

Federal Reserve Bank of San Francisco
101 Market Street, San Francisco, California 94105

September 24, 2008

**BANKING SUPERVISION AND REGULATION:
Regulation B Signature Rules**

To State Member Banks, U.S. Branches
and Agencies of Foreign Banks,
and Others Concerned,
in the Twelfth Federal Reserve District

The purpose of this letter is to raise a consumer compliance matter that warrants the attention of senior management. Anecdotal evidence and examiner experience – notably reflected in a recent Department of Justice (DOJ) report to Congress – suggest that misconceptions regarding the signature rule requirements of Regulation B, which implements the Equal Credit Opportunity Act (ECOA), may exist and that current internal control processes may be inadequate to prevent violations of these requirements.

Signature rule requirements apply in the case of both consumer and commercial transactions and can be found under section 202.7 of Regulation B. Both informal inquiries and examination experience have indicated that this issue deserves heightened attention, particularly in the current period where credit standards are typically being tightened. The most recent DOJ report to Congress regarding ECOA enforcement for 2007¹ highlights 15 referrals that involved allegations of marital status discrimination, a number of which were based on signature rule violations. Specifically, four referrals from the Federal Reserve Board involved improperly required spousal signatures on loan documents, thus making a non-applicant spouse liable for the entire amount of the loan – not just for any jointly owned collateral – even when the individual spouse should have independently qualified for the loan under the creditor's standards of creditworthiness. Based on the findings in this report in addition to recent examination experience here in the 12th District, we, concluded that a communication about this subject may help state member banks avoid such violations.

Our experience suggests that compliance with these regulatory provisions poses the greatest challenge in the area of commercial lending. Therefore, this letter will focus on these transactions.

It is important to understand who the applicants are in any transaction. To facilitate such understanding, in 2004 the commentary to Regulation B (section 202.7(d)(1)-3) was modified to incorporate the following:

A person's intent to be a joint applicant must be evidenced at the time of application. Signatures on a promissory note may not be used to show intent to apply for joint credit. On the other hand, signatures or initials on a credit application affirming applicants' intent to apply for joint credit may be used to establish intent to apply for joint credit.

Further, the commentary explains that:

The method used to establish intent must be distinct from the means used by individuals to affirm the accuracy of information. For example, signatures on a

¹ The report can be found at <http://www.usdoj.gov/crt/housing/documents/ecoa2007.pdf>

joint financial statement affirming the veracity of information are not sufficient to establish intent to apply for joint credit.

Model application forms found in Appendix B of the regulation provide examples of how to meet the joint intent-to-apply standard. As a general rule, if an individual applicant qualifies for a loan based on a creditor's non-discriminatory application of its creditworthiness standards, the creditor cannot require a second person's signature. The commentary to Regulation B (section 202.7(d)(1)-1) is very clear on this point:

It is impermissible for a creditor to require an applicant who is individually creditworthy to provide a cosigner—even if the creditor applies the requirement without regard to sex, marital status, or any other prohibited basis.

In the case of unqualified applicants, the creditor may require a cosigner, guarantor, endorser, or similar parties, but cannot require that it be the spouse. More broadly, in establishing guidelines for eligibility of guarantors, cosigners, or similar additional parties, a creditor may restrict the applicant's choice of additional parties but may not discriminate on the basis of sex, marital status, or any other prohibited basis.

Further, the commentary does provide that a creditor may require the personal guarantee of the partners, directors, or officers of a business, and the shareholders of a closely held corporation, even if the business or corporation is creditworthy. The requirement must be based on the guarantor's relationship with the business or corporation, however, and not on a prohibited basis. In the case of spouses of guarantors, the commentary to Regulation B (section 202.7(d)(6)-1) specifically states:

...although a creditor may require all officers of a closely held corporation to personally guarantee a corporate loan, the creditor may not automatically require that spouses of married officers also sign the guarantee.

These rules do not proscribe a spouse from guaranteeing a debt. The guarantee would have to be based on the spouse's relationship to the business, however, not the spouse's relationship to the applicant.

None of these rules affects a lender's ability to require the signature of a co-owner of collateral securing a debt on any instrument necessary to create a valid security interest in the property. The creditor may not require the spouse to sign the note evidencing the credit obligation if signing only the mortgage or other security agreement is sufficient to make the property available to satisfy the debt in the event of default. However, if under state law both spouses must sign the note to create an enforceable lien, the creditor may require the signatures. Barring specific state law to the contrary, if a creditor uses an integrated instrument that combines the note and the security agreement, the spouse cannot be required to sign the integrated instrument if the signature is only needed to grant a security interest. But the spouse could be asked to sign an integrated instrument that makes clear – for example, by a legend placed next to the spouse's signature – that the spouse's signature is only to grant a security interest and that signing the instrument does not impose personal liability.

In the case of unsecured credit, when an applicant is relying on jointly held property to establish creditworthiness the creditor must value the applicant's interest in the jointly owned property. In doing so, the creditor, as stated in the commentary to Regulation B (section 202.7(d)(2)-1.i):

...may consider factors such as the form of ownership and the property's susceptibility to attachment, execution, severance, or partition; the value of the applicant's interest after such action; and the cost associated with the action. This determination must be based on the existing form of ownership and not on the possibility of a subsequent change. For example, in determining whether a

married applicant's interest in jointly owned property is sufficient to satisfy the creditor's standards of creditworthiness for individual credit, a creditor may not consider that the applicant's separate property could be transferred into tenancy by the entirety after consummation. Similarly, a creditor may not consider the possibility that the couple may divorce. Accordingly, a creditor may not require the signature of the non-applicant spouse in these or similar circumstances.

If the applicant's interest in jointly owned property does not support the amount and terms of credit sought, the commentary notes that the creditor may offer the applicant other options to qualify for the extension of credit. For example:

- Ask the applicant to provide a cosigner or other party (though, as noted previously, the spouse cannot be required to be the other party and the creditor must apply non-discriminatory standards regarding the qualification of the other party as provided for in the commentary to section 202.7(d)(5);
- Ask the applicant to consider requesting that the credit be granted on a secured basis (following the rules regarding secured credit); or
- Ask for the signature of the joint owner on an instrument that ensures access to the property in the event of the applicant's death or default, but does not impose personal liability unless necessary under state law (e.g., a limited guarantee). A creditor may not routinely require, however, that a joint owner sign an instrument (such as a quit claim deed) that would result in the forfeiture of the joint owner's interest in the property.

An applicant who requests individual credit relying on the income of another person (including a spouse in a non-community property state) may be required to provide the signature of the other person to make the income available to pay the debt.

Whether dealing with a secured or unsecured credit request, if the transaction involves a community property state these rules may operate differently. The nine community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. In Alaska, personal or real property can be community property if it is designated as such in a community property agreement or trust. In addition to community property, other forms of property ownership for married couples such as joint tenancy can have an impact on the application of signature rules. Because statutes and judicial decisions can vary by state, it is recommended that legal counsel be consulted regarding specific requirements and prohibitions whenever dealing with community property or property held in joint tenancy.

Additional Information

All circulars and documents are available on the internet through the Federal Reserve Bank of San Francisco's website, at <http://frbsf.org/banking/letters/>.

For additional information, please contact our Banking Supervision and Regulation Department at (415) 974-3214.

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