Commentary: Ten Banking Trends in the 1990s - A Sea Change for America

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Ten Banking Trends in the 1990s -
A Sea Change for America
By Alvin C. Harrell

During casual discussions at the 1993 Southern Methodist University Banking Law Institute, SMU Professor of Banking Law Joseph J. Norton (co-chair of the Institute) posed the question: What's to become of banking? While this may have been merely polite conversation, it was a particularly appropriate inquiry, in view of the newly extraordinary developments that were being announced by various speakers at the SMU program.

Of course it is a question that cannot be answered because, as noted in the SMU program materials provided by Anthony D. Gaas of Micro Resources, Inc., "[predictions are] difficult, particularly when you're talking about the future." Still, it is a question that those concerned with the future of the financial services industry must consider. This article discusses ten trends and developments (and some related ironies) that were identified and discussed during the SMU Institute. As always, other views are welcome and will be considered for publication.

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address of an employee of a debt collector;

g. misrepresenting the character, extent, or amount of a debt against a consumer, or misrepresenting its status in any judicial or governmental proceedings;

h. falsely representing that any debt collector is vouched for, bonded by, affiliated with, or an instrumentality, agent of official of this state or any agency of federal, state or local government;

i. using, distributing, or selling any written communication which simulates or falsely represents to be a document authorized, issued, or approved by a court, an official, a governmental agency, or any other legally constituted or authorized governmental authority, or which creates a false impression about its source, authorization, or approval; or using any seal or insignia or design which simulates that of any governmental agency;

j. representing that a debt may be increased by the addition of attorney's fees, investigation fees, service fees, or other charges when there is no written contract or statute authorizing such additional fees or charges;

k. representing that a debt will definitely be increased by the addition of attorney's fees, investigation fees, service fees, or other charges when the award of such fee or charge is discretionary by a court of law;

l. falsely representing the status or true nature of the services rendered by the debt collector or his business;

m. using any written communication which violates or fails to conform to United States postal laws and regulations;

n. using any communication which purports to be from any attorney or law firm, when in fact it is not;

o. representing that a debt is being collected by an attorney when it is not; or

p. representing that a debt is being collected by an independent, bona fide organization engaged in the business of collecting past due accounts when the debt is being collected by a subterfuge organization under the control and direction of the person to whom the debt is owed; however, a creditor is not prohibited by this section from owning or operating its own bona fide debt collection agency.

8. Civil Remedies

In addition to any other relief available under any other consumer statutes, the TDCA provides its own civil remedies, which include injunctive relief, damages, and attorneys' fees reasonable in relation to the amount of work expended and costs. As long as the wrong complained of arises out of a debtor-creditor relationship, any person against whom prohibited acts are committed may maintain an action for actual damages sustained as a result of a violation of the Act, even if the person is not a "debtor." The standard for causation appears to be not one of "proximate cause," but rather whether the damages occurred "as a result"

of the debt collector's acts. Furthermore, in the case of a claim for mental anguish, proof of physical illness or injury is not required. Exemplary damages may be awarded for violations of the Act which are committed maliciously.

9. Relation to DTPA

A violation of any provision of the TDCA by any person is a deceptive trade practice, actionable pursuant to the Texas Deceptive Trade Practices - Consumer Protection Act, and is also subject to the venue and remedies provisions of the DTPA.

10. Bona Fide Error

No person shall be guilty of a violation of the Act if the action complained of resulted from a bona fide error notwithstanding the use of reasonable procedures adopted to avoid such error.

IV. Conclusion

Demand letters and acceleration notices should be viewed as a sometimes necessary evil. Attorneys and creditors should take great care to avoid having such notices create defenses and counterclaims that otherwise would not exist. Ideally, loan documents should be drafted so as to create waivers of any rights to such notices, but even those waivers will not excuse an attorney from compliance with the FDCPA, nor will they excuse the attorney and the creditor from compliance with the TDCA. Protection lies primarily in the creation of procedures that will set up a bona fide error defense, and such procedures should be reviewed and updated regularly.

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1. Legislative and Regulatory Micro-Management of Banking

In the competition between bank regulatory models, the model of the postwar thrift industry has prevailed. The result is an emerging regulatory regime eerily familiar to

those of us who observed first hand the decline of the thrift industry in the 1960s and 1970s. Ironically, this is perceived by

nearly all concerned to be part of an effort to reduce the level of risk in the system, in

2. NV, e.g., E. KANE, THE S&L INSURANCE MESS: HOW DID IT HAPPEN? (1989); J. BAPST, THE GREAT SAVINGS AND LOAN DISASTER (1991); Alvin C. Harrell, Commentary on (Continued from next column)

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2. (Continued from previous column)

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The L.A. Times article also notes that today's laws are
accelerating consolidation of the financial services
industry nationwide and supra-regional banking organizations. It's
even been possible to make one of Capra's popular movie heroes
"crazy."
The article notes how the Bankers' Trust, Bulding
and Loan likely would be "shut down" and sold to Peter for
conciliation with his bank.

