

What Lenders Should Know About ECOA and Business Purpose Loans (Part 1)



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The Equal Credit Opportunity Act (ECOA),[1] originally enacted October 28, 1974, and as modified, amended, and implemented by its implementing Regulation B,[2] is an important statute for members of the California Mortgage Association (CMA) because, as explained in more detail below, it is a federal statute that applies to "any person who, in the ordinary course of business, *regularly participates* in a credit decision."[3] (Emphasis added.) The purpose of this article is to help CMA members better understand ECOA and its implications for their business by a series of questions and answers.

What is ECOA and When Does it Apply to CMA Members?

As a general rule, subject to exceptions discussed below, ECOA makes it unlawful for any creditor to discriminate against any applicant, with respect to *any aspect* of a credit transaction —

(1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract);

(2) because all or part of the applicant's income derives from any public assistance program; or

(3) because the applicant has in good faith exercised any right under the Consumer Credit Protection Act (15 USCS §§ 1601 et seq.)[4]

The prohibition applies to any person who, in the ordinary course of business, regularly participates in a credit decision, including but not limited to banks, retailers, bankcard companies, finance companies, and credit unions. Unlike the Fair Housing Act (FHA), which is limited to residential real estate-related transactions, ECOA applies broadly to *all aspects of consumer and business credit transactions,* whether real estate-related or non-real estate-related.[5] And, ECOA prohibits discrimination in every stage of a credit transaction, including advertising, taking and evaluating applications, making credit decisions, loan servicing, collections, loss mitigation, and default.[6]

Are There Some Key Definitions That Will Help Explain ECOA's Scope of Coverage?

Under ECOA, the definitions of key terms in the statute are extremely important because they apply to the entire title (15 USC §§ 1691 et seq.) and have often been the subject of controversial regulations and interpretative guidelines put in place by regulators appointed by different presidential administrations. One such definition is that of "applicant."

The definition of "applicant"

Under 15 USC §1691(a) the term "applicant" is defined to mean "any person who applies to a creditor directly for an extension, renewal, or continuation of credit, or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit." However, Regulation B, §1002.2(e) defines "applicant" as follows:

> "**(e) Applicant** means any person who requests or who has received an extension of credit from a creditor, and includes any person who is *or may become* contractually liable regarding an extension of credit. For purposes of § 1002.7(d), the term includes guarantors, sureties, endorsers, and similar parties." (Emphasis added.)

Relying on the "may become" language, the Consumer Financial Protection Bureau (CFPB) under a previous presidential administration brought an enforcement action for "redlining" against a mortgage company called *Townstone Financial* arguing that ECOA's coverage extended not just to "applicants" but "prospective applicants." Townstone challenged that position in Federal District Court and the case went up on appeal to the Seventh Circuit who held, in July 2024, that the CFPB's interpretation of Regulation B was "consistent with the statute" and reversed the District Court's order granting Townstone's motion to dismiss. Townstone did not appeal to the Supreme Court but entered into a settlement with the CFPB in November 2024 under which it paid a $105,000 civil money penalty to CFPB. However, on March 26, 2025, Russell Vought (acting Director of the CFPB under the new Trump administration) moved jointly with Townstone to vacate the settlement and return the penalty stating: "CFPB abused its power, used radical 'equity' arguments to tag Townstone as racist with zero evidence, and spent years persecuting and extorting them – all to further the goal of mandating DEI in lending via their regulation by enforcement tactics. The more we uncover at CFPB, the more we see

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how this agency was weaponized against targeted Americans." But on June 12, 2025, Judge Valderrama (N. District Ill.) blocked the motion stating: to grant it "would erode public confidence in the finality of judgments" and open "a Pandora's box."[7]

The Definitions of "Credit" and "Creditor"

ECOA defines other key terms as follows:

> (d) The term "credit" means the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor.
>
> (e) The term "creditor" means any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit.
>
> (f) The term "person" means a natural person, a corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association."[8]

Regulation B, ECOA's implementing regulation, more specifically defines "creditor" as:

> "... a person who, in the ordinary course of business, *regularly participates in a credit decision,* including setting the terms of the credit. The term creditor includes a creditor's assignee, transferee, or subrogee who so participates. For purposes of §§ 1002.4(a) and (b), the term creditor *also includes a person who, in the ordinary course of business, regularly refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made.* A person is not a creditor regarding any violation of the Act or this part committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction. The term does not include a person whose only participation in a credit transaction involves honoring a credit card." (Emphasis added.)[9]

These refinements to the definition of "creditor" are very important because they extend the coverage of ECOA further than might initially be expected and clearly cover not only private money lenders but also brokers and even assignees. Thus, the Official Interpretation of Section 1002.2 of Regulation B states:

> "**Assignees.** The term creditor includes *all persons participating in the credit decision.* This may include an assignee or a *potential* purchaser of the obligation who *influences* the credit decision by indicating whether or not it will purchase the obligation if the transaction is consummated.
>
> **Referrals to creditors.** For certain purposes, the term creditor *includes* persons such as *real estate brokers,* automobile dealers, home builders, and home-improvement contractors who do not participate in credit decisions *but who only accept applications and refer applicants to creditors, or select or offer to select creditors to whom credit requests can be made.* These persons must comply with § 1002.4(a) [of Regulation B], the general rule prohibiting discrimination, and with § 1002.4(b), the general rule against discouraging applications." (Emphasis added.)

