditworthiness publicly known. For example, if the creditor uses the checklist reason "length of employment" as the basis for denial, he could also be required to disclose what exact period of employment (e.g., 6 months, 1 year) would satisfy his requirements. The use of both a checklist reason and an explanatory note obviously provides information sufficient to educate the applicant as to his ability to obtain credit, and if an error has been made, the applicant is in a position to correct it. Also, once an applicant is given this information, he can intelligently work toward reducing the deficiencies in his application. Moreover, the applicant is in a better position to investigate a suspicion of discrimination, since he is aware of the creditor's standards and his status in relation to those standards.

Although disclosure of the minimum creditworthiness standards furthers the objectives of the ECOA,¹⁰⁶ the ramifications of adopting an expanded interpretation of "specificity" must be examined before such a recommendation can be sanctioned. From the consumer viewpoint, a broader interpretation of specificity is highly desirable for several reasons. First, if the creditor knows he must support his checklist reason with an explanation, he will be less likely to discriminate. However, if an applicant suspected discrimination, a broader interpretation of specificity may, in some cases, add an evidentiary basis to an otherwise unprovable suspicion of discrimination. Also, as previously noted, requiring more information from creditors would direct the applicant toward deficiencies in his application, and allow him either to improve his application or correct any misinformation.¹⁰⁷ Finally, expanding the denial sufficiently comply with the ECOA specificity requirement.

¹⁰⁴. Note the similarities between the statement received by Mr. Berg and the model statement. See Note 54 supra.
¹⁰⁵. See note 57 supra.
¹⁰⁶. See text accompanying notes 50-51 supra.
¹⁰⁷. "[F]urnishing an applicant with a statement of reasons for adverse action has little educational value if the applicant cannot translate the reasons into concrete criteria." Comment, Equal Credit for All—An Analysis of the 1976 Amendments to the Equal Credit
statement of reasons requirement to include disclosure of minimum standards would meet the reasonable expectation that the reasons for denial relate to the creditor's policies on creditworthiness. Creditors, on the other hand, can be expected to question the practicality of expanding the requirements of specificity. While few creditors would argue with the Congressional goal of creating a more informed and better educated class of consumers, most would insist that the practical effects of requiring creditors to disclose their standards of creditworthiness should be thoroughly investigated before any action is taken to modify Regulation B.

B. Effect of Broadening the Meaning of Specificity on Judgmental Creditors

Several factors merit consideration in assessing the practical effect of requiring judgmental creditors to publicly disclose their minimum standards of creditworthiness by relating them to reasons for denial. First, the difficulties of compliance must be analyzed. Second, the financial consequences of imposing such a requirement must be discussed. Third, the non-financial implications of the proposal, such as the fundamental change in the traditional judgmental approach to screening credit applicants that would be required, must be assessed. In the final analysis, these factors must be considered in light of the benefits that would result from the imposition of the more stringent requirement.

1. Difficulty of Compliance

It would not be difficult for judgmental creditors to comply with the proposed expansion of the ECOA specificity requirement. Under the expanded interpretation, these creditors would simply have to include a concise explanatory statement along with the checklist reasons that denial was based upon, making sure that this additional statement related to the credit standards by which the applicant was judged. For example, the creditor may give the checklist reason “insufficient income” along with the accompanying explanation: “We require a minimum income level of $10,000;” or, the checklist reason “inadequate collateral” along with the explanation: “We accept only automobiles and real property as collateral.”

Such an expansion of the specificity requirement presupposes two things. First, it assumes that judgmental creditors base their

decisions on "creditworthiness" criteria that can be explained briefly, each creditor having established criteria for judging an applicant's ability and willingness to repay.\textsuperscript{108} Secondly, use of the expanded requirement does not mean that all checklist reasons will require an explanatory note in order to achieve the desired degree of specificity. Checklist reasons, such as "no credit file," "unable to verify income," and "we do not grant credit to any applicant on the terms and conditions you request" are self explanatory, and appear to simultaneously provide the threshold educational benefit Congress intended for consumers and the brevity Congress intended to ease a creditor's burdens.

Whether those checklist reasons warranting explanatory notes can be briefly articulated depends primarily upon whether the questions they raise can be briefly answered. As the following indicates, the typical checklist reason can be explained briefly, often in a single sentence:

\begin{table}[h]
\centering
\begin{tabular}{|l|l|}
\hline
\textbf{Checklist Reasons With Explanatory Statements} & \\
\hline
\textbf{"Checklist Reason"} & \textbf{"Explanatory Statements"} \\
\hline
Credit application incomplete & You failed to list credit references \\
Insufficient credit references & We require a minimum of three references \\
Length of employment & We require six (6) months continuous employment with one employer \\
Insufficient income & We require a minimum income of $10,000 \\
Too short a period of residence & We require a minimum of four (4) months at the same residence \\
Insufficient credit file & We require a minimum of three positive references; your file contains only one \\
\hline
\end{tabular}
\end{table}

\textsuperscript{108} See text accompanying notes 154-160 \textit{infra}.
Delinquent credit obligations

Your previous account with us shows delinquency in payments

Information obtained in credit report from consumer reporting agency is inadequate

Name of Agency, Street Address, Telephone Number; Account in question: Sears: File shows delinquent payments

Temporary employment

We consider all seasonal workers to be temporarily employed

It should be noted that checklist reasons accompanied by brief, explanatory notes, are not foreign to judgmental creditors, as a number of them already adhere to this format. Interestingly, some judgmental creditors who provided explanatory notes prior to Regulation B, may now be reluctant to deviate from the Federal Reserve Board’s form. In this respect, the promulgation of Regulation B has actually decreased consumer awareness of what constitutes creditworthiness. Since compliance with the Board’s form provides immunity from violation, those who undertake the task of providing a higher degree of specificity must carefully draft their statements to achieve consistency with Regulation B. Otherwise, they run the risk of unnecessarily inviting litigation based on technical violations of the specificity requirement. Thus, Regulation B as presently interpreted, does not provide incentives for creditors to be more specific than the checklist format. Lack of such incentives contributes to creditors’ feeling that use of the Board’s form is not only the easier but also the safer course of action.

Finally, it should be noted that the difference between the present reading and an expanded reading of Regulation B, in terms of the effort a creditor must expend to comply, is slight. A con-

109. Note, Equal Credit Opportunity Act Amendments of 1976—An Overview of the New Law, 55 N. CAROLINA L. REV. 267, 271 n.20 (1977). For example, the North Carolina Wachovia banks that offer Master Charge are instructed to include a checklist explanation when informing a customer that his or her Master Charge application has been denied.
110. See 12 C.F.R. § 202.9(b)(2)(1980), and text accompanying notes 53-56 supra.
111. Id.
sumer complaint registered with the Wisconsin Office of the Commissioner of Banking (OCB) illustrates the slight difference this change makes to the creditor while giving the applicant much greater feedback. The applicant alleged that a bank did not list the specific reasons for credit denial, having listed only "insufficient income" and "inappropriate credit references" as the basis for rejection. When the OCB investigated the complaint, the bank clarified these reasons. In explanation of "insufficient income," the bank cited its investigation that indicated the applicant's monthly expenses already consumed most of her income. In the bank's judgment, the applicant could not financially handle an additional credit obligation. In explanation of the "inappropriate credit references" reason, the OCB was told that the bank was unable to obtain credit information from the two oil companies the applicant had listed as references. In other words, the bank could not verify her credit references. While the differences between what the applicant was told and what the OCB was told appears at first glance to be slight, closer scrutiny reveals that this "slight" difference is the difference between giving a comprehensive statement which complies with the legislative objectives of the specificity requirement and one which does not. In view of what a broader interpretation of "specificity" would require in terms of creditor compliance, it is clear that judgmental creditors would not encounter major difficulties in modifying their present statement of reasons to conform with the more liberal readings of Regulation B.

2. Costs: Financial Consequences The cost of providing a more detailed statement of reasons does not appear to be significantly greater than that necessary to comply with the present statement. Explanatory notes as to exactly why credit was denied could easily be included on the currently used checklist. A minimum amount of expense from additional paper work and staff time would result, as the same person responsible for giving the checklist reason could, as part of the same operation, be responsible for

113. Although stating that the credit bureau would not release information about the accounts appears to be more specific than stating "inappropriate credit references," it may not be specific enough. In *Carroll v. Exxon Co.*, 434 F. Supp. 557, n.3 (E.D. La. 1977), Exxon stated that the reasons for denial were that the credit bureau could furnish little definitive information concerning the applicant's credit record. The court held that this reason was not "specific" and found Exxon in violation of the specificity requirement. See text accompanying notes 96-99 *supra*. 
supplying the explanation. The additional time required to supply the explanation would be minimal and would not involve expenses incongruous with those Congress deemed justifiable to achieve the ECOA objectives.