And how, with community lenders gone or afraid to make
loans, does the new federal plan envision that communities will
avoid the perils that may befall "Potterville"? By means of
federal regulation and enforcement of course "maybe the
answer lies with President Clinton's initiative to seek
tougher enforcement of the Community Reinvestment Act."

George Bailey is the only one who has strung decisions
about these things.

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order to protect the deposit insurance fund, and
promote service to the community. This was precisely
the rationale for much of the post-war micro-regulation
of the thrift industry. How odd that this failed
regulatory approach has not been imposed on
the entire banking system.

2. The Financial Regulatory
Agencies Have Virtually
Unlimited and Arbitrary Power

This is something of a corollary to number one above,
but it has occurred so suddenly, and involves such an
unprecedented change that it must be noted separately.
If you don't believe it, take a look at 12 U.S.C. section
1818. It seems safe to say that financial institutions-
affiliated parties (including officers, directors, and legal
counsel) no longer have anything resembling legal rights
in the traditional American sense.

Such parties' careers (and their families') exist and
survive largely at the pleasure of the regulators. In addition,
this power is now being turned against individual institutions
on the basis of even the most technical and harmless
errors. If this is not frightening in the extreme to every banker and
bank lawyer (especially in view of factor number three,
below), it should be.

3. The Government Cannot Be Trusted

There has been much discussion about this among
bank lawyers, and it was a topic of discussion during
the 1993 Banking Law Institute. Some may say that
government never has been trustworthy, but govern-
ment in the 1990s seems to have become more
blatantly unreliable, to the extent of abrogating its own
written contracts, abandoning any pretense of due
process, and in some cases simply ignoring basic rules.
This new attitude on the part of huge regulatory
agencies, in conjunction with their new and virtually
unlimited powers, and the lack of any meaningful
judicial review in any instances, represents a true
sea-change in the basic thrust of American law.

4. Narrowing Spreads and
the Coming Economic Squeeze

The legal and regulatory crises buffeting the financial
system have been overshadowed to some extent by the
profitability of the banking industry over the past three
years. Bankers and their counsel have been so distracted
by this economic windfall (in the face of a stagnant
economy) that they have generally been willing to
overlook the encroaching regulatory crisis. This "head
in the sand" approach is encouraged by a common belief
(or hope) that it can't really be that bad. But it is,
and when the easy profits from low interest rates are
gone, and institutions again begin to experience
financial stress, a new mix of economic and regulatory
pressures will create significant problems for bankers
and other institution-affiliated parties.

5. Increased Pressure to
Make Marginal Loans

This is another obvious trend, being manifested in
a variety of ways, including CRA and fair lending
enforcement, various regulatory initiatives, and contin-
uing public pronouncements by regulators and politi-
cians. Can de facto credit quotas be far behind?

One of the ironies of our time is the extent to which the credit
availability problems being addressed by these mea-
ures have resulted from the passive banking legisla-
tion supported and enacted by those who now blame
lenders for their reluctance to lend.

6. The Re-Balkanization of Credit

These regulatory pressures, and the trend toward
fewer and larger banks (and hence less banking
competition) is old news. Perhaps, however, it is not so
apparent that this trend heralds a new age of "nice"
banking, and a resulting balkanization of the finance
industry, with specialized lenders catering to various
niches abandoned by the regulated banking system.

Another irony. This balkanized system represents
something of a throwback to the early days of
customer finance, when each segment of the financial
services industry was dominated by specialized lenders
with little cross-industry competition. The result, of
course, was limited credit availability and relatively
high credit costs. A double irony: This earlier situation
was largely the result of balkanized state consumer
credit and commercial lending laws, a problem rectified
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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.6 The court concluded the bank's failure to reevaluate the need for the guaranty of Mrs. Stern gave rise to a claim under the ECOA. The court concluded that:

[the] ECOA imposes an affirmative obligation upon a creditor to reevaluate the need for an additional party when a credit obligation is renewed, and to do so without discriminating on the basis of marital status or any of the other bases enumerated in the [ECOA].7

Interestingly, the case does not state that the bank had in fact reevaluated the borrower's (Mr. Stern's) creditworthiness when it renewed the loan. Remember, the Official Commentary says "it" the bank reevaluates a borrower's credit worthiness it must also reevaluate the need for an additional party. The facts in this case do not state that Mr. Stern's creditworthiness was, in fact, reevaluated. Nevertheless, the court either knew of or assumed that action by the bank.