Does ECOA Expressly Exclude Any Activities From the Definition of Discrimination?

Under Section 1691(b) of ECOA, the following activities by a creditor are explicitly declared to *not* constitute discrimination under the statute:

> "(1) to make an inquiry of marital status if such inquiry is for the purpose of ascertaining the creditor's *rights and remedies* applicable to the particular extension of credit *and not to discriminate* in a determination of credit-worthiness [creditworthiness];
>
> (2) to make an inquiry of the applicant's age or whether the applicant's income derives from any *public assistance program* ***if*** such inquiry is for the purpose of determining the *amount and probable continuance* of income levels, credit history, or other pertinent element of credit-worthiness [creditworthiness] as provided in regulations of the Bureau;
>
> (3) to use any empirically derived credit system which considers *age* if such system is demonstrably and statistically sound in accordance with regulations of the Bureau, *except that in the operation of such system the age of an elderly applicant may not be assigned a negative factor or value;*
>
> (4) to make an inquiry or to consider the age of an elderly applicant when the age of such applicant is to be used by the creditor in the extension of credit *in favor of* such applicant; or
>
> (5) to make an inquiry under section 704B [(dealing with Small Business Loan Data Collection), in accordance with the requirements of that section."[10] (Emphasis added.)

Additional Activities That Do Not Constitute Discrimination

Under 15 U.S.C. §1691(c) of ECOA, it is also not a violation for a creditor to refuse to extend credit offered pursuant to: (1) any credit assistance program expressly

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authorized by law for an economically disadvantaged class of persons; (2) any credit assistance program administered by a nonprofit organization for its members or an economically disadvantaged class of persons; or (3) any special purpose credit program offered by a profit-making organization to meet special social needs which meets standards prescribed in regulations by the Bureau; provided that such refusal is required by or made pursuant to such program.

Does ECOA Impose Any Restrictions On Advertising?

Yes. Under §1002.4(b) of Regulation B "A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would *discourage* on a prohibited basis a reasonable person from making or pursuing an application."[11] (Emphasis added.)

Generally, the regulation's protections apply only to persons who have requested or received an extension of credit. However, in keeping with the purpose of the Act – to promote the availability of credit on a nondiscriminatory basis – § 1002.4(b) also covers acts or practices directed at *prospective applicants* that could *"discourage"* a reasonable person, on a prohibited basis, from applying for credit. Practices prohibited by this section include:

i. A statement that the applicant should not bother to apply after the applicant states that he is retired.

ii. The use of words, symbols, models or other forms of communication in advertising that express, imply, or suggest a discriminatory preference or a policy of exclusion in violation of the Act.

iii. The use of interview scripts that discourage applications on a prohibited basis.[12]



A creditor may also *affirmatively* solicit or encourage members of traditionally disadvantaged groups to apply for credit, especially groups that might not normally seek credit from that creditor.[13]

As discussed above, the April 22, 2026 Final Amendment to Regulation B also further clarifies what is meant by "discouragement" and amends §1002.4(b) to state:

> "(b) **Discouragement.** A creditor shall not make any oral or written statement, in advertising or otherwise, directed at applicants or prospective applicants that the creditor knows or should know would cause a reasonable person to believe that the creditor would deny, or would grant on less favorable terms, a credit application by the applicant or prospective applicant because of the applicant or prospective applicant's prohibited basis characteristic(s). For purposes of this paragraph (b), oral or written statements are spoken or written words, or visual images such as symbols, photographs, or videos."

The significance of this change is described in the commentary in the Federal Register leading up to the statement of the new Final Rule itself, as follows:

> "Thus, the revision would narrow prohibited discouragement to cover only statements that themselves would cause a reasonable person to believe that the creditor would make a different decision about credit terms or availability based on the applicant or prospective applicant's prohibited basis characteristic(s). *Prohibited discouragement does not include every statement a creditor makes.* As indicated by a commenter, discouragement has been interpreted in the past to capture generalized public-facing speech that is not based on any explicit exclusionary message, but on how certain listeners might react. Focusing on the connection between the credit transaction and the applicant's prohibited basis characteristic provides a clear workable standard.) (Italics in original; underlining added.)