During Congressional hearings on the 1976 amendments to the ECOA, Congress weighed the expense of providing applicants with reasons for denials against the potential benefits. Despite testimony from creditors,\(^\text{114}\) the opposition of several members of Congress,\(^\text{115}\) and data from various sources,\(^\text{116}\) indicating that the cost of complying with the statement of reasons requirement would be significant,\(^\text{117}\) the majority of Congress took the position that benefits outweighed the costs. In response to arguments that giving specific reasons for denial would be "burdensome, expensive and un-

\(^{114}\) Id. Drew Tidwell, Legislative Counsel for Consumer Bankers Association, has estimated the compliance cost to be $9.68 per application rejected. See Comment, Equal Credit Opportunity Act Amendments of 1976, supra note 1, at 214 n.66.

\(^{115}\) See S. Rep. No. 589, 94th Cong., 2d Sess. 20 (1976); reprinted in [1976] U.S.Cong. & Ad. News 403. Several members of Congress shared the creditors' concern that the statement of reasons requirement placed too severe a financial burden on them and thus on consumers. Senator Jesse Helms expressed the view that the requirement would result in "regulatory overkill" which could harm those it is intended to benefit by drying up credit sources, making credit more expensive, or both. He emphasized that the paper work cost would ultimately force many merchants, especially small ones, out of the credit business. He concluded that not only would the independent retailer business be hurt, but also that consumers' financing choices would be limited. Id. at 21. Senator Jake Garn expressed similar objections to the statement of reasons requirement. He thought the requirement might impose a great financial burden on creditors, who would ultimately transfer the additional costs to consumers. Id. As Senator John Tower stated: "Ultimately, the costs of such written notification must be borne by borrowers, and the paperwork burden and administrative expense associated with such written notification could easily outweigh any realized or anticipated benefits." Id. at 27.

\(^{116}\) Forrest D. Jones, speaking on behalf of the American Bankers Association, estimated that the cost of complying with the ECOA specificity requirement "would amount to literally million(s) of letters with a large increase in staff and expense to prepare for these letters," ECOA Hearings, supra note 15, at 265, and he concluded that the production cost of the statements was disproportionate to the expected benefit. The American Retail Federation and L.T.T. Aetna Corporation concurred. Id. at 409, 611. See also Smith, The Equal Credit Opportunity Act of 1974: A Cost Benefit Analysis, 32 J. Fin. 609, 614 (1977).

\(^{117}\) A spokesman for the National Retail Merchants Association, testifying before the Congressional Subcommittee on Consumer Affairs, described the potential cost of compliance as "monumental" and "staggering," and presented supporting data from Sears, Roebuck and Co.'s 1974 estimation that a statement of reasons would cost approximately $5.00 per letter, thus running that retailer's total cost of compliance into the millions. See ECOA Hearings, supra note 15, at 399 (statement of Robert Meyers). See also Smith, supra note 116, which notes that based on these estimates, compliance in 1975 would have cost the credit industry $286.25 million. Id. at 614.
necessary,"118 one Congresswoman presented the majority’s position on the cost factor by stating:

Without a requirement in the law and regulations to disclose the true reasons for rejection, creditors who may have perfectly good reasons for rejecting such an applicant (or who have made an innocent error in reaching the decision) face the possibility of unnecessary lawsuits alleging discrimination when the matter could have been straightened out quickly by a simple and direct explanation for the rejection. . . . Instead of being a burden to the creditor, this could be an effective device for avoiding unnecessary ill will among potential customers.119

Senator William Proxmire, while finding the specificity requirement justified because an “informed consumer is essential if we are going to have an effective market economy,”120 warned against forcing overdisclosure.121 Likewise, the Senate Committee on Banking, Housing and Urban Affairs voted in favor of the specificity requirement, although acknowledging that the requirement could, in some respects, be a double-edged sword. The fact that Congress enacted the specificity requirement despite strenuous objections from the credit industry indicates that they perceived the potential additional financial burden on both the credit industry and the consumer as necessary.

Congress’ acceptance of the expense and their emphasis on achieving the goals which initially prompted the promulgation of the specificity requirement continues to support maximum efforts toward this end. However, if creditors and consumers are to be required to make financial sacrifices to comply with the specificity requirement, they should reap the full extent of the benefits Congress intended. For this reason, it is important that a statement of specific reasons meet a level of specificity in harmony with Congress’ stated objectives; otherwise, it would be difficult to assert that the benefits flowing from the requirement outweigh anticipated and proven financial expenditures. Expanding the definition of specificity to require creditors to relate the reasons for denial to concrete creditworthiness standards provides the desired level of

118. See ECOA Hearings, supra note 15, at 34.
119. Id. (reply by Congresswoman Lenore Sullivan to questions submitted by Senator John Biden).
120. Id. at 211.
121. Senator Proxmire limited his position by insisting that the information disclosed “ought to be only that which is essential to provide the information that is required. . . .” Id.
3. **Costs: Non-financial consequences** The most significant non-financial consequence of expanding the meaning of specificity is the potential for disruption of the judgmental system's foundation. Traditionally, judgmental systems have operated under the assumption that an experienced loan officer or credit manager can use his professional instinct to screen credit risks. This flexible policy allows the manager to occasionally take a chance on a poor risk applicant if the manager has a "hunch" the applicant will repay. Similarly, if all indices of creditworthiness are positive, but the manager has an intuitive feeling that the loan should be denied, the loan is denied. It is this subjective elasticity which has made judgmental systems attractive to many creditors.

Many creditors who use judgmental systems consider informality and flexibility to be the system's major assets. According to one bank president, judgmental systems are favored because of their "very flexible and personal approach."122 Another bank president favors the latitude which judgmental systems allow, because she believes in making credit decisions based in part on "first impressions" received from personally conversing with prospective customers.123 Requiring a judgmental creditor to express specific reasons for denial based on concrete credit policies would act to bar decision making based even in part on premonitions. To a large extent, such a requirement would take the "judgment" out of judgmental systems, since "hunches" and "intuitions" are virtually nonquantifiable. For example, under the expanded specificity requirement, if two similarly situated applicants failed to meet a creditor's express creditworthiness standards, a loan officer could not approve a loan to one of them based on his "feel" for the person. This would be true despite the officer's proven ability to subjectively determine when objective indicators should be disregarded and the risk incurred. The expanded specificity requirement would transform judgmental subjectivity into objectivity. The creditor would have to eliminate the use of all subjective factors and rigidly adhere to policies on creditworthiness, disregarding any urge to deviate. In this respect, requiring the judgmen-

122. Letter from Emily H. Womach, President of Women's National Bank, to author (Nov. 1, 1978).
tal creditor to relate reasons for denial to rules on creditworthiness would tamper with his traditional, independent evaluation of an applicant for credit. This could mean reduction of available credit to the marginally qualified by stopping creditors from extending credit to any member of this group of applicants.

Congress was made aware of these potential consequences prior to the passage of the 1976 amendments to the ECOA. A spokesman for the National Retail Merchants Association told Congress that the proposed specificity requirement would in effect give the Federal Reserve Board the authority to:

freeze credit granting criteria into established molds, to the detriment not only of the creditor but of the consumer as well. This would have the effect of introducing one rigid structure in the credit granting process, i.e., immobilizing criteria so that the creditor's option of employing its own funds to extend credit to an applicant could almost be viewed as mandated rather than voluntary on the creditor's part. 124

In the face of the knowledge that the specificity requirement could lead to derogation of traditional credit evaluation systems, Congress nevertheless voted in favor of the original requirement. In effect, Congress decided that the anti-discrimination purposes expected to be obtained from the original requirement outweighed the need to preserve the fundamental structure of the judgmental system.

4. Costs: Discrimination deterrence, what price? Unfortunately, it is impossible to impose a tougher specificity requirement on judgmental creditors without additional cost. But whatever the increased cost, it will only minimally affect the larger creditors, most of whom are already following the trend toward credit scoring. 125 For these large creditors, the overall cost of imposing a more stringent specificity requirement will be sharply reduced by the adoption of a scoring system. However, smaller creditors, who would be directly affected by the proposed changes, will understandably question the efficacy of modifying Regulation B in a way which increases their economic burdens and impinges upon their business freedom. Again, their question cannot be answered without balancing the competing interests involved. For example, one inherent danger of the increased costs would be the inevitable clos-

124. See ECOA Hearings, supra note 15, at 400.
125. Id. at 34.
The folding of these businesses would reduce the credit options of some and in effect deny credit to others who might have otherwise received it. Also, as previously discussed, another harsh reality of expanding the requirement would be to further erode the subjective element in credit granting that has traditionally been the backbone of judgmental systems. However, these realities must be balanced against the consequences of non-expansion, including widespread discrimination. Without requiring creditors to relate reasons for denial to creditworthiness standards, there is no way to guarantee that a judgmental creditor’s “feel for the person” is not a “feel” for the person’s sex, race or age. Too often, intuition is a cover for discrimination, and while all judgmental creditors may not illegally discriminate, it will be difficult to separate those who discriminate from those who do not, absent the imposition of a more demanding specificity requirement. Of course, the proposed modification carries no guarantees that if adopted, all discrimination by judgmental creditors will cease. These creditors should, however, be less inclined to discriminate since it would become difficult for them to escape detection.

