1996

Commentary: The 1996 Banking Law Institute - Quiet Before the Storm?

Alvin C. Harrell, Oklahoma City University School of Law
The Conference on Consumer Finance Law presents
THE 1996 BANKING LAW INSTITUTE
September 19 – 20, 1996 • DoubleTree Hotel • Dallas, TX

Thursday, Sept. 19

Part I: Legislative and Regulatory Developments
Moderator: Professor Joseph J. Norton
8:45 – 9:00
Overview and Introduction
Joseph J. Norton • Professor of Law • Southern Methodist University
School of Law • St. John Fubione, Chair of Banking Law • University of London • of Counsel • Jenkins & Gilchrist, P.C. • Dallas, TX

9:00 – 9:50
Overview of Recent Legislative and Regulatory Developments
John Podvin • Braccezwell & Paterson • Dallas, TX

10:00 – 10:50
Update on Regulatory Enforcement Powers and Initiatives
Michael K. O’Neal • Winstead, Sechrest & Minick • Dallas, TX

11:00 – 11:50
BIF-SAIF and the Implications for Financial Institutions
Stephanie Bluhm • Little, Sapp, Zivley, Hill & LaBoon, L.L.P. • Dallas, TX

11:50 – 1:00 Lunch (on your own)

Part II: Financial Institutions: Structure, Powers, and Services
Moderator: Lynn A. Pringle
1:00 – 1:50
Regulatory Reform at the Agency Level
Carolyn J. Buck • Chief Counsel • Office of Thrift Supervision • Washington, D.C.

2:00 – 2:50
Changes in the Secondary Mortgage Market: An Update
Anne E. Dewey • General Counsel • Office of Federal Housing Enterprise Oversight • Washington, D.C.

3:00 – 4:30
Update on Interstate Banking and Branching: Bank Sales of Annuities and Insurance Products
Randall S. James • General Counsel • Texas Banking Department • Austin, TX

John Hearly • Senior Vice President • Texas Bankers Association • Austin, TX

4:40 – 5:30
Bank Sales of Nondeposit Securities and Investments Products
Lynn A. Pringle • Pringle & Pringle • Oklahoma City, OK

Friday, Sept. 20

Part III: Federal Regulatory Compliance
Moderator: Robert H. Liedig
8:45 – 9:00
Overview of World-Wide Regulatory Trends
Joseph J. Norton • Professor of Law • Southern Methodist University
School of Law • Dallas, TX

9:00 – 9:50
Update on Fair Lending and CRA Standards, Compliance and Enforcement; Other Regulatory Compliance and Enforcement Issues
Robert H. Liedig • Fried, Frank, Harris, Shriver & Jacobson • Washington, D.C.

10:00 – 10:50
Update on RESPA Regulatory and Case Law Developments
Marsha Williams • Middleberg Riddle & Gianna • Dallas, TX

11:00 – 11:50
Mortgage Companies: Labor Disputes; CBA Issues; Borrower’s Rights; and the New Troubled Asset Relief Provisions
Laura N. Pringle • Pringle & Pringle • Oklahoma City, OK

11:50 – 1:00 Lunch (on your own)

Part IV: Electronic Banking, International Issues, and Consumer Litigation
Moderator: Jacqueline Akins
1:00 – 1:50
UCC Article 4A and Wire Transfers
Jacqueline Akins • Bank One, Texas N.A. • Dallas, TX

2:00 – 2:30
Cyberbanking and Electronic Financial Services
Robert H. Liedig • Fried, Frank, Harris, Shriver & Jacobson • Washington, D.C.

Dan L. Nicewander • Gardere & Wynne • Dallas, TX

Michael K. O’Neal • Winstead, Sechrest & Minick • Dallas, TX

3:40 – 4:30
The Impact of International Regulation and Supervision on Bank Management
Joseph J. Norton • Professor of Law • Southern Methodist University
School of Law • Dallas, TX

4:30 – 5:20
Recent Developments in Consumer and Class Action Litigation
Lawrence A. Young • Hughes, Watters & Askanas, L.L.P. • Houston, TX

For further information or a registration form, call (405) 634-1445 or FAX your request to (405) 634-3305
QUARTERLY REPORT

This is the skeleton of the idea, which needs much refinement before a concrete proposal could be presented. But it addresses a core problem of TILA—the artificial division of the credit world into two "forms" which hamstring disclosure ingenuity and flexibility, and one of which (closed-end) is singularly inept at conveying useful information in timely fashion. This approach would preserve most other TILA concepts and terminology, so is not radical in that sense. It could be tweaked in any number of ways to make sure that nothing important from present law is lost while some current weaknesses could be repaired. It seems to offer advantages to both camps, consumer and industry. But we shall see.

