

## Federal Reserve Staff: Adverse Action Notice Required for Denials of Certain Loan Modification Requests

Legal counsel in the Division of Consumer and Community Affairs at the Federal Reserve has recently informed us that, pursuant to the Equal Credit Opportunity Act (ECOA), a denial of a residential borrower's request for a loan modification, *when the loan is not yet in default*, would require the lender or servicer to provide the borrower with an adverse action notice.

Pursuant to ECOA and Regulation B Section 202.9, lenders are required, upon the denial of an application for an extension of credit, to provide an adverse action notice to a loan applicant. Based on the definition of "extension of credit" under Regulation B Section 202.2(q), practitioners have traditionally regarded an adverse action notice as not required where the modification of a loan does not increase the amount of credit extended or replace the existing obligation (in other words, when the modification does not amount to a refinancing).

Under Regulation B, a loan modification or workout, where *a default on the loan has already occurred*, is explicitly excluded from the definition of adverse action. 12 CFR 202.2(c)(2)(ii). However, Federal Reserve staff has now opined that the denial of a requested loan modification by a consumer *who is not yet in default* would require the lender or servicer to provide the borrower with an adverse action notice.

The question of whether the lender must provide an adverse action notice (under circumstances described above) originally stemmed from concerns related to lender and servicer participation in the Obama Administration's Making Home Affordable loan modification program. However, counsel at the Federal Reserve has informed us that there is nothing unique about the Making Home Affordable program with respect to the Federal Reserve's position. As such, Federal Reserve Staff is of the opinion that, irrespective of whether or not the borrower's request was made pursuant to the Making Home Affordable loan modification program, when a loan is not yet in default, a denial of a residential borrower's request to have the loan modified requires the lender or servicer to provide the borrower with an adverse action notice.

As noted above, pursuant to ECOA and Regulation B Section 202.9, lenders are required, upon the denial of an *application* for an extension of credit, to provide an adverse action notice to a loan applicant. Under Regulation B, an "application" is defined as a request made "in accordance with *procedures used* by a creditor for the type of credit requested." 12 CFR 202.2(f) (emphasis added). As such, we asked counsel at the Federal Reserve whether a creditor who does not have any established procedures for performing loan modifications (and thus who would not fit within the definition of "application" under Regulation B) could avoid adverse

action responsibilities. Federal Reserve counsel stated that the Federal Reserve has held if there is no “application” as defined under Regulation B, then that “could be a possibility to avoid adverse action.” However, the Federal Reserve counsel cautioned that any attempt to fall outside the Regulation B definition of “application” would have to be done very carefully, and Federal Reserve suggestions on how to circumvent the definition of “application” were not “met with much appetite” from industry officials.

In light of the Federal Reserve’s opinion, institutions should keep in mind that a denial of a residential borrower’s request for a loan modification, when the loan is not yet in default, may be seen as adverse action, which would require the lender (or servicer) to provide the borrower with an adverse action notice. If one accedes to this position, and if the creditor used a credit report in whole or in part to deny the modification request, then according to the Fair Credit Reporting Act the creditor would have to notify the borrower of this fact as part of its adverse action notice.

Clients with further questions on this issue are encouraged to contact the Consumer Practice Group of Aldrich & Bonnefin, P.L.C. for specific guidance.