If eradication of credit discrimination is a serious and desirable goal of the ECOA, then any regulation enacted to achieve this goal must be carefully drafted so that it will go far enough toward curbing discriminatory practices and toward providing the necessary evidence of discrimination for prosecution. Judgmental creditors should not confuse freedom of business judgment with freedom to discriminate. Although the current model statement of reasons seeks to interfere with creditor judgment only to the extent necessary to accomplish the specificity requirement’s objectives, it does not go far enough to accomplish these objectives. The proposed modification solves this problem by requiring creditors to relate the reasons for credit denial to creditworthiness standards.

C. Summary: Judgmental Systems and the Specificity Requirement

The ECOA specificity requirement is designed to further two Congressional objectives: providing an education benefit to the consumer and improving administrative enforcement of the general

126. See note 115 supra.
provisions of the Act. It is contemplated that the consumer will become better educated by receiving statements that specifically disclose the reasons underlying the decision to deny credit. It is also hoped that the disclosure requirement will help to identify violators of the ECOA and serve as an incentive for non-violators to continue to conduct their lending practices in a non-discriminatory manner. The specificity requirement objectives logically imply that creditors must relate reasons for credit denial to specific policies on creditworthiness. In many respects, the model checklist statement of reasons used by most judgmental creditors does not achieve these objectives. The proposed statement requires creditors to disclose criteria on creditworthiness relating to denial and thus seeks to cure the deficiencies in the model form.

The costs of complying with the present specificity requirement, while undeniably major in some cases, are justifiable in light of the requirement’s stated purpose. The proposed modification would not significantly increase these costs. It could be argued however, that any increases in a creditor’s already substantial economic burdens would be significant. Nevertheless, the ECOA’s legislative history clearly supports any adjustments necessary to accomplish the Act’s objectives.

III. MEETING THE SPECIFICITY REQUIREMENT: CREDIT SCORING CREDITORS

A. Inadequacies in Present Practices

The problems of compliance with the ECOA specificity requirement are not confined to judgmental creditors; credit scoring creditors also have their share of problems. As noted earlier, credit scoring systems allocate numerical values to those personal characteristics which are considered key attributes of creditworthiness, and the decision to grant credit is based on the applicant’s total score. Problems of compliance arise when credit scoring creditors attempt to translate a nonqualifying score into a statement of specific reasons. For example, consider the following hypothetical credit scoring system and its application to a hypothetical applicant.127

127. See Credit Scoring: Why and How, supra note 5, at 12, 14.
HYPOTHETICAL CREDIT SCORING SYSTEM

<table>
<thead>
<tr>
<th>Applicant Characteristics</th>
<th>Allotted Points</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Home Phone</strong></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>36</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
</tr>
<tr>
<td><strong>Own or Rent</strong></td>
<td></td>
</tr>
<tr>
<td>Own</td>
<td>34</td>
</tr>
<tr>
<td>Rent</td>
<td>0</td>
</tr>
<tr>
<td><strong>Other Finance Company Debt</strong></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>-12</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
</tr>
<tr>
<td><strong>Bank Credit Card</strong></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>29</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
</tr>
<tr>
<td><strong>Applicant Occupation</strong></td>
<td></td>
</tr>
<tr>
<td>Professional and Officials</td>
<td>27</td>
</tr>
<tr>
<td>Technical and Managers</td>
<td>5</td>
</tr>
<tr>
<td>Proprietor</td>
<td>-3</td>
</tr>
<tr>
<td>Clerical and Sales</td>
<td>12</td>
</tr>
<tr>
<td>Craftsman and Nonfarm-laborer</td>
<td>0</td>
</tr>
<tr>
<td>Foreman and Operative</td>
<td>26</td>
</tr>
<tr>
<td>Service Worker</td>
<td>14</td>
</tr>
<tr>
<td>Farm Worker</td>
<td>3</td>
</tr>
<tr>
<td><strong>Checking or Savings Account</strong></td>
<td></td>
</tr>
<tr>
<td>Neither</td>
<td>0</td>
</tr>
<tr>
<td>Either</td>
<td>13</td>
</tr>
<tr>
<td>Both</td>
<td>19</td>
</tr>
<tr>
<td><strong>Applicant Age</strong></td>
<td></td>
</tr>
<tr>
<td>30 or less</td>
<td>6</td>
</tr>
<tr>
<td>30+ to 40</td>
<td>11</td>
</tr>
<tr>
<td>40+ to 50</td>
<td>8</td>
</tr>
<tr>
<td>Over 50</td>
<td>16</td>
</tr>
<tr>
<td><strong>Years on Job</strong></td>
<td></td>
</tr>
<tr>
<td>5 or less</td>
<td>0</td>
</tr>
<tr>
<td>5+ to 15</td>
<td>6</td>
</tr>
<tr>
<td>Over 15</td>
<td>18</td>
</tr>
</tbody>
</table>

HYPOTHETICAL APPLICANT AND THE CORRESPONDING CREDIT SCORE

<table>
<thead>
<tr>
<th>Applicant's Characteristics</th>
<th>Allotted Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home Phone</td>
<td>36</td>
</tr>
<tr>
<td>Rents</td>
<td>0</td>
</tr>
<tr>
<td>No other finance company debt</td>
<td>0</td>
</tr>
<tr>
<td>Bank credit card</td>
<td>29</td>
</tr>
<tr>
<td>Farm worker</td>
<td>3</td>
</tr>
<tr>
<td>Both checking and savings accounts</td>
<td>19</td>
</tr>
<tr>
<td>Age 48</td>
<td>8</td>
</tr>
<tr>
<td>Same job for 18 years</td>
<td>18</td>
</tr>
</tbody>
</table>

If a favorable decision requires 114 or more points, the applicant will be denied credit; however, it will be unusually difficult to pro-
vide a statement of specific reasons for denial that is consistent with the ECOA objectives. There seems to be a relationship between the characteristics for which the applicant received the fewest points (renter status, occupation and age) and denial, but can it be said that credit is denied because the applicant is a 48 year old farm worker who rents? Probably not. Thus, the problem of how to translate the applicant's denial into an accurate statement of reasons for credit denial is presented.

Consumers have complained that the reasons for denial given by credit scoring creditors violate the ECOA specificity requirement.128 One rejected applicant complained to the F.T.C. that the credit scoring system itself was not adequately explained to her.129 The applicant, rejected under a creditor's scoring system, received a statement of reasons which related the denial to the creditor's point formula. The statement showed the applicant scored lowest in the "time on the job" and "credit references" categories. Dissatisfied with this response, the rejected applicant wrote for further clarification of the reasons for denial, and for the creditor's mini-

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128. One of the earliest complaints challenging the specificity of a credit scoring creditor's reasons was filed in December, 1976 against Montgomery Ward & Co., Inc. The F.T.C.'s complaint charged that a number of rejected applicants were not given specific reasons for denial. The applicants had received a statement which informed them that they had failed to meet the minimum point score under Montgomery Ward's credit scoring system. Because the specificity requirement had not yet become effective, the complaint charged a violation of the original regulation, C.F.R. § 202.5(m) (1975) which required creditors to give reasons for denial if rejected applicants requested them.

On October 5, 1977, the F.T.C. motioned to have the complaint against Montgomery Ward dismissed. United States v. Montgomery Ward, No. 77-9092 (D.C. 1977) (complaint withdrawn by plaintiff). The Commission indicated that although dismissal was appropriate at this time because the complaint was issued prior to the effective date of the 1976 ECOA amendments, it would reissue the complaint if further investigation revealed that Montgomery Ward was violating the ECOA as amended. A new complaint containing essentially the same allegations was subsequently filed on May 5, 1979. A few weeks later the Federal Trade Commission announced that Montgomery Ward had entered into a consent judgment in which it agreed to pay a $175,000 civil penalty to settle charges that it had violated the ECOA by failing to give consumers who were denied credit accurate and specific reasons for the denial. F.T.C. News, May 29, 1979. Similarly, an applicant who had been denied credit complained to the F.T.C. that she did not understand the reasons for denial and felt she was entitled to an additional explanation. The creditor's statement of reasons for denial indicates that a credit scoring system had been used and that credit was denied because the applicant did not receive the system's maximum score in the categories, "housing classification" and "source of other income." See note 54 supra. Due to random sampling technique used and F.T.C. confidentiality policies, the complainant's name cannot be revealed.