IV. Conclusion

I end where I began. TILA will and should be with us for a long time. It is a decently robust, important and reasonably principled statutory regime to deal with the information flow to consumers in an increasingly sophisticated market. TILA does not deserve much of the criticism directed at it, but it undoubtedly can be improved. The most likely, and appropriate, improvements in TILA are those that focus on information consumers genuinely and demonstrably want to have in the current marketplace, as opposed to credit cost details dictated a priori by lawmakers and induly confined by congressional thinking of the 1960s.

Commentary: The 1996 Banking Law Institute—Quiet Before the Storm?

(Continued from page 122)

...financial intermediaries. As in previous years, this report on the Institute reflects your author's interpretations of comments made during the program; other perceptions may differ and the program speakers should not be held responsible for the comments reported herein.

Generally, and with several significant exceptions, there seems to be a perception in the financial services industry that there was something of a lull in financial services law and regulation during much of 1996. From the perspective of banking institutions, at least until the 1996 omnibus banking and regulatory relief legislation and last-minute resolution of the BIF-IFAIF deposit insurance premium disparity, there was no major federal banking legislation and the focus of 1996 banking regulation was on internal regulatory reform. Non-banking creditors, not attuned to the BIF-IFAIF issues, may have been even more complacent during 1996. Yet, any such perception of a legislative and regulatory lull was misleading, and likely to be temporary.

In 1996, even before ERMRA, there were significant developments in fair lending, industry mergers and consolidation, interstate branching and branching, bank sales of insurance, annuities, and securities products, RESPA, electronic banking, regulatory compliance, consumer credit litigation, and class action liability, plus dozens of other regulatory and legal developments worthy of note. Moreover, 1996 may have been a more prologue to what lies ahead in 1997, as a number of the 1996 developments seem to represent accelerating trends that may be laying the foundation for even greater changes in 1997.

For example, most of the federal bank regulatory reduction and reform programs are slated to terminate this year, suggesting that the regulatory focus may shift elsewhere next year. Among other things, it seems likely that fair lending will receive renewed emphasis. An economic recession also remains a significant possibility, and no one knows how well the latest regulatory compliance tools and enforcement powers will work in the context of financial stress. Bank underwriting standards and systems have not been tested in a recessionary environment for a number of years, and consumer credit, credit card and bankruptcy losses seem to...
contacts occurred in one state,114 so the result is uncertain if contacts are present in two or more states. In 1992, the OTS's General Counsel concluded that a federal savings association is "located" in the state where its home office is situated, as well as any state where the association maintains a branch office.115 In the case of loans originated from a branch, the General Counsel opined that the association may apply the most favored lender rates of either its home state, which always may be applied, or the state in which the branch is situated.116 The OTS consequently has propounded a more expansive interpretation of a multistate insured institution's exportation rights than the OCC.

III. Conclusion

Smiley represents an important victory for national banks and other federally-insured financial institutions in their quest to establish uniform nationwide lending programs. Nonetheless, there remain numerous unanswered questions regarding the scope of these institutions' exportation and most favored lender rights and the extent to which they can rely on informal federal banking agency interpretations of the laws that these agencies are charged with enforcing.

Commentary: The 1996 Banking Law Institute—Quiet Before the Storm?

(Continued from page 122)

be mounting. As noted infra there is evidence that overall portfolio losses for mortgage lenders have averaged nearly 10% during previous periods of economic stress. Obviously, overall losses of this magnitude would sink most banks and mortgage lenders, even with enhanced capital standards and levels.

All in all, 1997 appears likely to be an unusually interesting year. And if the past is prologue, it may be relevant to consider the comments of spokesmen describing the events of the past year at the 1996 Banking Law Institute.

