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## Attention Lenders: Reevaluate Spousal Signature Policies and Procedures

by Paul H. Schieber

Under the Equal Credit Opportunity Act ("ECOA"), it is unlawful for a creditor to discriminate against an applicant on the basis of sex or marital status.<sup>1</sup> The Federal Reserve System has effectuated this prohibition by issuing Regulation B, which restricts the practice of requiring one spouse to co-sign the other's credit application and collateral documents.<sup>2</sup> Two recent federal court decisions have clarified the spousal signature restrictions as they apply to guaranties executed by the spouses of credit applicants.

### I. SPOUSAL SIGNATURE VIOLATION DOES NOT VOID SPOUSE'S OBLIGATION

A recent decision of a federal district court in Virginia limited a creditor's exposure for violating the spousal signature rules of the ECOA and Regulation B.<sup>3</sup> In *CMF Virginia Land, L.P. v. Brinson*, the lending institution acknowledged that it had required guaranties from the spouses of the borrowers, in violation of the ECOA provisions.<sup>4</sup> The issue was whether this violation rendered the guaranties unenforceable. The court held that it did not.<sup>5</sup>

Rejecting the guarantors' contentions that the ECOA conferred broad remedial power to void the guarantors' obligation to the lender, the court stated that "[i]nvalidation of the debt itself is a remedy too drastic for the Court to implement simply by reading between the lines of the ECOA."<sup>6</sup> Without legislative authorization of such a remedy, the court reasoned that remedial pow-

ers under the ECOA were best exercised through a restructuring of the defense as a compulsory counterclaim. Such a measure would give the defendant the opportunity to prove an ECOA violation at trial. Any damages proven by the defendants on this claim could be used to offset the amount of the guaranties.<sup>7</sup> Acknowledging that the guaranty obligations could be reduced by these damages, the court further noted that damages could in some instances equal the amount of the guaranty.<sup>8</sup>

The guarantors alternatively argued that because they did not benefit from the loans to their spouses, the obligations should be declared unenforceable for lack of consideration.<sup>9</sup> Rejecting this defense, the court stated that acceptance of this rule would undermine the "entire philosophy behind the guaranteeing of loans" and would contradict long established precedent.<sup>10</sup>

Though lenders may take some comfort in the *Brinson* holding, the ECOA and Regulation B still contain substantial penalties for violation of the spousal signature restrictions.<sup>11</sup> These penalties, coupled with the aggravation and expense of litigation, may result in the effective invalidation of the guaranty.

### II. LENDER MUST REEVALUATE THE NEED FOR GUARANTORS

In *Stern v. Espirito Santo Bank of Florida*,<sup>12</sup> a federal district court in Florida held that the ECOA requires lenders to reevaluate the necessity of maintaining a third party's guaranty when a loan is

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renewed.<sup>13</sup> In *Stern*, the borrower obtained a loan for himself and for corporations of which he was the principal. The borrower did not qualify for the credit, and as a result, his wife executed a guaranty. Later, the bank and the borrower executed a renewal and, replacement note, relying in part on the prior guaranty, which covered future indebtedness.<sup>14</sup>

The court did not address the issue of whether obtaining the spouse's guaranty violated the spousal signature rules of Regulation B. Instead, the court considered whether renewal of the loan obligated the bank to reassess the need for the spousal guaranty.<sup>15</sup> The court focused on the official commentary to Regulation B, which requires creditors to reassess the need for an additional party upon reevaluation of a borrower's creditworthiness triggered by a credit obligation renewal. As a result, the court held that lenders have an affirmative obligation to reevaluate the need for the additional party at the time the loan is renewed. The bank's failure to reevaluate this need in *Stern* violated the ECOA.<sup>16</sup> Such a reevaluation must be performed without discrimination based on marital status or any other statutory enumerated basis.<sup>17</sup>

The opinion did not reveal whether the bank had actually reappraised Stern's creditworthiness when it renewed the loan, a prerequisite under Regulation B to the reevaluation of the need for a guarantor.<sup>18</sup> The court's ruling may imply that a violation under the Act would have existed regardless of whether the bank had reevaluated the borrower's creditworthiness or the need for a guaranty. Thus, the bank was obligated to reevaluate the borrower's creditworthiness at the time the loan was reviewed.

In light of *Stern*, lenders would be well advised to reevaluate their credit renewal procedures and poli-

cies and to focus on this often forgotten provision of Regulation B and the Commentary. ♦

#### ENDNOTES

<sup>1</sup> 15 U.S.C. § 1691 *et. seq.* (1988 & 1991 Supp. III). The relevant portion of the statute provides:

It shall be 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)....

15 U.S.C. § 1691 (a)(1) (1988) (emphasis added).

<sup>2</sup> 12 C.F.R. § 202 (1992). With regard to spousal signatures on credit documents, Regulation B provides:

[A] creditor shall not require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditor's standards of creditworthiness for the amount and terms of the credit requested.

12 C.F.R. § 202.7(d)(1) (1992).

<sup>3</sup> *CMF Virginia Land, L.P. v. Brinson*, 806 F.Supp. 90 (E.D. Va. 1992).

<sup>4</sup> *Id.* at 94.

<sup>5</sup> *Id.* at 95.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at 94.

<sup>10</sup> *Id.*, citing *D'oench Duhme & Co. v. FDIC*, 315 U.S. 447, 459-60 (1942).

<sup>11</sup> See 12 C.F.R. § 202.14 (1992). Penalties for violation of the ECOA include compensatory damages, punitive damages up to \$10,000, attorneys fees, and injunctive relief.

<sup>12</sup> 791 F.Supp. 865 (S.D. Fla. 1992).

<sup>13</sup> *Id.* at 869.

<sup>14</sup> *Id.* at 866, 869.

<sup>15</sup> *Id.* at 869.

<sup>16</sup> *Id.*, citing 12 C.F.R. Part 202 Supp. I, Par. 7(d)(5) (1992). The Official Commentary to Regulation B states:

If the borrower's creditworthiness is reevaluated when a credit obligation is renewed, the creditor must determine whether an additional party is still warranted and, if not, release the additional party.

<sup>17</sup> *Stern*, 791 F.Supp. at 869.

<sup>18</sup> 12 C.F.R. Part 202, Supp. 1, par. 7(d)(5) (1992). See also *supra* note 15 and accompanying text.

## Tips on Protecting Your Privacy

In our increasingly computerized world, information you may have preferred to keep private may become available to computer databanks nationwide. Here are some tips for consumers who would like to keep as much information private as possible:

- Do not buy anything from a telephone caller who insists that you give your credit card number over the phone.
- If you are interested in the product, ask the caller to send you literature on it before you commit to a purchase.
- Never write your social security number on a check or credit card slip.
- Guard your driver's license number. In some states, it is the same as your social security number.
- Check your social security records periodically to make certain that no one else is using your number. Call (800) 772-1213.

## Home Warranties Can Prevent Unexpected Expenses

Almost 60 percent of all single family homes sold in California in 1992 had home service warranty contracts, up 20 percent from 1991. Home warranties, which cost between \$225 and \$295, cover breakdowns in plumbing and electrical systems and major appliances. The warranties help protect home buyers from unexpectedly large bills. They usually last one year but are renewable.