129. Id. This information was obtained through the author's search of consumer complaint files. See note 56 supra.
mum requirement for time on the job and the number and type of credit references required. The creditor responded that the information requested could not be given because there were no minimum standards, and apologetically explained that because different point values are assigned to each factor considered, concrete standards for any one factor could not be established. The creditor further explained that the most information it could provide would be to list the five categories in which the applicant failed to score the maximum number of points. Still frustrated, the applicant again corresponded with the creditor and voiced her dissatisfaction, stating that she still could not understand why she was denied credit.

Unfortunately, the F.T.C. response to complaints such as this one does not effectively address the consumer’s complaint. The F.T.C. usually responds by sending the consumer general information on scoring systems and the ECOA provisions. It further informs the rejected applicant that although it does not handle individual ECOA complaints, it will collectively use individual complaints to investigate a creditor if it suspects that the creditor’s actions represent a pattern of discrimination in violation of the ECOA rather than an isolated occurrence. Thus, the F.T.C. leaves unresolved the question of how credit scoring creditors could give specific reasons, while the creditors continue to claim that they cannot make their denials more specific because they are unable to state them in the manner suggested by the Federal Reserve Board’s model checklist form.

Furthermore, these creditors argue that denial is usually based upon the interplay of a variety of factors which cannot be reduced to a standard form; indeed, even the Federal Reserve Board concedes that the interdependence of these factors, no one of which controls the decision making process, makes it almost impossible to articulate the reasons why credit is denied. These comments suggest a serious problem: regardless of their predictive value, credit scoring systems lack sufficient precision to specifically explain the reasons for rejecting applicants.

The Federal Reserve Board offers little guidance to creditors on how they can develop and articulate the reasons for their deci-

130. Id.
131. Id.
132. See note 54 supra and accompanying text.
133. See ECOA Hearings, supra note 15, at 400.
sion, beyond directing them to the Regulation B form. Furthermore, even when credit scoring creditors attempt to comply with the specificity requirement by using the model checklist, they still find themselves answering complaints alleging ECOA violations. For example, *United States v. Federated Dep't Stores, Inc.*, the Attorney General charged that Federated, a credit scoring creditor, used checklist reasons that violated the ECOA specificity requirement. The complaint alleged, among other things, that Federated's use of the reason "inadequate credit references" failed to reflect the actual or specific reason for credit denial because it could be interpreted several ways: "inadequate credit references" could mean "insufficient number of positive references," "excessive number of references which the creditor considered to be negative predictors of creditworthiness" or "no credit references." This ambiguity led the Justice Department to conclude that the reason is inconsistent with the specificity requirement since it serves no educational purpose. Significantly, the Justice Department's dissatisfaction with Federated's statement of reasons went beyond singling out individual reasons which were not specific. The complaint indicates that the Department believed the entire statement was defective because Federated gave no explanation about the use or operation of its scoring system. In a consent judgment drawn

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134. Letter from Federal Reserve Board to Bank of California (Apr. 26, 1976). In this staff opinion letter, the Board explained to the Bank of California that its general explanation of its credit scoring system did not adequately inform an applicant of the specific reasons for credit denial. Without expressly suggesting methods of compliance, the Board cited the literal language of the specificity requirement as prohibiting the Bank's general statements explaining credit scoring. The Board did imply, however, that specificity could be achieved by use of its model Regulation B checklist or one similar to it. *Id.*


136. *Id.* The complaint was filed against Federated pursuant to the Attorney General's independent grant of authority to enforce the ECOA when he suspects a pattern and practice of discrimination in violation of the Act.

137. *Id.* Based on these conclusions, it appears that the Justice Department would likewise charge that checklist reasons such as "insufficient credit references," "insufficient credit file," and "inadequate collateral" lack specificity. Like "inadequate credit reference," these reasons are ambiguous and fail to impart meaningful information to rejected credit applicants.

138. *Id.* Federated's statement contained the following denial reasons:

1. Credit application incomplete
2. Inadequate credit references
3. Unable to verify credit references
4. Temporary or irregular employment
5. Unable to verify employment
up by the Justice Department, Federated agreed to pay $50,000 in punitive damages, to provide notice to all credit applicants who were denied credit because they were improperly evaluated, and to inform them of their right to reapply and be evaluated according to the requirements of the ECOA and Regulation B. To insure proper re-evaluation, Federated discontinued using its statement of reasons and prepared a new one using the guidelines set forth in the consent decree.\textsuperscript{140} Based upon these guidelines, it is apparent

6. Length of employment  
7. Insufficient income  
8. Excessive obligations  
9. Unable to verify income  
10. Inadequate collateral  
11. Too short a period of residence  
12. Temporary residence  
13. Unable to verify residence  
14. No credit file  
15. Insufficient favorable credit experience  
16. Delinquent credit obligations  
17. Garnishment, attachment, foreclosure, repossession, suit or similar adverse credit experience  
18. Bankruptcy  
19. We do not grant credit to an applicant on the terms and conditions you request.  
20. Insufficient bank references  
21. No home telephone  
22. Age group  
23. Living status  
24. Type of employment  
25. Other

\textsuperscript{139} United States \textit{v.} Federated Dep’t Stores, Inc., 78-730 (S.D. Ohio 1978) (consent judgment entered Nov. 16, 1978). In a stipulation order which was attached to the consent decree, the government agreed that Federated’s documentary material on how it derived its “neutral number of points,” or point maximum for each characteristic scored, could be deleted from the public record. Federated claimed that its method of deriving its “neutral number of points” contained confidential trade secret data and thus should not be made public. \textit{Id.}

\textsuperscript{140} The consent decree permits the use of a checklist reason if the reason is one which (1) significantly affects the decision to deny credit, (2) relates to a criterion for which the applicant failed to receive the “neutral” number of points, or (3) produces the greatest difference between the applicant’s score and the maximum number of points obtainable for each criterion. \textit{Id.} It appears that the following would be acceptable:

Dear Applicant:

We regret that an account cannot be established at this time. We used a credit scoring system which scored the information we had concerning you and found that you did not achieve the score required for the credit for which you applied.

Checked below are the factors which most significantly affected our decision
that Federated may properly give a statement of specific reasons which informs a rejected applicant that a scoring system was used and that the factor which most significantly affected the decision to deny credit was inadequate credit references.\textsuperscript{141} This statement, however, still appears to conflict with the ECOA specificity requirement since the ambiguity of inadequate credit reference as a reason is neither eliminated nor even minimized when prefaced with a statement indicating that a credit scoring system was used. Merely changing the introduction to a checklist statement of reasons does little to make Federated's revised statement more intelligible than the one they originally drafted.\textsuperscript{142} Specificity is not achieved by merely associating checklist reasons with a creditor's point scoring system.

There are other problems with the Justice Department's resolution of the \textit{Federated} case. For example, the Department's determination that the checklist reason, "inadequate credit references," lacks specificity is inconsistent with Regulation B. The Federal Reserve Board states in Regulation B that creditors who use the model checklist reasons cannot be found in violation of the specificity requirement,\textsuperscript{143} yet the complaint in \textit{Federated} was filed against a creditor who gave reasons substantially similar to those sanctioned by the Board. It seems that this inconsistency went unnoticed, as it was not raised in the consent decree or in any other

\begin{itemize}
\item insufficient credit references
\item credit application incomplete
\item unable to verify credit reference
\item length of employment
\item delinquent credit obligations
\item too short a period of residence
\item we do not grant credit to any applicant on the terms you requested
\item insufficient income
\item excessive obligations
\item inadequate collateral
\item no credit file
\item temporary residence
\item bankruptcy
\item unable to verify employment
\item other, specify
\end{itemize}

\textsuperscript{141} Id.

\textsuperscript{142} Compare the \textit{Federated} statement of reasons, supra note 138, to the F.T.C. statement of reasons based on guidelines in the \textit{Federated} consent decree, supra note 140.

\textsuperscript{143} 12 C.F.R. § 202.9(b)(2) (1980).
document relating to either the complaint or the eventual settlement.

The Justice Department's position produced problems from the onset. The Department suggested that Federated could comply with the specificity requirement by disclosing that a scoring system was used and listing the factors producing the greatest difference between the maximum points available and the applicant's score. However, before these instructions were issued, the F.T.C. received many complaints objecting to similar statements as being inconsistent with the specificity requirement. Thus, even before the Justice Department directed Federated to comply with the specificity requirement in this manner, rejected applicants had severely criticized similar statements as lacking the specificity Congress intended. One applicant who complained to the Federal Trade Commission in 1977 had received the following reasons for denial:

You did not receive the minimum score required for an account with us. The principal reasons contributing to the decline are listed below:

- age grouping
- occupational grouping
- types of credit accounts
- specialty shop listed

The above list represents the areas where there was the greatest difference between your actual score and the maximum points available.

