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Novel ECOA Claims Asserted Against Lenders & Servicers Regarding Loan Modification Requests

The Equal Credit Opportunity Act (ECOA), 15 U.S.C. §§ 1691 *et seq.* requires creditors to notify an applicant of its decision on a credit application within thirty days of receiving a completed application. 15 U.S.C. § 1691(d)(1). Furthermore, each applicant against whom “adverse action” is taken is entitled to a notice describing the reasons for the decision. 15 U.S.C. § 1691(d)(2).

A series of at least five class action lawsuits have recently been filed asserting that a request for a loan modification, even when made as part of settlement negotiations in ongoing litigation, constitutes an application for credit under ECOA. The lawsuits claim that the defendants violated ECOA by not sending adverse action notices where loan modifications were not granted. The lawsuits appear to have been prompted at least in part by a non-binding letter issued by the Federal Reserve Board on December 4, 2009, which states that requests for loan modifications may be applications for credit under ECOA.¹ Because the cases were just filed, no rulings have been made on the merits of the claims.

This article will briefly summarize the relevant arguments that lenders or servicers should consider if named as a defendant in such a case.

1. Adverse Action Notices are Generally Not Required Where the Borrower is in Default

ECOA defines an adverse action as “a denial or revocation of credit, a change in the terms of an existing credit arrangement, or a refusal to grant credit in substantially the amount or on substantially the terms requested.” 15 U.S.C. § 1691(d)(6). But, ECOA specifically excludes “a refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or otherwise in default.” *Id.* Thus, the FRB’s December 4, 2009 letter recognized that “a creditor is not required to provide an adverse action notice to a borrower whose account is currently delinquent or in default.”

A lender or servicer faced with this ECOA claim should determine whether the borrower was in default at the time the request for loan modification was made. A failure to timely make payments is the most obvious example of a default, and falling behind on payments is often what prompts a borrower to request a loan modification. However, payment delinquency is not the only potential example of a default. Indeed, ECOA’s own language refers to the borrower being “delinquent or *otherwise in default*,” suggesting that a default can be triggered in ways other than missing payments. For instance, some security instruments provide that the initiation of litigation that threatens a lender’s security interest can constitute an event of default. A lawsuit filed by the borrower demanding rescission of their loan would seem to constitute an event of default under this language of the security instrument.

Defendants should carefully examine the applicable notes and security instruments to determine whether the borrower was in default at the time the loan modification was requested. If such a default existed, ECOA’s adverse action notice requirements would not generally apply.

2. Requests for Loan Modification Often Do Not Seek “Credit”

Adverse action notices are only required in response to an application for “credit.” ECOA defines “credit” as the right to “defer” payment of a debt. 15 U.S.C. § 1691a(d). But a request for a loan modification often involves more than merely *deferring* payment on the debt. Rather, a loan modification request typically contemplates some sort of debt *forgiveness* through a reduction in the principal balance or the interest rate.² Thus, defendants should evaluate the terms of the loan modification requested by the borrower, and consider whether the requested modification was limited to a request for credit, or was actually a request for debt forgiveness.

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Novel ECOA Claims Asserted Against Lenders & Servicers Regarding Loan Modification Requests (cont'd.)

3. Requests for Loan Modification May Not Be “Applications”

Adverse action notices are only required in response to an “application.” ECOA defines an “application” as a “request for an extension of credit that is made *in accordance with procedures used by a creditor for the type of credit requested.*” 12 C.F.R. § 202.2(f) (emphasis added). Requests for loan modifications, particularly those made as part of litigation settlement negotiations, are often not made as part of a creditor’s typical process of evaluating credit applications. Such requests may be as simple as a letter, or e-mail, from a borrower’s attorney, and may be supported by little or no documentation of the type typically provided in a normal credit application. If the request for a loan modification is not made as part of the normal credit application procedures, then ECOA’s adverse action notice requirements may not apply.

4. Loan Servicers May Not Be “Creditors”

Only “creditors” are obligated to provide adverse action notices. Loan servicers should consider whether they are a “creditor” as defined in ECOA. Creditor is defined as someone who “regularly extends” credit, 15 U.S.C. § 1691a(e), or “a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of the credit.” 12 C.F.R. § 202.2(l). Loan servicers that are not responsible for making credit decisions may not fall within either of these definitions of creditor. Indeed, courts have dismissed ECOA claims against loan servicers for that reason. See *Wenglicki v. Tribeca Lending Corp.*, No. 07-4522, 2009 WL 2195221, *5 (E.D. Pa. July 22, 2009); *Flowers v. South Western Motor Sales, Inc.*, No. 08-449, 2008 WL 4614307, *3 (N.D. Ill. Oct. 14, 2008). Accordingly, loan servicers should consider arguing that they are not creditors subject to ECOA’s adverse action notice requirements.

While the legal landscape has yet to fully develop with respect to this new theory of ECOA violations, there are several arguments that defendants should consider if faced with such a claim.

Endnotes

- 1 <http://www.federalreserve.gov/boarddocs/caetters/2009/0913/caltr0913.htm>.
- 2 Although the FRB’s December 4, 2009 letter suggested that interest rate reductions are “credit” under ECOA, no analysis was provided to support that conclusion. And, unlike the FRB’s binding Commentary, the letter is non-binding in any event as it was not promulgated through the formal rule-making process.

About the Authors

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