The court's ruling could be construed to provide that the bank's violation would have existed whether or not the bank had done a credit reevaluation of Mr. Stern and whether or not the bank had in fact determined that the guaranty was still required. In other words, in this view the bank was obligated to reevaluate the borrower's creditworthiness at the time the loan was reviewed.

In view of these cases, lenders would be well advised to reevaluate their credit renewal procedures and policies and to focus on this often forgotten provision of Regulation B and the Commentary.

7. 794 F. Supp. at 869.

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in large measure (to the great benefit of American society) by the Uniform Commercial Code and (to a lesser extent) by consumer credit reforms such as the Uniform Consumer Credit Code. Advocates of the federalization of state law regime invariably cite even greater uniformity as the primary potential benefit; yet, it is the increased federalization of banking law (and the resulting impairment of traditional banking functions) that is leading to the re-outline of the entire financial system. It is, in the words of Professor Lawrence Baxter, an example of "The Rule of Too Much Law."6

9. The Disintermediation of Financial Services

All of this reflects a significant reversal of prior banking policy. And as another result, bank customers are increasingly bypassing bank intermediaries, withdrawing their funds to invest directly in mutual funds, securitized loans, and derivatives, in order to achieve a higher yield. The banks themselves have abetted this trend. Banking institutions are left with a residue of very low cost deposits, invested at a decent (though declining) spread in U.S. Treasury securities or other low-risk assets, plus some requisite CRA lending and a dwindling share of commercial finance. As a consequence the banking system is maintaining good profits at low risk to the deposit insurance fund, while the public is assuming greater investment risk, more so than at any time since the 1920s.

This represents a socialization of banking profits (for the benefit of the deposit insurance fund) and a privatization of banking risks (as more investment risk is assumed by the public), precisely the opposite of the socialized risks and privatized profits identified in the 1980s as part of the moral hazard created by deposit insurance. In this sense a primary goal of recent banking law and policy - to preserve the deposit insurance fund and shift the risks of loss elsewhere - has been achieved, though at a terrible cost to the economy (and to unsophisticated investors) should those risks not work.

8. Criminalization of Commercial and Banking Law

This trend has previously been noted in this journal,11 and the discussion need not be repeated here. To paraphrase the words of Professor Green at the 1993 SMU Banking Law Institute, the orientation of the criminal law has shifted from a view of banks as potential victims, to be protected by the law, toward a view of banks and bankers and their customers as villains to be punished. Suffice it to say that this represents a significant development that drastically alters the risk of engaging in any banking transaction.

9. In the 1990s the Strategic Advantage is With the Least-Cost and Highest-Service Lender

Pretty obviously this does not include heavily regulated banking institutions, with their incredible cost and regulatory burdens and a resulting adversity to risk (and hence to the extension of credit services on an entrepreneurial basis). Another irony: This competitive environment confers an advantage not only on less-regulated institutions, but on smaller ones, since they can often react faster and can more easily custom-tailor their services to meet individual needs. Smaller, less regulated institutions also can more easily apply the kinds of flexible underlying standards and procedures that are crucial to successful niche lending; and they may be closer to their markets (physically and culturally) than their larger brethren. As a result of these inherent disadvantages, the largest institutions likely will have to continually merge in order to grow, itself a disruptive process.12

10. In Conclusion: The Utility Model of Banking

It is now national policy that virtually all banking decisions be made by reference to a detailed regulatory system, supplemented by rigid written policies and procedures.13 It is not contemplated that any banker will exercise creative judgment or deviate from the approved operations manual.14 The bank's compliance staff has been depersonalized to report (and thereby prevent) any and all exceptions.

This has various implications. First, it probably means the end of the federally-regulated community banking institution, since small institutions do not have the resources to support or comply with the new requirements for a bureaucratic management and compliance.