The applicant who received this statement found it completely incomprehensible and strenuously objected to its lack of specificity. Unfortunately, these same objections can be made to statements formulated according to the guidelines of the consent decree in Federated. The difference between the statement of reasons received by this applicant and one based on the consent decree guidelines is negligible, and the same objections can be made about both.

Thus, the Justice Department's attempt to help credit scoring creditors comply with the specificity requirement fails in its essential purpose: to ensure that creditors provide rejected applicants with clear and meaningful explanations of the reasons why credit was denied so that the applicant can correct any mistake that may have led the creditor to reject him, or change factors within his

144. The author's investigation of the F.T.C.'s ECOA complaint files in January, 1978 revealed that consumers strongly object to reasons which merely tell the applicant how many more points he needs to receive credit, based on the areas in which he failed to achieve the maximum points available. See note 57 supra.

145. Id. F.T.C. policies require that complainants' names be kept confidential.
control which could cause the creditor to reverse the decision. The guidelines suggest that the applicant should be given checklist reasons indicating the areas where he failed to obtain the requisite score for credit approval or a list of reasons which cumulatively signify the areas where higher scores are needed for credit approval. However, neither interpretation allows the applicant to correct a mistake or change factors within his control which influenced denial. While the applicant is given general information about the scoring system and about his failure to meet its requirements, he receives no specific information as to why he failed to meet the creditor's standards or as to what he can do to remedy the defects in his application. Clearly, denial statements based on the Justice Department's guidelines do not provide rejected applicants with an opportunity to go back and find out what went wrong or correct either errors or deficiencies. Consequently, the guidelines fail to supply the benefits Congress intended rejected applicants to receive.

In summary, the Justice Department's interpretation of the ECOA specificity requirement in *Federated* is laden with conflicts. The use of a statement of reasons based on the Department's guidelines is inconsistent with its own assessment that reasons such as "inadequate credit references" lack specificity. Also, the Department's position that certain reasons are not specific directly conflicts with the Federal Reserve Board's pronouncement that these same reasons are specific. It also is in opposition to what consumers want and need; even before the Department promulgated these guidelines, many consumers were reacting adversely to denial statements that were drafted according to similar guidelines. Finally, it is clear that the Department's guidelines do not further the objectives of the ECOA. The inescapable conclusion is that the Justice Department's interpretation of what suffices as a statement of reasons is at best of minimal assistance to credit scoring creditors in their efforts to meet the ECOA specificity requirement.

Despite the problems raised by the Justice Department's interpretation of specificity, a statement of reasons for denial based on its guidelines still has its proponents: most significantly, the Federal Trade Commission. Since the F.T.C. was of counsel in *Federated*, it presumably favored the terms and conditions of the consent decree and, ultimately, any statement of reasons drafted according to the decree's guidelines. More importantly, however,
the Justice Department's position in *Federated* apparently was predicated on similar guidelines proposed by the F.T.C. in *In Re Aldens, Inc.*, a case involving another credit scoring creditor. The F.T.C. complaint alleged that the following statement given by Aldens to rejected credit applicants violated the ECOA specificity requirement:

> Your application for credit has been reviewed and at the present time we may not open an account for you. Our decision was according to our usual policies, and was based solely on information you supplied to us.\(^{147}\)

In November, 1978, the F.T.C. accepted a consent order in *Aldens* which followed the pattern of the *Federated* order and which would allow for statements of reasons similar to those based on the Justice Department's guidelines in *Federated*.\(^{149}\) By its disposition of *Aldens*, the F.T.C. demonstrated its approval of statements similar to those drafted by the Justice Department in the *Federated* case. It should be remembered, however, that F.T.C. approval does not erase consumer objections to the specificity of such statements,\(^{150}\) nor does it remove the obvious inconsistencies between the sanctioned reasons and the purposes Congress intended they serve. Thus, to date, the enforcement authorities have failed to resolve the problem of how credit scoring creditors can meet the ECOA specificity requirement.

### B. Alternatives for Credit Scoring Creditors

1. **Disclosure of Minimum Standards of Creditworthiness**

Unlike judgmental creditors, credit scoring creditors cannot resolve the specificity problem by publicly disclosing their minimum standards of creditworthiness, because a credit scoring system does not use "minimum standards" in the absolute sense.\(^{151}\) A credit scoring creditor can reveal the maximum points available under each criterion for which the applicant failed to receive the maximum score, or the minimum overall aggregate score necessary for credit approval. However, review of the hypothetical credit scoring system

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146. 92 F.T.C. 916 (1978).
147. Id.
148. Id.
149. *See* note 139 and accompanying text.
150. *See* note 144 *supra*.
151. *See* note 159 *infra*, for a discussion of how a typical scoring system operates.
THE SPECIFICITY REQUIREMENT

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described above indicates that merely revealing the maximum points would not place a consumer in the position Congress intended. Under the hypothetical scoring system, the maximum number of points available for the “occupation” category is 27, and the sample applicant received only 3 points. Informing the applicant that he was denied credit because he failed to achieve the 27 maximum point score in this category is confusing and misleading. The statement logically implies that the applicant would need to receive 24 additional points under this criterion to receive credit. This statement is inaccurate in this hypothetical because the sample applicant is only one point below the 114 preselected cutoff score, and if he received one additional point under any of the criteria listed, credit would be granted. Thus, only revealing the maximum qualifying score does not give the rejected applicant a clear and meaningful indication of why credit was denied. Similarly, only revealing the overall necessary score for credit approval fails to comport with Congressional objectives because it is useless to the applicant to know that he failed to receive the minimum qualifying score of 114 unless he also receives an explanation of how he might achieve that score.

Since the statement’s purpose is to give a rejected applicant an opportunity to take remedial action or correct erroneous information, an applicant must be given an explanation of the score detailed enough to allow him to act. There is, however, a danger of supplying explanations of why and how the applicant failed to meet the creditor’s minimum score which are so detailed that they overwhelm a rejected applicant. Highly technical information can have the effect of only adding to the applicant’s confusion. Conceptually, there is a point of diminishing return involved, and it is possible that disclosure of all information which might conceivably be useful to a rejected applicant will not result in a better informed applicant. Because rejection is normally based on a combination of variables, the denial explanation would have to include a discussion of the possible ways the different variables could be adjusted for the applicant to qualify. For example, the applicant should be told that an increase in his score under one criterion

decreases the amount by which he must increase his score under the other criteria. Such explanations could hinder rather than help the rejected applicant understand the reasons for denial, unless the applicant has more than a basic understanding of how scoring systems operate. Explaining the operation of scoring systems in a manner which facilitates understanding the reasons for denial could lead to lengthy and confusing statements of reasons which go beyond the non-detailed, brief statements Congress regarded as sufficient.\footnote{53}

Thus, the inherent conflict between the scoring system and the specificity requirement is apparent. Credit scoring creditors are incapable of giving precise, specific reasons for denial, even though Congress has mandated that precision and simplicity are of paramount importance in the statement of reasons. From all indications, scoring systems and the specificity requirement, as presently formulated, cannot coexist. In light of this realization, the practicality of prohibiting the use of scoring systems should be carefully examined.

2. The Practicality of Prohibiting the Use of Scoring Systems in the Credit Evaluation Process

Scoring systems are becoming increasingly popular as more and more creditors use them to replace their judgmental systems.\footnote{54} The question of whether the use of scoring systems should be discontinued in light of their inability to comply with the ECOA specificity requirement requires careful and thoughtful consideration. Although scoring systems cannot comply with the specificity requirement, they do provide some advantages over judgmental systems. Thus, in order to properly consider the question of their continued use, the advantages and disadvantages of scoring systems must be discussed in light of the objectives of the specificity requirement. The key determination to be made is whether the objectives of the specificity requirement outweigh the benefits derived from using scoring systems instead of judgmental systems.