Introducing John Podvin Jr., your author asserted that many in banking believe that 1996 was a quiet year for banking law and regulation. Mr. Podvin responded by describing more than 10 major regulatory and legislative developments, not counting EGGPRA, belying any perception that 1996 was, in fact, an uneventful year. Among other things, he noted the importance of understanding and properly using the new "Suspicious Activity Report" in lieu of the old criminal referral forms. Michael K. O'Neal then described the current regulatory enforcement powers of the federal banking agencies. He noted that these powers are triggered generally by any "unsane and unsound banking practice," an ill-defined concept that may cover actions that are otherwise in compliance with agency guidelines and regulations. Mr. O'Neal noted that after a full, agency enforcement actions appear again to be on the rise. He noted that the new safety and soundness enforcement powers provide the agencies great flexibility to issue enforcement orders to institutions that are well capitalized and profitable, on grounds of largely discretionary standards. He also noted that the agency enforcement powers are not subject to the new agency appeals processes (although in some cases a basis for an enforcement action may be subject to appeal).

Stephanie C. Bihler spoke on the SAIF-BIF deposit insurance premium disparity, the FICO bonds shortfall, and efforts to merge the deposit insurance funds. At the time of the Institute, the SAIF fund was at 51% of insured deposits, compared to the 1.25% target or required level. The BIF fund is in surplus to the required level. As a result the SAIF deposit insurance premium rate has been 2.3%—3.5% compared to an effective zero rate for most banks; a single large thrift was paying more in deposit insurance premiums than the entire banking industry. She also noted predications that projected declines in the SAIF-insured deposit level (due to deposit "migration" to BIF deposits) were expected to impair the income streams dedicated to payment of the FICO bonds, so as to cause a 1997 default on the bonds unless a solution was found. As described elsewhere in this issue, EGGPRA addressed this in part by recapitalizing SAIF, apportioning the FICO obligation among thrifts and banks, and prohibiting deposit migration.

Dwight Smith, Deputy Chief Counsel for Business Transactions at the Office of Thrift Supervision (OTS), discussed regulatory reform at the agency level, noting that the OTS now regulates under 1,400 institutions, with a stable asset base, currently earning record profits and a return on assets of 99 basis points. Equity capital for the industry is over 6% and virtually all thrifts are well capitalized. He reported that the threats to SAIF-insured thrifts are now largely external, rather than internal.

Mr. Smith noted several thrust-industry trends and developments, including: (1) rising interest in the use of thrift charters in innovative ways,10 (2) increased use of subprime lending programs including secured credit card lending; (3) OTS Chief Counsel Carolyn Bauck's Institute program materials advocating a new community bank charter to combine the best elements of thrift and community banks;11 (4) the current regulatory focus on the depository institutions industry.

(Continued from page 144)

7. The general view of the courts and agencies is that an enforceable and uniform practice is "conduct deemed contrary to accepted standards of banking operations which might result in substantial loss to a banking institution or shareholder." See, (Continued in next column)

114. OCC Ltr. No. 767, supra note 112.
116. Id. at 62,007.
improving the competitive position and lending opportunities of federally chartered thrifts vis-a-vis their nonbank competitors; and (5) a "freeing up" of the regulations providing for federal preemption of state laws. 13

Randall R. Ryikamp, District Counsel for the Southwestern District of the Office of the Comptroller of the Currency (OCC), also spoke on regulatory reform at the agency level. He noted that the OCC regulatory reform project began in mid-1993 at the behest of Comptroller Eugene Ludwig, who brought in Julie Williams (formerly with the OTCs, now OCC Chief Counsel) to spearhead the effort. This comprehensive review process is expected to be completed by year-end 1996. The project has four goals: (1) to reduce the regulatory burden; (2) to improve clarity; (3) to create "differential regulation" tailored to the varying circumstances of banks; and (4) to enhance the value of the national bank charter.

The highlights of the OCC project include: revisions to Part 5 (corporate activities); streamlining the agency application and approval process; a revised Part 7 (OCC interpretations), designed in part to facilitate the marketing of electronic banking services and to clarify the federal preemption of state consumer credit laws; revisions to Part 16 governing securities law issues (to incorporate SEC rules); revisions to Part 32 (Lending limits and calculations) to revise quarterly lending limit calculations; and revisions to Part 1 (investment securities) to broaden the investment authority of national banks. Several of these issues are discussed elsewhere in this issue in an article by F. John Podrin, Jr.