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12. This follows a historical pattern. See, e.g., G. KOLODZIEJEVSKY, THE THREE WHEELS OF CONSERVATISM (1963). Anthony J. Dass, "Development of a Limits Pricing" 1993 Banking Law Institute, Southern Methodist University School of Law, Dallas, Texas, Spring 1993, at 31-40, 19, 20, 21; Bill Alford, Top Virginia Banker Focuses on Development of merger, Asset Bank, Naco. 3, 1993 at 6. Proposed increase in employee customer for employee health insurance costs, social security taxes and the like will add further to the cost of employing the increased staff necessary to assure compliance with federal banking regulations and mandates. While this will serve to reduce employment for regulatory and compliance staff (as the current that banking institutions survive), it will further impair the competitive position of regulated institutions.

13. To compensate for these regulatory costs and to prevent (or at least retard) the decline of the industry, the regulator will have to provide significant competitive benefits to regulated institutions, perhaps by fostering an oligopolistic competitive environment or offering increased protection of customer protection of customer protection. As a single, more powerful bank regulatory agency, it will be a stronger position to grant such a merger to a market to prevent it. See, e.g., James L. Brooks & R. Dan Boucher, Jr., Merger Regulator Will Help Banks Compete, Amer. Banker, Dec. 2, 1993, at 39, 39, 40-41. The institutional design of the savings and loan became increasingly influential as a result of the growing involvement of the federal government in the regulation and supervision of the industry.

14. Again this sounds unfortunately similar to the payday loan regulatory model. See, e.g., Kase, supra note 2, at 26-28. ("Through 1993, FSLIC examiners have focused their investigations more on regulatory compliance than on examining an institution's health. . . . FSLIC examiners conducted their investigations by checking with checkers and bank and loan associations to get the impression."")
dangers, in the context of Article 9, which creates a series of priorities based on demonstrable events (constituting "perfection") designed to give notice to third parties (filing, possession, perhaps in the future making a bank deposit or delivering securities to a broker), irrespective of the time the interests are created or assigned. This system of "perfection" is largely hostile to the law of assignment as the basis for priority. Awarding priority on the basis of an assignment theory would dramatically change Article 9 priorities from a system based on perfection to one based on the time of attachment.

Beyond this, the UCC in general is founded on the notion that certain parties take rights greater than those of their transferees, and Article 9 is no exception. Cases that have failed to recognize this basic point, and have instead relied on the law of assignment for guidance in resolving Article 9 priority disputes, typically rank among the most analytically unsound in UCC history. Reemergence of these arguments in discussions of the proposed Article 9 revisions suggests a need to remind interested parties that the time of assignment or attachment is generally not a deciding or even relevant factor in an Article 9 priority dispute.

V. Conclusions

This report has focused on a few of the more controversial aspects of the PEB Report. This should not be taken to reflect the tone or nature of the overall Report. The vast number of Article 9 revisions proposed in the PEB Report will be unquestionable improvements over current law and are not controversial. Future articles in this journal will describe many of these and most readers will be pleased with the results. Like the 1990 Article 3 and 4 revisions, this revision promises major improvements in the law.

The Article 9 revision process is probably essential to the survival of commercial law as we know it. Article 9 is the cornerstone of the UCC, its most preeminent element, and in turn the UCC is the foundation for our system of state commercial law. The emphasis in the UCC on party autonomy, of facilitating private transactions and letting the market lead (rather than seeking to impose a legislative or regulatory mandate on unwilling parties) represents an important counterpoint to much modern public policy.

It is important that this system be updated, while preserving its essential character. While it is not a sure thing, given the current political climate, the Drafting Committee and Reporters are off to a good start. They and the sponsors of the UCC are to be commended for undertaking this effort, and deserve the active support of all interested parties.

Conference Joins UCC Article 9 Revision Project

The Conference on Consumer Finance Law (the "Conference") has accepted an invitation from William M. Burke, Chair of the Uniform Commercial Code Article 9 Drafting Committee, to participate in the work of the Drafting Committee as it considers proposed revisions to UCC Article 9. The Conference will be represented at meetings of the Drafting Committee, and will seek to provide input as regards matters of interest to Conference members.

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As James Sexton noted during the 1993 SMU Institute, the regulator's job is to round up stray and keep the herd together, but if public policy runs the herd off the cliff, this just means they will all go over together (an apt description of the thrift crisis). Fourth, financially healthy institutions are no longer safe; the utility model means that healthy institutions are just as likely as insolvent ones to be destabilized and pushed into a downward spiral by a regulatory focus that breeds agency enforcement actions on the basis of technical errors, inadequate policies and procedures, CRA deficiencies or the lack of a bureaucratic management system. The age of banking, as we have known it for over 200 years, is over. But what if anything will take its place? As these trends develop, the very nature of our economy, and our society as a whole, will depend on the answer to Joe Norton's question.