Professional Perspective

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# Using Special Purpose Credit Programs to Counteract Economic Disparity

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Financial institutions continue to make efforts to bridge disparate impacts in the economy and to increase diversity, equity, and inclusion in lending practices. There are certain programs, like residential mortgage programs, whereby financial institutions have made clear their intentions to expand beyond what already exists, and seize upon the additional fair lending programs that will provide a more inclusive landscape.

Due to the Covid-19 pandemic, almost half of black-owned businesses have closed, thus demonstrating how critical access to credit is for creating and maintaining a diverse marketplace. Special purpose credit programs (SPCPs), already in existence, endeavor to bridge the glaring disparity in credit accessibility and are a critical tool for increasing consumer and business access to credit if used effectively. This article explores SPCPs as an effective method for increasing access to credit and a powerful solution to counteract pervasive economic disparity.

In 1974, Congress passed the Equal Credit Opportunity Act (ECOA) to prohibit discrimination in credit access based on one's sex or marital status. After two years, Congress realized the criteria was insufficient and expanded the law to include a prohibition of discrimination, in any credit transaction, based on age, color, religion, race, receipt of public assistance benefits, and other criteria as described in the Federal Consumer Credit Protection Act. See Equal Credit Opportunity (Regulation B); Special Purpose Credit Programs, Op. Bureau of Consumer Finance Protection, 1 (Dec. 21, 2020).

SPCPs came to fruition under the ECOA and are a special carveout to allow for-profit organizations to lower thresholds and overcome barriers to credit access that would otherwise perpetually disadvantage a certain class of people. Despite the prohibition of discrimination based on the aforementioned criteria, the law permits a for-profit organization—i.e., a creditor, for-profit lender, financial institution, etc.—to consider such criteria in the formation of a special program intended to meet a distinct social need.

Although an institution may still lawfully deny credit if an applicant fails to meet the criteria in a specific SPCP, and such denial could arguably be viewed as discrimination, under the ECOA and Regulation B certain criteria as a basis for easier access to credit encourages inclusivity and diversity in the marketplace. 12 C.F.R.1002.8; see also Official Interpretations, 12 C.F.R.1002 (supp. I), sec. 1002.8.

Regulation B, the ECOA's implementing regulation, delineates the general rules and standards for SPCPs. An SPCP can come about in one of three ways to benefit an economically disadvantaged class of people: a credit assistance program expressly authorized by federal or state law, a credit assistance program as provided in Section 501(c) of the Internal Revenue Code of 1954, or any special purpose credit program offered by a for-profit organization to meet social needs. SPCPs are fairly easy to create according to statute, however, a for-profit organization utilizing the third prong to create its own SPCP must take the following additional steps.

- The program must be established through a written plan and administered pursuant to such written plan
- The written plan must specify the duration of the program, or contain a statement explaining when the program will be reevaluated to determine its ongoing need
- The written plan must specify the class of people it intends to benefit
- The written plan must describe the procedures and standards for extending credit in accordance with the program
- The class of people the plan intends to extend credit to who, according to the specific for-profit organization's customary standard of creditworthiness, would not be eligible to receive credit or would receive credit on less-favorable terms than typically available to other applicants who apply for a similar type and amount of credit.

Since 2010, the Consumer Financial Protection Bureau (CFPB) has exercised rulemaking authority and enforced fair lending laws and regulations under ECOA. Despite statutes, regulations and accompanying commentary, several things remain unknown. First, a for-profit organization does not necessarily have means to identify an economically disadvantaged class or a mechanism to determine such class. Second, such organization does not necessarily know what constitutes a "social need."

If SPCPs are not created and structured well, then such organizations may unknowingly commit CFPB violations and therefore be exposed to resultant penalties. What's more, a for-profit organization need not seek prior approval from a governmental agency, and the CFPB will not determine whether a proposed SPCP constitutes a lawful SPCP, even if requested. Thus, the lack of safe harbor for for-profit organizations that desire to create SPCPs, but fear potential penalties, obstructs this goal of driving access to credit in a more diverse and equitable manner.

As a result of growing economic disparities and a desire to effect change, several institutions wrote to the CFPB during an open comment period requesting that the CFPB provide further guidance on SPCP creation and maintenance. In response to the inquiry and to bridge disparate impact, the CFPB released an advisory opinion that clarified some of these unknowns.

The CFPB clarified in its opinion that a written plan must describe whether the SPCP will benefit a class demonstrating a financial need or sharing a common characteristic. Therefore, the class of people that an SPCP must benefit means that such class shares a common financial need or characteristic that typically, absent an SPCP, would result in credit denial or less favorable credit terms.

Congress's intent in passing the ECOA to further advance access to credit regardless of one's sex, race, public assistance program participation, and other bases may help determine a benefitting class in an SPCP, but the CFPB explained that for-profit organizations are not restricted to such classes listed in the statute.

For example, a for-profit organization could create an SPCP for women-owned businesses or individuals in a low-income census tract if such classes struggle with credit access. It basically comes down to what the for-profit organization sees as a class of people who need credit but are generally denied.

A for-profit organization should determine a class and such class's need for an SPCP based on research. Such research serving as a basis for the determination can be in the form of such organization's internal data collection, statistical analysis, external data from a governmental entity, or historical or societal information. For example, the Small Business Administration could serve as a solid source to determine whether there is a certain social need for greater access to credit for women- or minority-owned businesses.

Often, the murkiness of data collection to determine a social need arises when an institution relies on its internally collected data. Although a for-profit organization can deny credit to an individual who does not meet SPCP criteria, a for-profit organization cannot collect demographic data for an SPCP that is not yet created or, put another way, cannot collect demographic data to determine the requisite social need for forming a new SPCP.

Regulation B strictly prohibits institutions from collecting demographic data solely for the creation of an SPCP. Rather, a for-profit organization must first turn to broad research—e.g., historical or societal information as previously discussed) or governmental data to determine whether or not there is a need for such an SPCP.

Thereafter, a for-profit organization may collect demographic data as part of its SPCP procedures as soon as such SPCP is established. When such SPCP is later evaluated or concludes in accordance with its written plan, the for-profit organization can rely on the demographic data, collected over the duration of the SPCP, to determine ongoing need and refining of the SPCP overall.

Finally, the CFPB explained in its advisory opinion that there is a safe harbor for for-profit organizations that establish SPCPs in good faith. The CFPB stated that Section 706(e) of the ECOA (concerning civil liability) applies to SPCPs, and therefore no liability is imposed on any act or omission performed "in good faith and in conformity with an official rule, regulation, or interpretation thereof by the Board …"

Further, the CFPB's advisory opinion containing such information is an interpretive rule and reaffirms that the safe harbor provision in Section 706(e) applies to for-profit organizations that create SPCPs in good faith and in conformity with the law.

SPCPs have been around for quite a while, and financial institutions and other organizations are trying to better understand and use them more effectively to increase access to credit among underserved groups. Financial institutions are increasing these efforts in their lending practices, and SPCPs can provide a valuable mechanism to pave the way there.

 