Gary Norton, Deputy General Counsel at the Office of Federal Housing Enterprise Oversight (OFHEO), described issues affecting the secondary mortgage market. OFHEO was created by federal legislation in 1992 as an independent safety and soundness regulator for Fannie Mae and Freddie Mac, within the Department of HUD. Fannie and Freddie are federally chartered, government sponsored enterprises (GSEs) with implicit taxpayer liability for any losses. Fannie is the largest U.S. private corporation with assets and obligations of $289.8 billion (as of December 31, 1995) and 1995 profits of $2.1 billion. Freddie had 1995 assets of $596.2 billion and profits of $1.1 billion. The subsidy resulting from the implicit taxpayer guarantee of GSE liabilities is valued at $66.2 billion per year, with approximately $4 billion being passed through to mortgage lenders and possibly borrowers. Recent Congressional studies of Fannie and Freddie recommended more study of the possibility further privatization of the GSEs, but no study endorsed a full privatization. OFHEO conducts safety and soundness examinations of Fannie and Freddie, which to date have been limited to management level oversight, dealing with such issues as derivatives, corporate governance, risk management, flood insurance, and executive compensation. A significant issue is the
In Larson, the plaintiffs contended that they were entitled to rescind a loan secured by their home because the defendant bank failed to properly notify them of their right to rescind under the TILA at the time of consummation of the loan. On October 26, 1990, the plaintiffs signed three documents: a commitment letter, a promissory note and a deed of trust. That same day, the bank notified the plaintiffs of their right to rescind, indicating that the right expired on October 30, 1990. On October 31, 1990, the plaintiffs signed a property improvement agreement authorizing the bank to withhold $5,000 of the loan for installation of a heating system and an addendum notifying the plaintiffs of the withholding.

The plaintiffs, in their rescission action, argued that the Bank's rescission notice was defective because it expired before consummation of the loan, which they allege occurred when they signed the property agreement and addendum on October 31, 1990. The court, in looking to California law to decide when a consumer becomes contractually obligated (and therefore when consummation occurred), determined that the loan agreement was consummated on October 26, 1995. Thus, the court held that in notifying the plaintiffs that their right to rescind expired October 30, 1990, the bank complied with the rescission notice requirements of TILA.

In another consummation case, Lombardi v. Domestic Loan and Investment Bank, plaintiffs had entered into a home improvement contract on May 13, 1992 that included the words “pending financing” before the amount of the balance due. No TILA disclosures were given at that time. On September 22, 1992, after the work had been completed, the plaintiffs attended a closing at the contractor's offices at which they executed a “Negotiable Consumer Note and Home Improvement Contract, Security Agreement and Disclosure Statement” and a mortgage and also received TILA disclosures which they conceded were accurate. The court held that the plaintiffs were entitled to rescind the September mortgage because the contractor had violated TILA by failing to provide TILA disclosures to plaintiffs in May. According to the court, the evidence showed that the contractor intended or agreed to provide financing in May and thus the May and September documents were to be viewed as a single transaction which was consummated in May. A question here, which the court did not address, is why the TILA disclosures provided on September 22 did not suffice to commence the running of the three business day rescission period.

C. Waivers

The Ninth Circuit Court of Appeals again addressed the issue of rescission under the TILA in Palmer v. Statewide Group, Inc. In Palmer, the plaintiffs contended that the defendant violated TILA by failing to obtain from the plaintiffs a valid waiver of the right to rescind the transaction and by failing to give proper notice of the expiration date of the rescission period. The purported waiver signed by the plaintiffs lacked the written description of the "personal financial emergency" explicitly required by TILA to effectuate a valid waiver and therefore was held to violate TILA and Regulation Z. Generally lenders should avoid taking an emergency waiver for the precise reason evident in this case—the prospect of a court second-guessing the lender's judgment.

D. Force Placed Insurance

In Rochon v. Citicorp Mortgage, Inc., the court granted Citicorp's motion to dismiss a forced placed insurance class action. The plaintiff mortgagor, on behalf of a putative class, claimed that Citicorp violated the TILA disclosure requirements when it "forced placed" property insurance. The court, citing the official Staff Commentary to Regulation Z, found no violation of the original TILA disclosures and no duty to provide new ones upon force placement of the insurance. However, the plaintiff was granted leave to amend to attempt to plead that Citicorp knew that the plaintiff already had insurance and nevertheless forced placed the insurance, a circumstance that may give rise to TILA liability according to the court.

Commentary: The 1996 Banking Law Institute—Quiet Before the Storm?

