

# Special Purpose Credit Programs — Taking a Second Look at a Familiar Tool

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

## Anand S. Raman

Partner / Washington, D.C.  
202.371.7019  
anand.raman@skadden.com

## Austin K. Brown

Counsel / Washington, D.C.  
202.371.7142  
austin.brown@skadden.com

## Darren M. Welch

Counsel / Washington, D.C.  
202.371.7804  
darren.welch@skadden.com

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One Manhattan West  
New York, NY 10001  
212.735.3000

1440 New York Avenue, N.W.  
Washington, D.C. 20005  
202.371.7000

Increasingly, lenders are interested in pursuing proactive efforts to increase lending opportunities for members of African-American, Hispanic and other communities that may have traditionally been underserved. These well-intentioned efforts, however, must be undertaken in compliance with the prohibition in the Equal Credit Opportunity Act (ECOA) and its implementing regulation (Regulation B) against considering a prohibited basis, such as race or ethnicity, in any aspect of a credit transaction.

Notwithstanding this prohibition, ECOA and Regulation B permit creditors to create “special purpose credit programs” in order to extend credit to applicants who meet certain eligibility requirements. Pursuant to such a program, lenders may offer special underwriting or pricing for traditionally disadvantaged groups. This article briefly discusses the requirements of such programs, including guidance on how they may be used.

## Background and Examples of Special Purpose Credit Programs

ECOA provides that “[i]t shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction” on a prohibited basis.<sup>1</sup> Regulation B likewise provides that a “creditor shall not consider race, color, religion, national origin, or sex ... in any aspect of a credit transaction.”<sup>2</sup> This prohibition applies not only to discrimination against racial and ethnic minority groups, but also to any consideration of race or ethnicity in a credit transaction. As such, ECOA prohibits so-called “reverse discrimination,” no matter how well-intentioned it may be.

Lenders may, however, favorably consider prohibited factors such as race or ethnicity in connection with a special purpose credit program. Such programs may include initiatives for “low-income minority borrowers,” government sponsored housing<sup>3</sup> credit subsidies for the “aged or the poor,” small business lending programs providing credit to minority- or disabled-owned businesses, and student loan programs based on the family’s financial need.<sup>4</sup>

Special purpose credit programs have explicitly been permitted for more than 40 years, though creditors have tended to use the programs sparingly. Among the concerns by creditors are that regulators have provided limited guidance regarding the parameters of an acceptable special purpose credit program and have indicated that they will not provide prior approval of a program.<sup>5</sup>

## Requirements for Special Purpose Credit Programs

The key elements of a special purpose credit program for a for-profit lender are:<sup>6</sup>

- **Written plan.** The program must be established and administered according to a “written plan” that identifies the “class of persons that the program is designed to

<sup>1</sup> 15 U.S.C. § 1691(a).

<sup>2</sup> 12 C.F.R. § 1002.6(b)(9).

<sup>3</sup> While the Fair Housing Act does not include an explicit special purpose credit program concept for mortgage loans, some regulatory guidance and limited case law indicates that mortgage special purpose credit programs are permitted under ECOA. *See, e.g., Diaz v. Virginia Housing & Development Authority*, 101 F. Supp. 2d 415, 417 (E.D. Va. 2000).

<sup>4</sup> *See, e.g.,* S. Rep. No. 94-589, at 3, 7 (1976); 12 C.F.R. Part 1002, Supp. I, ¶ 8, CFPB; Supervisory Highlights, Issue 12, Summer 2016, § 2.52; and Letter from Carolyn J. Buck, Chief Counsel, Office of Thrift Supervision (Oct. 7, 1997).

<sup>5</sup> 12 C.F.R. Part 1002, Supplement I, ¶ 8(a), comment 1.

<sup>6</sup> Regulation B sets forth different but generally similar requirements for governmental, nonprofit institution and for-profit institution special purpose credit programs.

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benefit and sets forth the procedures and standards for extending credit.”<sup>7</sup> The written plan must state how long the special purpose credit program will last or when it will be reevaluated to determine the continuing need for it.<sup>8</sup>

- **Demonstrated need for the program.** The program must be designed to provide credit to a class of persons who, “under the organization’s customary standards of creditworthiness, probably would not receive such credit or would receive it on less favorable terms than are ordinarily available to other applicants applying to the organization for a similar type and amount of credit.”<sup>9</sup> This need for the program can be established by an “analysis using the organization’s own research or data from outside sources, including governmental reports and studies.”<sup>10</sup>
- **Program must not discriminate against applicants.** The program must be “established and administered so as not to discriminate against an applicant on any prohibited basis.” The lender can require applicants to “share one or more common characteristics (for example, race, national origin, or sex), so long as the program was not established and is not administered with the purpose of evading the requirements of” ECOA and Regulation B.<sup>11</sup>

Some examples of special purpose credit programs include programs with:

- A higher maximum loan-to-value ratio or lower minimum down payment for minority loan applicants, where the lender determines that most minority borrowers are unlikely to qualify otherwise.
- Discounted interest rates for applicants in majority-minority neighborhoods in a particular market, where the lender determines that those applicants are not likely to qualify for lending because their payment-to-income ratio under normal pricing exceeds the lender’s caps.
- A small business lending program for woman-owned businesses that relaxes a requirement for a certain amount of experience in the industry, where it is determined that this requirement had prevented most woman-owned businesses from qualifying.

As noted above, regulatory guidance in this area is limited. Consequently, before implementing a special purpose credit program, lenders may wish to obtain legal advice on a number of issues, including: (i) what constitutes a strong showing of need for the program; (ii) whether a special purpose credit program can be used to prioritize application processing on a prohibited basis where there are no changes to underwriting or terms and conditions; (iii) whether a lender’s entire business or line of business can be based on a special purpose credit program; and (iv) how frequently a program must be reevaluated and what the standard is for doing so.

## Conclusion

In sum, special purpose credit programs are a useful but underutilized tool. The programs can be used in a variety of contexts, and can be especially beneficial for increasing lending to minority borrowers who otherwise would be unable to qualify for a loan. Lenders should bear in mind that additional tools are available that may help improve lending rates to underserved populations. For example, regulators have indicated that “affirmative marketing” to traditionally disadvantaged groups, including communities of color or those with incomes below a certain level, would not violate ECOA.<sup>12</sup> Lenders may also permissibly implement “second review” programs to review the proposed denial of minority applicants under the same underwriting standards applicable to all applicants to determine if those standards were applied consistently.<sup>13</sup> Additionally, lenders may want to consider adopting or expanding other loan programs or services that may tend to benefit minority borrowers, including Federal Housing Administration loans, loans through the U.S. Department of Veterans Affairs, state bond program and other agency loans, Limited English Proficiency services, and innovative programs such as Individual Taxpayer Identification Number (or ITIN) loans.

<sup>7</sup> 12 C.F.R. § 1002.8(a)(3)(i).

<sup>8</sup> 12 C.F.R. Part 1002, Supplement I, ¶ 8(a), comment 6.

<sup>9</sup> 12 C.F.R. § 1002.8(a)(3)(ii).

<sup>10</sup> 12 C.F.R. Part 1002, Supplement I, ¶ 8(a), comment 5.

<sup>11</sup> 12 C.F.R. § 1002.8(a)(3).

<sup>12</sup> 12 C.F.R. Part 1002, Supplement I, ¶ 4(b), comment 2.

<sup>13</sup> Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18267 (1994).