Commentary: Federal Credit Allocation and the Private Credit System

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By Alvin C. Harrell

Under the new Community Reinvestment Act (CRA) regulations (and to some extent as a result of the "effects test" promulgated by the Federal Reserve Board under Regulation B), loan-to-deposit ratios, market share tests, and other statistical factors are being used to determine whether lenders are properly serving their communities. Vigorous

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Schedule of Upcoming Conference Meetings and Programs

March 21–23, 1996  
Chartering Alternative and Operating Strategies for Consumer Financial Services Providers  
—San Antonio, Texas

March 29, 1996  
Current Issues in Debt Collection and Bankruptcy  
—Nashville, Tennessee

May 9–10, 1996  
Consumer Protection, Debtor's Rights, and Creditors' Remedies in the 1990s  
—Oklahoma City, Oklahoma

May 16–17, 1996  
Oil and Gas Law 1996: The Law of Oil and Gas Titles, Exploration, Production, Acquisitions and Finance  
—Oklahoma City, Oklahoma

May 24, 1996  
Health Care Law  
—Oklahoma City, Oklahoma

May 31, 1996  
Property Rights and Liabilities—Land Use Issues in the 1990s  
—Oklahoma City, Oklahoma
options may be explored, including obtaining protective orders, where appropriate.

F. Expense Reimbursement

Expenses incurred by the financial institution for both reproduction of the documents and the giving of testimony is compensable. This would include research and retrieval time, expense of copies and transportation necessary to see the documents to their final destination. Cost of managerial or legal advice is not reimbursed.

G. Precautionary Remarks

Once again, it is important to emphasize that adequate procedures be established for the acceptance of and compliance with Summons and Collection Summons. Of special note is the period within which the customer may file proceedings to quash the Summons. In every case, care should be taken not to release records before that time period has elapsed. Although the statute does not provide for a private right of action in the case of noncompliance, no doubt creative and zealous plaintiffs' counsel will make such an argument to the extent that it benefits their clients. However, reluctant taxpayers are generally not well received by the federal magistrate or judge hearing their claims and defenses.

VI. Conclusion

The Internal Revenue Service has been delegating the arduous responsibility of collecting taxes and endowed with significant authority to successfully achieve that goal. While some of the legislation enacted to facilitate the tax collection effort of the IRS appears to be at odds with traditional notions of due process, it has nonetheless withstood the test of time, with a paucity of modifications. Financial institutions may limit the exposure inherent in processing Notices of Levy and Summons by implementing detailed and precise policies and procedures. However, as far as tax liens are concerned, the lender is somewhat at its peril with respect to funding ongoing financing arrangements and must rely on periodic investigations for tax lien filings to provide some measure of protection.

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2. Small, conservative institutions lost the market power, augmented hedging capabilities, and liquidity reserves of larger institutions, and hence (in managing interest rate and liquidity risks) maintain higher liquidity ratios that may be viewed with disfavor under the new CRA regulations. See, e.g., Matt Schulte, As Banks of Creditors Die for Working Sessions, S. Ct. to Assumes, New CRA Proposals, Am. Bank., Aug. 24, 1995, at 5 (noting that the agencies will now require a "reasonable" "as-issuer" test for bank); Brazell & Johnson, On Standards of Bank Credit Risk, Am. Bank., Oct. 7, 1994, at 11 (noting that the agencies will now require a "reasonable" "as-issuer" test for bank). In addition, previous CRA proposals suggest that a minimum 60% loan-to-depositor ratio may be required. See the current CRA proposals, at 59 Fed. Reg. 31202 (Oct. 3, 1994), and 50 Fed. Reg. 26486 (Dec. 21, 1995). Moreover, it is possible that (by meeting this test), a small bank would forfeit its exemption to the proposed interest rate risk (IRR) requirements. As a result, small banks may be forced to fail either the small bank CRA test or the IRR exemption test.

On the other hand, the new CRA proposals depend largely on examiner and regulatory discretion, so that these issues need not become a problem unless the agencies adjust the issues quickly. A small bank may be forced to fail either the small bank CRA test or the IRR exemption test. However, the agencies may choose to adjust the issues quickly. A small bank may be forced to fail either the small bank CRA test or the IRR exemption test.

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"down time" associated with repair versus replacement, and the possible loss of business activity.153

The benefit to the defendant is realized in two situations. First, a defendant may introduce evidence that the plaintiff has mitigated damages to rebut the damages sought by the plaintiff. Second, a defendant may introduce evidence that the plaintiff has failed to mitigate damages. In that situation, the defendant would not be responsible for those damages caused by the plaintiff's failure to mitigate or minimize his loss.