(Continued from page 144)

optimal level of risk-based capital that should be required for the GSEs. The basic capital requirements are 2.5% for balance sheet liabilities and 4.5% for off-balance sheet liabilities; the question is the appropriate risk-based component to be added to account for the credit and interest rate risk inherent in mortgage lending and investment. Fannie and Freddie are increasingly holding mortgages in their own portfolios as well as securitizing mortgage assets, thus assuming significant credit and interest rate risks.

To deal with these risks, OFHEO is creating a "risk-based capital stress test." This test is based on an average 63% loss rate on defaulting mortgage loans, as experienced in sample loan markets during recent periods of economic stress, demonstrating again that mortgage loans are not always as safe as many people assume. During the sample periods the overall portfolio loss ratio for mortgage lenders was 9.5%, a rate that would deplete the capital of almost any bank or mortgage lender and helps explain what happened to the thrift industry in the 1980s. Mr. Norton predicted further consolidation.

(Continued on page 165)
QUARTERLY REPORT

UCC to release the lessor from its duty to pay the lessee the profits from the collateral may be all that is necessary. This agreement in the lease would not have to fulfill the clear and conspicuous standards of the CLA, but rather would have to satisfy the UCC. The prudent drafter of a lease would undoubtedly try to conform to the requirements of the CLA, however, for in light of these recent cases it is quite conceivable that not doing so could result in a suit challenging the retention of profits under the CLA, UCC or both.

The Werbosky opinion is a cursory treatment of an important issue, and as a result the decision will needlessly encourage further litigation. Presently the leasing community is without adequate guidance in determining whether the courts will determine that lessors have new obligations under the UCC. For now they must await a more thoughtful and thorough analysis for such guidance.

Commentary: The 1996 Banking Law Institute—Quiet Before the Storm?

(Continued from page 160)

and increased automation in the mortgage industry, and generally endorsed the use of credit scoring systems (which he called automated underwriting systems or AUS), though he noted the need to be sensitive to fair lending concerns.

Randall S. James, Deputy Banking Commissioner for the Texas Department of Banking, John Heasley, Senior Vice President for the Texas Bankers Association, and OCC District Council Ryskamp then discussed interstate banking and branching, and bank sales of annuities and insurance products. Mr. Ryskamp discussed upcoming OCC insurance regulations, reporting that advertising, staff qualification and training, privacy, and advertising requirements are expected to be included. Mr. James reported that the Texas Insurance Department has been very cooperative and responsive in dealing with the requirements of the Barnett decision.

Mr. Heasley discussed interstate banking and branching, noting that Texas alone has opted out of the new Riegel-Neal interstate branching regime. Mr. James pointed out that under Riegel-Neal a state becomes subject to interstate branching in 1997 unless the state opts out, and that the vote to opt out was unanimous in the Texas legislature. He also described the agreements (called interstate compacts) being developed by state banking departments to facilitate interstate regulation of state chartered banks. Mr. James and Mr. Ryskamp discussed the current and pending litigation on use of the "30 mile rule" for relocating a main bank office, as a means to anticipate interstate branching.

Lyndy Pringle addressed the sale of nondeposit securities and investment products by banks. He noted that despite predictions of great changes in this area of law and business, in terms of the legal requirements very little had changed since the 1995 Banking Law Institute. He noted that bank participation in nondeposit sales programs has increased dramatically; securities market sales have become an important contributor to the profits of some banks, and some banks have become major players in the securities industry. Unfortunately, compliance violations and enforcement actions have also increased, and the penalties can be severe. Should the securities markets suffer a serious decline, even more problems can be expected. Mr. Pringle emphasized the need for banks engaging in this activity to carefully monitor their compliance efforts, as noted by surveys indicating that a number of banks do not properly disclose the risks and lack of deposit insurance for the securities products they sell.

He predicted a trend toward convergence of the securities-related regulatory requirements for banking institutions and SEC-regulated brokers and dealers.

Robert Ledig, co-author of The Fair Lending Guide, discussed fair lending issues. He reported an emphasis on the issue of "quality of assistance" in the loan application process (the extent and nature of assistance provided to loan applicants by bank staff), noting that OCC efforts to focus on this in the examination process have not yielded any significant evidence of disparate treatment of minority loan applicants. While many observers may feel intuitively that disparate treatment is widespread, this may reflect a political perspective rather than a measured judgment. In fact, valid evidence of disparate treatment is very sparse.