\footnote{53}{See note 53 supra.}
\footnote{54}{Scoring systems have been in use since World War II. \textit{Computers Judge Your Credit Ability}, 18 \textit{Everybody's Money} 3, 5 (No. 3). Recently, however, their popularity has increased. More than 200 scoring system models are currently used by major retailers, banks, oil, travel and entertainment credit card companies. Among those companies that use scoring systems are Montgomery Ward, J.C. Penney, Spiegel, Sears, American Express, Household Finance, Mobil Oil, and National Car Rental. See G. Chandler & D. Ewert, \textit{supra} note 1, at 19 n.3.}
a. Advantages of Scoring Systems to Creditors In comparing scoring systems to judgmental systems, scoring systems are said to be more advantageous to creditors because they objectively consider only those factors that are permissible under the ECOA. For example, the ECOA now prohibits consideration of such factors as sex, race and marital status in making a credit determination, but prior to the passage of the ECOA, many creditors considered these factors. Even though these factors can no longer be considered, judgmental creditors find it difficult to disregard them. Scoring system proponents assert that their system avoids this problem because it allows them to simply delete such factors. In contrast, judgmental creditors must rely on a loan officer's ability to subjectively discount factors previously used. An officer's ability to completely ignore these factors, however, is highly suspect. Scoring system advocates believe that human judges cannot totally free themselves of bias, and that only scoring systems can provide the objective uniformity implicit in the ECOA's central theme that a creditor shall not treat one applicant less favorably than another for any prohibited reason. Furthermore, the use of credit scoring systems allows creditors to reap various other significant benefits. First, scoring systems allow a creditor a great deal of control over the decision making process since the cutoff score can be raised or lowered depending on whether it is in the creditor's best business interest to decrease or increase the number of loans made at a particular time. Second, scoring systems eliminate the difficulty of transmitting the skills acquired over the years by a senior loan officer to a new loan officer and eliminate the cost of having to


156. See the following works by Churchill, Nevin & Watson: Credit Scoring— How Many Systems Do We Need, THE CREDIT WORLD, Nov. 1977; Credit Scoring System, THE CREDIT WORLD, Apr. 1977; The Role of Credit Scoring In The Loan Decision, supra note 155; Credit Scoring: Why and How, supra note 5; see also, Churchill & Nevin, Developing and Assessing The Performance of Credit Scoring Systems, Apr. 1976, Wisconsin Working Paper.

157. Although the use of uniform standards in the scoring system should enable the creditor to better determine how much tightening or loosening is required, it must be remembered that these decisions are subjective ones—made not by the system but rather by various loan officers acting as agents on the creditor's behalf. See Credit Scoring: Why and How, supra note 5, at 13.
train new loan officers in the art of evaluating loan applicants.\footnote{158} Third, more applications can be processed in a shorter time period when a scoring system is used, because fewer credit checks are required. Scoring system creditors do not run credit checks on all new applicants; instead, credit checks are made only on those applicants whose score falls within a preselected range.\footnote{159} Fourth, the use of a scoring system allows a creditor to develop consistent credit approval and rejection policies and to show that the same standards are uniformly applied to all applicants; thus a charge of unlawful discrimination is easier to defend. Fifth, scoring systems provide creditors with the opportunities to collect useful information about their borrowers. Since the applicant information can be incorporated into the creditor's data processing system, it can easily be retrieved and used for a number of purposes: for example, to develop an up-to-date profile of the company's loan portfolio, or to develop forecasts of bad debts expected in the near future. For these reasons, credit scoring systems are considered more advantageous to creditors than judgmental systems. One study has shown that the use of credit scoring systems would enable a judgmental creditor to reduce his credit costs.\footnote{160}

\textit{b. Advantages of Scoring Systems to Credit Applicants}

Credit applicants also benefit from the objectivity of scoring systems as an "art" rather than a "science" which must be taught through an apprenticeship method. They believe that through this teaching process, the teacher will convey not only his skills, but the benefit of his experience. The capacity of the teacher to successfully convey the knowledge gleaned from his experience is limited, however, by the limited data processing and recall capacities of the human mind. See \textit{ECOA Hearings, supra} note 15, at 445 (statement of Richard Cremer).

\footnote{158} Montgomery Ward views the judgmental form of reaching credit granting decisions as an "art" rather than a "science" which must be taught through an apprenticeship method. They believe that through this teaching process, the teacher will convey not only his skills, but the benefit of his experience. The capacity of the teacher to successfully convey the knowledge gleaned from his experience is limited, however, by the limited data processing and recall capacities of the human mind. See \textit{ECOA Hearings, supra} note 15, at 445 (statement of Richard Cremer).

\footnote{159} Montgomery Ward, for example, follows a typical management process for using a scoring system to reach credit decisions. It operates as follows:
\begin{enumerate}
\item If the applicant's score falls \textit{below} a predetermined minimum score, the applicant is rejected immediately on the basis that the risk is too high.
\item If the applicant's score falls \textit{above} a predetermined upper limit, the applicant is accepted immediately on the basis that the risk is acceptable.
\item If the score falls between the two limits, additional information is obtained via a credit bureau report, direct investigation or both. Based on the information received, the applicant is accepted or rejected depending on whether the final score with the information included is above or below the predetermined minimum cut-off.
\end{enumerate}

\textit{Id.} at 442.

\footnote{160} See \textit{Proposal For Development of Your Credit Scoring System}, (1978) (General Electric Credit Corp.), which concluded that use of a credit scoring system may allow a judgmental creditor to save 20 to 35 percent in credit and collection expenses.
tems, since the system's impartiality will in some cases provide the applicant with a more equitable result than would the operation of a loan officer's built-in bias. The following situation illustrates this point: what happens if, a judgmental creditor's loan officer had been unsuccessfully attempting to collect from a plumber, when another plumber asks for a loan? The loan officer's recent bad experience may well adversely affect his evaluation of the second plumber and result in denial of the loan. In contrast, a scoring system does not require time to regain an objective or impartial composure that a judgmental loan officer might need. Similarly, denial would seldom, if ever, result from consideration of any single factor, or from an arbitrary policy like the four "B's" policy of never lending to beauticians, bartenders, bricklayers, or barbers. Judgmental creditors have, however, utilized such policies.

As the ECOA's legislative history reflects, Congress favors the use of scoring systems over judgmental systems because of the former's objectivity. Because they are more objective, Congress believes that statistical analysis reduces rather than increases illegal discrimination and individual unfairness in credit evaluations. This belief is shared by several proponents of scoring systems, who state that "a credit scoring system is created for the purpose of legitimately or fairly differentiating between high risk credit applicants and low risk applicants." Another commentator noted that "credit scoring may not be as friendly as a loan officer, but in most cases it's probably fairer. Computers may be heartless, but they're not prejudiced." Besides making the credit evaluation process fairer and more objective, at least one commentator has noted that the majority of lenders who use scoring systems have found that they actually make credit more available. This belief is supported by a report from a major scoring system developer, who estimates that there are from 10% to 40% fewer denials as a

161. See generally ECOA Hearings, supra note 15.
162. Computers Judge Your Credit Ability, supra note 154, at 5.
163. See ECOA Hearings, supra note 15, at 436 (statement by Montgomery Ward).
165. Id.
167. Id.
168. Computers Judge Your Credit Ability, supra note 154, at 5.
169. Id.
result of computer judging.170

c. Disadvantages of Scoring Systems Despite the arguments for using scoring systems, scoring systems are arguably deficient because they make loan decisions based on generalizations, distort objectivity, produce illogical results, and reflect past biases. Additionally, they are not always followed.

i. Scoring Systems Contradict the Underlying ECOA Philosophy Apart from being inconsistent with the ECOA specificity requirement, scoring systems directly contradict the underlying premise of the ECOA.171 The ECOA encourages creditors to treat applicants indiscriminately on the basis of their individual creditworthiness, while scoring systems group and evaluate applicants based on the conduct of prior applicants. Critics note that the major drawback to using a scoring system is that it “attempts to predict the behavior of a group of people, not individuals.”172 Some members of Congress believed that saddling each applicant with the statistical characteristics of similar prior applicants is inherently discriminatory, and they objected to “prediction based on generalizations” during the ECOA hearings;173 however, Congress

170. Id.
171. See notes 127-44 and accompanying text.
172. Credit Scoring: Does It Ease Discrimination or Make Discrimination Easier?, SAVINGS & LOAN NEWS 72, 74 (July 1978).
173. Senator John Biden made the following comments during the Congressional hearings on the 1977 amendments to the ECOA:

As we move toward this credit card society which encompasses everything, my concern is that we will not have the old fashioned kinds of discrimination where the credit manager doesn’t want to give credit to Roosevelt Jones because Roosevelt happens to be black, and he just doesn’t like blacks.

I am getting less and less concerned about that kind of discrimination and more and more concerned about the person getting caught between the rock and the hard spot, becoming the statistic, the person becoming the punch card in a computer and somehow falling into a general category which is used in a point scoring analysis when really they are an exception to that category, and there is no way they can get out from under it.

You know, in the name of objectivity, I am afraid we are getting more toward a mechanized society which in fact will discriminate more than the risk we ran when we had the plain old rednecked prejudiced antiblack who sat there and said, “I don’t want that boy to get no credit.”

ECOA Hearings, supra note 15, at 455. Senator Biden was particularly disturbed that scoring systems operate under generalizations which lead to the deterioration of individuality in the decision making process:

I am not sure that you should be able to use any statistical data which in fact does not relate specifically to that person, John Doe, namely statistical data as to how often he paid.
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did not see fit to proscribe the use of credit scoring systems.