What Are the Latest Definitions of "Protected Basis?"

Regulation B defines "Prohibited basis" as follows: "Prohibited basis means race, color, religion, national origin, sex, marital status, or age (provided that the applicant has the capacity to enter into a binding contract); the fact that all or part of the applicant's income derives from any public assistance program; or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act or any state law upon

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which an exemption has been granted by the Bureau."[14]

On March 9,2021 the CFPB, under former Director Rohit Chopra, issued an Interpretive Rule purporting to "clarify" that "the prohibition against sex discrimination under the Equal Credit Opportunity Act (ECOA) and *Regulation B* includes *sexual orientation* discrimination and *gender identity* discrimination. This prohibition also covers discrimination based on actual or perceived *nonconformity with traditional sex- or gender-based stereotypes,* and discrimination based on an applicant's social or other associations." (Emphasis added.)

However, after the 2024 presidential election, on May 12, 2025, the CFPB, under Acting Director Russel Vought, officially *withdrew* this "Interpretive Rule" and several other ECOA-related "Interpretive Rules, Policy Statements and Advisory Opinions"[15] previously issued by the CFPB that had sought to expand the definition of "protected class" beyond more traditional definitions and the current version of §1002.4 and the current version of Regulation B and related commentary do not include the more expansive definitions.[16]

What types of Discrimination Claims May Be Brought Under ECOA?

Over the years, courts, federal banking regulators and regulatory enforcement agencies have uniformly recognized two (2) legal theories of discrimination under ECOA:

(1). **Overt Discrimination** – I.e., open disparate *treatment* on a prohibited basis. This may occur even when a creditor merely expresses, but does not act on, a discriminatory preference

(2). **Comparative or Circumstantial Disparate Treatment** – This is where a creditor intentionally treats a person differently based on one of the prohibited bases, but evidence need not be overt to be actionable and there is no need to prove prejudicial motive or conscious intention to discriminate beyond an intent to engage in differential treatment.

All that must be shown under this theory for a "prima facie" case are the following four elements: (a) membership in a protected class; (b) an application for credit for which Plaintiff was qualified; (c) rejection of credit despite qualification; and that (d) the defendant approved credit for similarly qualified applicants. The burden of proof then shifts to the creditor to articulate a legitimate reason for the disparate treatment.

In recent years, however, a more controversial third (3) legal theory of liability has emerged in some legal opinions and administrative regulations: *Disparate Impact* (sometimes called the "effects" test). As described in a former Official Interpretation of Section 1002.4(b):

> "The effects test is a judicial doctrine that was [originally] developed in a series of employment cases decided by the U.S. Supreme Court under title VII of the Civil Rights Act of 1964 (42 U.S.C. 2000e *et seq.*,)... The Act and regulation may prohibit a creditor practice that is discriminatory *in effect* because it has a disproportionately negative impact on a prohibited basis, *even though the creditor has no intent to discriminate and the practice appears neutral on its face,* unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact.... (Emphasis added.)

There is conflicting authority, however, over whether ECOA actually authorizes the so-called "Disparate Impact" or "effects test." Although many Circuits recognize and permit that theory, there has been no final determination by the Supreme Court. And, when directorship of the CFPB changed after the 2024 Presidential Election, the CFPB *withdrew* the foregoing interpretive rule on May 12, 2025, along with other regulatory guidance embracing the Disparate Impact theory. Then, on April 22, 2026, the CFPB issued a Final Rule officially amending Regulation B to remove the "effects test" from Regulation B and officially state that ECOA *"does not provide that the 'effects test' applies for determining whether there is discrimination in violation of the Act."*

Endnotes

1 15 U.S.C. §§ 1691 et seq.)
2 12 C.F.R. pt. 1002
3 12 C.F.R. 1002.2(L)
4 15 U.S.C. §1691(a)
5 See 12 C.F.R. §§ 1002.1(a), 1002.2(l) and official interpretations
6 12 C.F.R. § 1002.2(m)
7 Since the Seventh Circuit's ruling in Townstone, the CFPB has been engaged in the process of amending Regulation B to address, among other things, the issue of "discouragement" to prospective applicants, and a Final Rule amending Regulation B was issued on April 22, 2026 and discussed in more detail below in connection with ECOA's rules on advertising. (Federal Register April 22, 2026.)
8 See 15 USC §1691(a)
9 12 C.F.R. 1002.2(l)
10 15 USCS § 1691c-2 dealing with Small Business Loan Data Collection.
11 12 C.F.R. §1002.4(b)
12 Official Interpretation of Reg. B §1002.4(b)
13 Ibid.
14 12 CFR §1002.2(z)
15 Federal Register May 12, 2025, p. 20084-87
16 See 12 CFR 1002.2(z) and related commentary.

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