This largely leaves the advocates of fair lending initiatives with a single tool: The disparate impact test (or "effects tests") theory. But carried to its logical extreme this theory would bar use of virtually all traditional credit underwriting criteria. Moreover, to the extent that loan rates and charges are negotiated on an individual basis between loan officers and borrowers, there will always be differentials based on negotiating ability. This goes to the heart of the private credit market; disparate impact analysis potentially calls into question the fundamentals of our legal and economic system.

Mr. Ledig noted that the recent Long Beach Mortgage settlement by the U.S. Department of Justice effectively deputized lenders who deal with dealers, by making lenders responsible for fair lending violations of dealers who close loans as agents for the lender. There was a general consensus that the significance of this case has not been generally recognized in the industry or the press. In the settlement, Long Beach Mortgage was also cited for violations based on the marketing of subprime loans in low income areas without disclosing that cheaper loans might be available elsewhere (this was cited as a "deceptive practice"). This is disparate impact analysis run amok, but the more basic point is that these new concepts are inconsistent with basic principles of contract law, market pricing and risk-based credit underwriting. The enforcement authority of the Justice Department means that few lenders can afford to fight these cases, so that Justice Department investigations result in ambiguous settlements based on nebulous legal concepts, that provide little in the way of legal guidance but create opportunities for broad public relations claims by the Justice Department about combating discrimination. Probably the result will be more widespread use of generalized credit scoring systems. Perhaps smaller institutions will be driven out of business by the cost and complexity of the required analysis, while larger institutions will be permitted to make amendments for using statistically sound credit criteria by using large sums to the correct charities. But it seems unlikely that

(Continued on page 162)
K. Record-Keeping

Under the Final Flood Rule, Banking Institutions are required to maintain copies of the SFHA Form and a record of receipt by the borrower and the servicer of the SFHA Notice. The record of receipt must include the borrower’s signature or initials indicating receipt. These records are required to be maintained for as long as the Banking Institution owns the loan.

V. Conclusion

The deluge of new regulations and secondary market guidelines that began immediately following enactment of the Reform Act and which culminated with the adoption of the Final Flood Rule has left few lenders and servicers with the freedom to continue to ignore federal flood insurance requirements. Banking Institutions and their subsidiaries and servicers must comply with the Final Flood Rule. Non-banks which originate and sell loans to and/or service loans for Fannie and/or Freddie are subject to even more rigorous flood insurance requirements (including conducting prospective and retroactive portfolio reviews) than their banking institution brethren which keep loans in portfolio. Nonconforming non-bank lenders need to study the Final Flood Rule to decide on a prudent approach. Only time will tell whether the new regulations and guidelines will succeed in fulfilling the Reform Act’s primary objective, which is to improve the financial health of the NFIP and assure comprehensive flood insurance coverage.

Commentary: The 1996 Banking Law Institute—Quiet Before the Storm?

(Continued from page 165)

any of this will result in any real benefit for low income or minority borrowers.

This raises a fundamental question: Do Americans really want to substitute a national statistical scoring system for the individual judgements of loan officers at thousands of competing banks, thrifts, credit unions, mortgage brokers, finance companies and other lenders, as the basis for determining access to credit? Apparently for a number of influential parties, the answer is yes.20 But it will be unfortunate if these advocates prevail without any legislative debate or judicial scrutiny, on the basis of unstated legal theories or unsound factual assumptions imposed unilaterally by an administrative department of the executive branch. This is not the way public policy is supposed to be made in the United States.

Marsha Williams described recent RESPA developments, including the new rules governing disclosure of mortgage broker fees.21 She noted that true secondary market transactions are not subject to RESPA, but the distinctions between primary and secondary funding are complex and subtle. She also discussed the new rules on “controlled business arrangements” (CBAs),22 seeking to distinguish between payments for bona fide services and illegal “kickbacks.” This requires use of a written disclosure of the affiliate relationship, and also provides special rules for computer loan origination (CLOs). RESPA does not restrict the pricing of CLOs as long as the payments are not prohibited referral fees.

Ms. Williams noted the problem of sham CBAs (new ABAs designed to disguise illegal referrals as a legitimate CLO). Typically this arrangement is used to create a sham mortgage broker using a CLO, as a joint venture between a lender and real estate broker, for the purpose of channeling illegal fees to the real estate broker for referring loans to the lender. She cited a number of “tests” applied by HUD to determine whether the CBA/CLO is a bona fide service provider.