Instead of evaluating each applicant independently, scoring systems assume that each applicant will act like members of a specific group. For example, a scoring system might evaluate pregnant applicants on the basis of a previous determination that, generally, pregnant women will permanently leave the labor market after giving birth and therefore are poor credit risks. Obviously, such classifications may not accurately reflect the conduct of all of the individual group members the system purports to characterize. For this reason, many believe that generalizations should be avoided and that each individual should stand on his or her own merits with respect to credit history. Of course, this system fails when applicants are denied credit because they have never previously received it.

ii. Credit Scoring is not Necessarily Objective

Calling a scoring system "objective" does not mean that it is objective in fact. The following examples illustrate that while most data used in scoring systems appears neutral, the point value restrictions creditors place upon the characteristics scored can distort objectivity. Regulation B is silent on the point allocation process and some scoring system points are allocated in a manner which allows

You can calculate as many statistics as you want about him. . . . That is one thing. But when you make him part of a category which is totally beyond his control, where he has no way of affecting what happens within that category, and you in fact then impose upon him certain limitations because he falls within that category, it seems to me to be a pretty insensitive thing to do.

Id. at 458.

174. The United States Supreme Court addressed this problem in City of Los Angeles v. Manhart, 435 U.S. 702 (1978), which involved a pension contribution scheme that required female contributors to pay more than their male counterparts. The justification for requiring the higher sum was that it had been statistically proven that, generally, women live longer than men; therefore, they would receive more benefits from the pension fund. Without denying the statistical findings, the Supreme Court held the contribution scheme unconstitutional, primarily on the ground that the statistics generalized. In denouncing such generalizations, the Court said: "Even a true generalization about a class does not justify its use if there is at least one person within the class to whom the generalization does not apply." Id. at 708. If the Court's reasoning signals future judicial reactions to such generalizations, scoring systems stand within a clearly marked danger zone.

175. See S. REP. No. 239, supra note 53, at 4 (statement of Dr. Lee Richardson, Director of the National Office of Consumer Affairs in Washington, D.C.).

176. The methodology of point allocation is beyond the scope of this article. However, it should be noted that creditors usually hire scoring system development companies to make the necessary point allocations. Capon, Credit Scoring—Some Unanswered Questions, Am. Banker, Mar. 19, 1979, at 10.
these facially neutral variables to serve as surrogates for variables prohibited by the ECOA. 177 For example, the variable "zip code" appears to be neutral, but if zip code areas inhabited predominantly by minority groups receive the lowest point assignments, then the courts may decide that a zip code was improperly used in the scoring system. 178 Similarly, "occupation" may appear neutral on its face, but if predominantly "female" occupations 179 are awarded low point scores, the courts may again conclude that the ECOA has been violated. 180 Another variable affecting a scoring system's objectivity is "income source." The 1977 ECOA amendments require creditors to consider income from sources other than employment as any other income source would be considered. 181 Therefore, a scoring system which considers "occupation" but not "income source" would appear to discriminate against persons who do not work for their income. For example, a person receiving $100.00 weekly unemployment compensation may receive no points, while an employed person receiving an equal amount as "salary" will receive points. Similarly, a retired person or an alimony recipient would receive no points because his income is not derived from an occupation. Since occupation is so closely linked to income, a scoring system which neither considers income source separately nor allows for its consideration under the occupation variable does not adhere to the ECOA requirements.

iii. Scoring Systems are Illogical Another concern of scoring system foes is that the systems sometimes defy logic. One scholar illustrated a certain scoring system's senselessness by examining the following point assignments for the variables "time at present address" and "time with employer:"

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>TIME AT PRESENT ADDRESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 6 months</td>
<td>39 points</td>
</tr>
<tr>
<td>6 months - 1 year 5 months</td>
<td>30 points</td>
</tr>
<tr>
<td>1 year 6 months - 3 years 5 months</td>
<td>27 points</td>
</tr>
<tr>
<td>3 years 6 months - 7 years 5 months</td>
<td>30 points</td>
</tr>
</tbody>
</table>

177. Id.
178. Id.
179. For example, nursing, clerical work and social work.
180. See Capon, supra note 176.
182. Capon, supra note 176.
Under this system, applicants who have lived at their present address for less than six months are awarded 39 points, a level which they could not reach again until they had maintained the same residence for seven and one-half years. Furthermore, applicants who have been residents for between six months and 1 year 5 months (30 points) are considered more creditworthy than those who have been residents for between 1 and 1/2 years and 3 years 5 months (27 points). Even more absurd is the fact that under this system, a person who does not answer the question receives more points than applicants in fifty percent of the time categories scored. Furthermore, the “time with employer” variable shows that an applicant who has been with his current employer for less than six months cannot score more points, that is, cannot be considered more creditworthy, until he or she has been with his or her employer for more than 151/2 years. It is also interesting to note that this scoring system indicates that it is better to be unemployed than to have worked with one’s employer for between six months and 81/2 years.183

The potential absurdity is even clearer when viewed in connection with the specificity requirement’s policy that applicants denied credit are entitled to specific reasons for denial so they can learn how to become an acceptable credit risk. How do you explain to an applicant that the longer he retains his job and residence the less creditworthy he will become, and that his chances of being granted credit are greater if he moves his residence and quits his job? This suggests a valid reason for “overriding” scoring system determinations, or even discontinuing use of the system altogether.

183. Id.
since a scoring system which requires an override to be logical does not meet the fairness goals of the ECOA.

iv. Many Creditors Override the Scoring Systems In some cases in which a credit applicant is rejected, the scoring system prediction is disregarded and management subjectively grants credit despite a total point score which would indicate denial to be appropriate. This process is commonly referred to as “judgmental override.”184 Overriding usually occurs because credit scores are not always consistent with a credit manager’s intuitive belief about what characteristics accurately predict creditworthiness.185 For example, credit history is ordinarily unscored by scoring systems. Many loan officers believe that there is a positive correlation between past and future repayment behavior and therefore consider credit history in conjunction with the credit score.186 Thus, an applicant who scores below the cutoff may still receive a loan if his record reveals an unblemished history of repaying his credit obligations. If, on the other hand, an applicant scores high but has a poor repayment history, a loan officer may disregard the score and rely on personal judgment. Therefore, the scoring system’s score may sometimes be used only as a guideline to weed out applications requiring no further review.187 It appears, however, that judgmental overrides are more often used to give low scoring applicants the benefit of the doubt,188 but regardless of their use, personal overrides inevitably increase the potential for discrimination in credit analysis189 and lead to the potential problems of inconsistency and unfairness found in purely judgmental systems.

v. Scoring Systems Have a Built-In Bias Scoring systems are founded on the assumption that a creditor’s future credit expe-

184. See Computers Judge Your Credit Ability, supra note 154, at 4. According to Sandy Boone, attorney for the Federal Reserve System, Division of Consumer Affairs, the majority of scoring system users override their systems. Statement made at Fair Housing and Fair Lending Legal Seminar, in Madison, Wisconsin (Apr. 20, 1979). The author could find no available statistics to indicate how prevalent overriding is, but there is some indication that most creditors depend to some degree on human judgment to personalize their scoring systems. Id.

185. Id.

186. See generally, ECOA Hearings, supra note 15, at 440-43, 450-52 (statement by Montgomery Ward & Co.).

187. See Computers Judge Your Credit Ability, supra note 154, at 4. See also note 159 and accompanying text.

188. See Computers Judge Your Credit Ability, supra note 154.

189. See Hsia, supra note 70, at 430.
perience will mirror its recent past.\footnote{190} Because data used to construct
the system may contain characteristics which were once legal but
are now prohibited by the ECOA, a system designed to reflect re-
cent creditor experience may in fact perpetuate past biases and
discriminatory lending practices. This creates what is often re-
ferred to as the dirty-data base\footnote{191} problem. For example, a system
may have been based on the characteristics which project a profile
of a married, white male as the most desirable credit risk. Such a
system unfairly discriminates against all single persons, minorities
and women. Many believe that the dirty-data base problem is fur-
ther compounded by the private nature of scoring systems which
makes it difficult to prove that the systems use biased data.\footnote{192} Be-
cause the facts upon which the systems are based are not visible
from ordinary observation, it is questionable whether any scoring
system is in fact sound. Additionally, there is no standard to mea-
sure a system's fairness.\footnote{193}

While it is true that there is no universal method of testing a
scoring system's fairness, Regulation B does require creditors to
"validate" their systems. As noted earlier,\footnote{194} the process of valida-
tion involves testing a scoring system by using a second, indepen-
dent set of data to check its predictive accuracy, and by examining
the characteristics scored to statistically determine whether the
system contains tainted data which may lead to illegal discrimina-
tion. For example, validation should allow a creditor to statistically
show that a higher rate of credit denial to women than men results
from their respective income levels or some other permitted vari-
able rather than from their sex.\footnote{195} Since Regulation B requires scor-