An interesting argument was made by the defendant in regard to mitigation of damages in the case of HOW Insurance Co. v. Patriot Financial Services of Texas, Inc.154 In that case, HOW argued that the consumer failed to mitigate her mental anguish damages because she refused to accept HOW's settlement offer and proceeded to trial. The consumer had testified that she was distressed by the problems with her condominium and the difficulties in obtaining repairs. She also testified that she lived under constant pressure trying to get the problems fixed. The court rejected HOW's mitigation claim, noting that the evidence indicated that the consumer suffered mental anguish as a result of HOW's unconsensually actions before the first settlement offer.

XII. Conclusion

The DTPA provides a variety of remedies for both consumers and the business community. Recent decisions have expanded the DTPA to provide a wide range of recoverable damages including actions for breach of contract, lost profits and mental anguish. While the courts are continuing to define and clarify its meaning, in conjunction with other, more traditional remedies, the DTPA has become a very effective litigation tool.

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sible to prove in advance that credit allocation measures will produce specific loan losses, or that a conservative lending strategy is essential on safety and soundness grounds. Consequently, lenders have generally been unable to resist credit allocation measures on the basis of traditional safety and soundness arguments, leaving unresolved the basic policy issue: To what extent should private lenders be subject to federal control of their loan underwriting policies and standards on "feariness" grounds? Obviously lenders using funds that are subject to federal deposit insurance must be supervised by federal regulators, who may be subject to political influence. There appears to be a broad political consensus that the public's guarantee of the safety of FDIC-insured deposits gives society a stake in the administration of those funds, with extensive related authority delegated to the federal banking agencies. So long as this regulatory mandate was limited primarily to safety and soundness issues, based on objective financial criteria, there was no inconsistency of purpose between prudent bankers, their regulators, and elected officials.

But all of this changed when the regulatory mandate was expanded to include a new, more activist view of fair lending and the CRA. Today, a federal regulator mandates only safe loans; it may be subject to criticism and sanctions for not lending to marginal borrowers. If it makes marginal loans it may be subject to criticism for overbidding on unsophisticated borrowers, and ultimately may suffer losses and severe regulatory penalties if these loans go bad. In either case, the critics will have the full benefit of hindsight, without ever taking a risk. As a result, federal regulators must now tailor their lending programs so as to anticipate and accommodate perceived shifts in the social policies favored in Washington, D.C. The authority to make fundamental strategic decisions has been shifted from the private to the public sector. Loan underwriting is no longer an economic decision to be made solely by the party responsible for supplying the funds and collecting the loan.

This separation of authority and responsibility is an inevitable consequence of current federal credit allocation policies, indeed some might say it is a primary purpose of such policies. Efforts by the Justice Department and the bank regulatory agencies to publicly soften their fair lending enforcement stance in the aftermath of the 1994 ele-


154. 776 S.W.2d 533 (Tex. App.—Austin 1990, writ denied).
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11. See, e.g., Grunder v. Packard, Credit Scoring, Used Alone, Serm Protecting Loan Bases, Am. Bank., Sept. 27, 1985, at 3; Wil-}

10. (Continued from previous column)

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18. This is not entirely a unique issue. Continual efforts to regulate local decisions from Wash-}

ton, D.C. mean that all business and lending deci-
sions increasingly are political as much as econ-}

omic. The federal government has created impor-
tant "country risk" for any lender in the busi-

ness of extending credit in the United States. No-

where is this more apparent than in the context of

fair lending and the CRA. Ultimately this may en-

danger our traditional system of private credit, if

so, borrowers will pay a high price for the regula-
y

tory activism being promoted on their behalf.

The views expressed herein are solely those

of the author and do not represent a position of

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15. See generally Jonathan R. Mark, The Lawmakers as Lending Discrimination, Wol. Str. Jr., Aug. 9, 1985, at 38. It should be noted that "subjective" lending to marginal borrowers has ex- }


dended dramatically outside the banking system, perhaps in response to the general consolidation and downsizing of the regulatory/banking system and lack of leadership among non-bank alterna-

tives seeking to fill the void. Left unmentioned in this com-

petition will provide all of the credit needed by creditworthy consumers at all economic levels, without any federal insur-

ance. But this does not seem to be what the lending advan-

tes have in mind.