She also described abuses involving the payments of excessive sum for rental of office space, “lock-outs” where the borrower is essentially required to sign a particular loan application before leaving the real estate broker’s office, and employer retaliation against employees who fail to steer customers to certain lenders. Some of these are deemed to be outside the scope of RESPA, but all are risky from a compliance and liability standpoint.

Ms. Williams also described a proposed new rule to amend the HUD escrow accounting requirements.23 This would address the question of whether real estate taxes must be paid by the installment method. One option under consideration would require deference to the borrower’s choice, an approach that would be very costly for mortgage servicers. The proposals also deal with borrower “payment shock,” when taxes and insurance costs rise substantially in a given year. Ms. Williams noted that recent RESPA litigation has focused on two issues: Escrow calculations, and yield spread premiums. She noted that much of the litigation has been in the form of class actions.

University of Houston Professor of Law Stephen Huber discussed the use of arbitration agreements in financial transactions. He questioned how a bank or any other lender could prudently do business in a litigation-prone state like Alabama without the use of an arbitration clause in the loan documents. He noted that in this area of law there is much federal preemption of inconsistent state laws, with a result that there is much nationwide uniformity of laws favoring arbitration. The old days of judicial hostility toward arbitration are gone, and the grounds for appeal of arbitration decisions are very limited. But Professor Huber and Robert Legd also emphasized that arbitration panels are not required to follow the law, a feature that some lenders consider disconcerting.

Laura Pringle discussed a variety of new or revised regulations governing insider transactions, lending limits, privacy issues, suspicious activity reports, CTRs, flood insurance and high rate mortgage loans. She noted a trend toward shifting requirements that were previously considered to be compliance issues, into the safety and soundness arena, with serious consequences for federally regulated institutions found to be in violation.24 This is based in part on a recognition that consumer credit and compliance errors can have severe financial consequences. But the result is that seemingly minor compliance errors can be viewed as having

(Continued on page 168)

20. See, e.g., Edward Kilinsky, Freddie: Automated System To Bring Half of '97 Volume, Am. Bank., Nov. 18, 1996, at 12. Some advocates of credit scoring systems argue that advances in technology will allow every community bank and even a small finance company to devise a separate underwriting credit scoring system reflecting the less experience of that individual office, as an effective substitute for loan officer judgement. Maybe it will happen, but it seems more likely that a standardized process will be ruled acceptable by the regulators and will then become the national model, effectively dismantling the legitimate credit system anyone whose qualifications do not fit the standard model. For these people, at least, a judgmental system implemented individually by thousands of competing loan officers probably offers a better base of scores to the credit system. See, e.g., James S. Kaufman, Consumer, Statutory Asnnnclity Penalties For Lending Error, Am. Bank., Nov. 18, 1995, at 14. But apparently there is considerable disagreement on this point.


22. 61 Fed. Reg. 29228 (June 7, 1996) (new called affiliate business arrangements, or ABAs, under provision amended Sept. 30, 1996 as part of DURSPA). The effective date of these rules has now been postponed by DURSPA. See Paul H. Schleifer, New DURSPA, Developments Inceping Employee Payments, Affiliated Business Arrangements (including "Sham" Joint Ventures), Computerized Loan Origination Systems, Lender Lock-Outs, and 307 Authorities" in this Issue.


24. One example is the Bank Secrecy Act, previously considered a compliance matter but now regarded as a safety and soundness issue. Ms. Pringle also noted that the Bank Secrecy Act rules are now applicable to wire transfers.
frivolous suit or defense. Better remedy changes are essential to reduce unreasonable disposition sales and resulting unfairly high deficiencies.

X. Conclusion

Consumer secured transactions need to be included in revised Article 9. They have been included in existing Article 9 since its inception. No existing consumer provisions should be lost. Some of the existing provisions need to be massaged to deal with problems that have arisen under existing Article 9. Many of the changes being proposed for inter-business transactions are inappropriate for consumer secured transactions. Some consumer secured transactions should be exempted from those changes or have different rules. Some modest new consumer protections should be added. It should be emphasized that all decisions of the Article 9 Drafting Committee remain tentative. The Drafting Committee is, in particular, considering some changes in the test for commercial reasonableness where the secured party buys at its own risk in an inter-business or consumer transaction. But the consumer Observers are not very concerned whether the outcome will be something that will be satisfactory.