\footnote{190} See ECOA Hearings, supra note 15, at 442.
\footnote{191} The dirty-data base problem can be further explained by looking at how a scoring
system selects the most desirable credit risks. If a scoring system uses a creditor's past lend-
ing experience to define "good" and "bad" credit risks and the bad risk category includes
the characteristics of those individuals who were rejected in the past, the system may in
effect assign negative values to attributes possessed in high proportions by minorities, wo-
men, and other ECOA protected classes. Since factors such as marital status, race and sex
were legitimate considerations prior to the passage of Regulation B, many scoring systems
based on pre-Regulation B lending experience will not identify creditworthy members of the
ECOA protected classes as effectively as they identify creditworthy white males. See Note,
\footnote{192} See Computers Judge Your Credit Ability, supra note 154, at 4.
\footnote{193} Id.
\footnote{194} See text accompanying notes 79-83, supra.
\footnote{195} See Baer, The Equal Credit Opportunity Act and "The Effects Test," 95 Banking
ing systems to be validated prior to their initial use\textsuperscript{196} and periodically thereafter,\textsuperscript{197} creditors should have their validation information available to defend against lending discrimination challenges, particularly challenges arising under Regulation B's "effects test" provision.\textsuperscript{198} Essentially, the "effect test" bars conduct which has the effect of discriminating against persons in the ECOA's protected classes. The creditor's intent is irrelevant for purposes of applying the test, and the Federal Reserve Board has determined that Congress intended the "effects test" concept to be carried over to the credit field as it developed from court interpretations in employment discrimination cases\textsuperscript{199} such as Griggs \textit{v. Duke Power Company}\textsuperscript{200} and \textit{Albermarle Paper Company v. Moody}.\textsuperscript{201} In \textit{Griggs}, the United States Supreme Court held that requirements which appear to be neutral but which in fact operate to exclude black job applicants at substantially higher rates than white job applicants are prohibited under Title VII of the Civil Rights Act of 1964, unless the employer shows that such requirements are sufficiently related to job performance.\textsuperscript{202} Thus, an employer could violate the Act without intending to discriminate if the plaintiff successfully shows that the questioned requirement has a disproportionate impact on minorities and the employer fails to show its job-relatedness.\textsuperscript{203} In \textit{Albermarle}, the Court attached an additional step to the effects test by allowing an employee to defeat an employer's claim of job-relatedness by showing that the employer can meet his legitimate business needs through a less discriminatory alternative practice.\textsuperscript{204} One author suggests that, in the credit scoring context, the effects test requires a credit applicant to show that the scoring system disproportionately affects a protected class in

\textsuperscript{196} L. J. 241, 248 (1978).
\textsuperscript{199} 12 C.F.R. § 202.6(a) note 7 (1980).
\textsuperscript{200} Id.
\textsuperscript{201} 401 U.S. 424 (1971).
\textsuperscript{202} 422 U.S. 405 (1975).
\textsuperscript{203} 401 U.S. at 429-33. Black employees challenged their employer's requirement of a high school diploma or acceptable aptitude test scores as a condition of employment because these requirements excluded a disproportionate number of black applicants from qualifying for available jobs.
\textsuperscript{204} See \textit{Credit Scoring: Does It Ease Discrimination or Make Discrimination Easier, supra} note 172, at 74-75.
order to establish a prima facie case. The creditor is then entitled to rebut by showing that the system predicts creditworthiness. This makes validation critically important for credit scoring creditors. The validation process should establish the credit scoring system's fairness. During validation a rejected applicant's suspicions that a scoring system contains "dirty data" which results in illegal discrimination will either be eliminated or substantiated.205

While the validation process is undoubtedly beneficial to both creditors and consumers, several unresolved problems are associated with it. First, although Regulation B requires periodic revalidation of scoring systems, "periodic" is undefined. Individual determinations of validation frequently diminish a creditor's incentive to keep his scoring system free of "dirty data" and other discriminating criteria. Second, Regulation B is silent as to the number of complaints necessary to initiate validation procedures. Will one complaint trigger the process? That is, if a rejected female applicant alleges she was discriminated against because of her sex, will the creditor be required to prove through the validation process that he does not discriminate against women? If not, under what circumstances will creditors be required to support their claim of non-discriminatory practices? Third, most scoring systems use sample data from which the system was originally developed to test the system's predictive effectiveness. The dangers associated with validating scoring systems by using the same data that was used to construct them are obvious. Although validation procedures can be instrumental in pointing out scoring system biases, their effectiveness will not become fully realized until validation frequency, initiation and testing methodology problems are resolved.

C. Summary: Scoring Systems and the Specificity Requirement

It is difficult to determine whether scoring systems will eventually be found to be at odds with the specificity requirement. One thing appears certain: Congress favors scoring systems, the reservations of some members206 notwithstanding. However, it seems that Congress had two principal objectives in mind when it incorpo-

206. See note 74 supra.
rated the specificity requirement into the ECOA. First, it was concerned that rejected credit applicants become meaningfully informed about the reasons for rejection. Second, it was concerned that creditors evaluate applicants objectively, that is, equally and without regard to consideration of factors unrelated to creditworthiness. Scoring systems cannot satisfy the first objective because they are incapable of giving reasons for denial consistent with Congressional intent. On the other hand, scoring systems have the potential to objectively screen credit applicants, and thus can be consistent with the second objective of the specificity requirement, to eliminate discrimination.

The ECOA legislative history does not indicate that Congress recognized these conflicting characteristics of scoring systems. In view of this conflict, it seems that Congress will continue to sanction the use of scoring systems only if they can in reality produce the objectivity Congress perceived as their redeeming quality. One way to insure objectivity is by requiring closer administrative scrutiny of scoring system validation procedures. As added insurance, the Federal Reserve Board needs to establish meaningful validation guidelines which would delineate the validation process and control the frequency of revalidation. Additionally, promulgation of a uniform method of validating scoring systems would help identify unsound systems and resolve the “dirty data problem.” Stricter requirements for revalidation would help ensure the continued soundness of credit scoring systems.

Greater administrative monitoring, however, would not enable creditors who use a credit scoring system to give specific reasons for denial. But given greater administrative surveillance of the scoring system’s objectivity, it is possible that Congress would be satisfied with denial reasons that do not strictly adhere to the requirements of specificity. Thus, in order to gain scoring system objectivity, Congress might sanction a method of disclosing reasons for denial similar to that suggested by the Justice Department in Federated and the F.T.C. in Aldens, such as requiring the creditor to state that a scoring system was used, and thereafter, to disclose the factors which produced the greatest difference between

207. See text accompanying notes 52-54 supra.
208. See Baer, note 195, supra at 258-59.
209. See notes 146-51 and accompanying text supra.
the applicant's score and the maximum number of points obtainable for each factor. If these kinds of reasons are given, increased agency enforcement will serve the additional purpose of policing scoring systems. Consumers are forced to rely on agency policing because a list of the areas in which the applicant scored the lowest will not give the consumer adequate information to pursue a suspected claim of discrimination, to inform him of application deficiencies, or to allow him to check on a credit systems validity.

It cannot be conclusively maintained that Congress intended to differentiate between the manner in which scoring systems and judgmental systems must comply with the ECOA specificity requirement. If, however, practical meaning is to be given to the Congressional policy in favor of scoring system objectivity and credit denial specificity, the meaning of specificity as reflected in the ECOA legislative history must be broadened to accommodate both. Greater emphasis on proper validation procedures, coupled with the FTC and Justice Department suggestions for giving specific reasons, provide excellent starting points for broadening the specificity concept. It should be remembered, however, that a broader interpretation of "specificity" will not resolve the inherent conflicts between scoring systems and the specificity requirement; rather, it will merely reflect an attempt to satisfy the requirement as much as possible while allowing for the continued existence of properly validated scoring systems.

CONCLUSION

The problems of compliance with the ECOA specificity requirement have recently received national attention. In April, 1979 the Federal Reserve Board requested public comment on how the specific rules of Regulation B should apply to certain practices of credit scoring creditors. Among other things, the Board solicited comments as to how scoring system creditors can give specific reasons for denial which meet the objectives of Regulation B. By

211. Id. Specifically, the Board solicited comments on how Regulation B should be applied to the following scoring system practices:
(1) scoring number of jobs or number of sources of income;
(2) not scoring the amount of an applicant's income from part-time employment, pension, or alimony;
(3) selecting the reasons for adverse action judgmentally; and
soliciting public comment, the Board has acknowledged the gravity of the specificity problem as it relates to scoring systems and has made the first step toward resolving it. It can only be hoped that while the Board is seeking solutions for scoring system creditors, it will not overlook the fact that the problems faced by judgmental creditors in meeting the ECOA's specificity requirement also require immediate resolution.

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(4) using reasons for adverse action from the model statement when they do not correspond to the characteristics scored.

Id.