As noted at the beginning of this article, your author hopes to have shown the theoretical and practical underpinnings for the consumer provisions espoused by Gail Hillebrand of the Consumers Union and the other consumer Observers. If anyone is interested in doing further reading or research on the particulars of proposals made by the consumer Observers, we have an “abstract” of issues and a one-inch thick notebook of background materials that can be obtained for a small charge from your author.

Commentary: The 1996 Banking Law Institute—Quiet Before the Storm?

(Continued from page 192)

safety and soundness implications, triggering enforcement actions and potentially severe regulatory penalties.

Jacqueline Akins, counsel for Bank One, Texas, described the rules governing wire transfers, including UCC Article 4A, Federal Reserve Board Regulations E, J and S, and related laws. She emphasized the importance of the bank’s financial agreements and security procedures.

Dan Nicewaner joined Robert Ledig and Michael O’Neal for a three-way presentation on Cyberbanking. Mr. O’Neal described the Federal Reserve Board’s proposed amendments to Regulation E dealing with stored-value cards, the FDIC’s September 12, 1996 public hearing on stored value cards, and the OCC’s September 10, 1996 bulletin on stored value cards, demonstrating the importance of and current regulatory focus on stored value cards. Dan Nicewaner emphasized the rapid pace of technological change and noted that it represents a sea change for banks, banking law, and bank regulation. Concern was expressed that cyberbanking will render banks obsolete as financial services delivery systems. Mr. Nicewaner noted that a significant range of issues remains unresolved regarding the nature and extent of appropriate cyberbanking regulation. While the federal banking agencies have publicly recognized the need for a deregulatory environment to facilitate the development of cyberbanking, some observers remain skeptical over the willingness of the federal regulators to remain on the sidelines and their ability to resist the urge to regulate.25 Mr. Nicewaner noted that if stored value cards are to be an equivalent of cash, they should be as unregulated as cash; efforts to regulate consumer protections for smart cards could simply kill the product as an alternative to cash. The proposed FRB amendments to Regulation E confront this by regulating only very small dollar amount cards.

Robert Ledig emphasized that the pace of change in cyberbanking makes effective regulation very difficult, and means that effective regulation would likely have a stultifying effect. He noted that even the use of regulatory definitions and structures can have an inhibiting effect on innovation. As a result, efforts to preserve regulation in the context of “banks’ electronic cash services may simply favor nonbanking service providers. Mr. Ledig noted that the line between banking and commerce is rapidly disappearing, with significant implications for banks and their regulators—he called this the “end of demarcation” based on access to the payments system, which together with deposit insurance has previously distinguished banking institutions and justified the extensive system of bank regulation.26 Indeed, electronic cash may come to represent an entirely new, parallel payments system outside the traditional banking system.

Lawrence Young, Vice President of the Conference on Consumer Finance Law, concluded the 1996 Institute by discussing a topic that several other speakers had mentioned in the context of their topics: class action liability. Almost any legal problem can be magnified literally by a factor of thousands in a class action suit, with some plaintiffs’ law firms signing virtually every leader in a state once a problem area is identified. Subsequent purchasers of consumer credit contracts in the secondary market are also at risk, sometimes as a result of alleged assignor violations that are virtually impossible for the assignee to detect. As a result, a single error or alleged error relating to a form or practice can literally threaten the existence of an entire industry. Considering the complex nature and constant, creative evolution of state and federal consumer credit requirements, it is very difficult to avoid this risk. Mr. Young discussed ways that lenders and their counsel can ameliorate these risks; he also noted several recent appellate decisions affecting regulation.27

(Continued on page 201)


27. Id. (asserting that the Federal Reserve Board and the OCC should be replaced by a new federal regulatory agency to regulate cyberbanking).
Bankruptcy filings are increasing at an alarming rate. While this may reflect various societal factors, human nature does not change this rapidly and creditors are no more greedy or profligate today than in the past. When economic and legal developments coalesce to create this kind of dramatic change, government policies are usually implicated, and that is the case here.

By simultaneously facilitating a consumer credit expansion and making bankruptcy more attractive for debtors, the federal government has created a bankruptcy boom that threatens private creditors, nondefaulting borrowers, and the national economy. The dangers are exacerbated by the perceived deficiencies and unfairness to creditors in the current Bankruptcy Code and process.

It is essential that the Bankruptcy Review Commission address these issues, free from the stereotypes and political agendas that have previously plagued bankruptcy reform efforts and have contributed to the current problems.