Strong Banks, Weak Economy

Alvin C. Harrell, Oklahoma City University School of Law

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Commentary: Strong Banks, Weak Economy
By Alvin C. Harrell *

1. The 1991 Banking Bill: FIDREA III

In late 1991 Congress passed and President Bush signed into law the Federal Deposit Insurance Corporation Improvement Act ("FIDICA" or "the 1991 banking bill")! Contrary to reports in the popular media, this is far more than a "narrow" banking bill that merely recaptures the FDIC and imposes tougher regulations on institutions with inadequate capital. FIDICA contains extensive and detailed provisions that will significantly affect the legal and regulatory environment for banks, thrifts, and credit unions. Even more importantly, it is the first pattern of developments that represents a major turning point for the American financial system.

FIDICA is the third major banking bill enacted in many years, and together these laws form a comprehensive package with long-term implications for the financial system and the entire economy. A significant exception has accompanied these new laws, with the economy achieving downward revisions that affect corporate equity. Even more remarkably, policy makers, investors, and the media (and indeed the public) seem uncertain as to what these laws mean.

In August of 1989 Congress passed the Bush administration's Financial Institutions Reform, Recovery, and Enforcement Act ("FIEREA"), which tackled the industry with the very kinds of investor and regulatory limitations that contributed to the demise of so many banks and ultimately doomed the FSLIC. FIEREA faced some legal and procedural hurdles, and the value of real estate, junk bonds, and bond covenants just as the government faced the market with offerings of all sizes. The collateral values declined, new lending began to slump, and a credit

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Vol. 46 Spring, 1992 No. 2

The Quarterly Report is published four times a year. Please address all correspondence concerning editorial content to Professor Alvin C. Harrell, Editor, Consumer Finance Law Quarterly Report, The Oklahoma City University School of Law, 2501 N. Blackwelder, Oklahoma City, Oklahoma 73106.
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- Federal regulators will set compensation standards that will essentially determine the salaries of financial institution managers.
- Audit committees must be made up of outside directors and in large institutions must have members with financial expertise and outside counsel.
- Federally chartered banks and thrifts can acquire or be acquired by any insured depository institution.
- The Truth in Savings Act will mandate uniform disclosures of certain data, based on the Truth in Lending Act model.
- Institutions with capital below 2% must be placed into conservatorship.
- Institutions will be placed into five categories: (1) Well Capitalized, (2) Adequately Capitalized, (3) Undercapitalized, (4) Significantly Undercapitalized, and (5) Critically Undercapitalized. Subject to certain exceptions, institutions in the two lowest categories must dismiss all directors and senior officers in office more than 180 days prior to the date the institution became undercapitalized.
- Tougher restrictions are imposed on loans to financial institution insiders.
- Independent annual audits are required for all banks and thrifts with assets over $150 million; all audits must follow standards set by the FDIC and any other "primary" regulator.
- The banking regulators may remove, suspend, or bar any independent accountant, for "good cause."  

- State banks must conform their activities to those permitted for national banks.
- FDICIA adds 12 new grounds for federal seizure of a bank or thrift.
- Enforcement actions are authorized on new, amorphous grounds such as unsatisfactory asset quality, management, earnings, or liquidity.

For thrifts, there is some minor consolidation. Thrift consumer lending authority was increased from 10% to 35%, and the Qualified Thrift Lender test has been reduced from 70% to 65%, (and the range of qualifying assets was expanded). Arguably the value of the thrift charter was enhanced relative to the bank charter because the new regulatory powers and restrictions are more akin to the traditional regulatory environment for thrifts, so that banks will be "not more." But somehow it seems unlikely that many thrift executives will be cheerfully by this line of reasoning.

There is, however, some reason for relief that a wide range of even worse proposals was not included in the final bill. As just a sample, these proposals included the infamous cap on credit card interest rates, statutory loan-to-value ratios, and a requirement that individual controlling shareholders be treated as a bank holding company.

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The final product looks cribbed overall compared to the proposals that received such strong support.

Revised regulations proposed to merge the regulatory agencies, restructured the Board of Directors, and allow referrals of actions to a three-member panel. The new structure is seen as a key improvement over the current system.

II. The Banking Law Debate in the 1980s

Challenges to the dominant role of the Federal Reserve in the financial system have been ongoing since the 1980s. These challenges have focused on issues such as the independence of the Federal Reserve, the role of the Fed in monetary policy, and the implications of financial innovation.

III. The Economic Importance of Current Banking Laws and Policy

The economic consequences of current banking laws and policies have been the subject of much debate. Economists have examined the impact of changes in banking regulations on the efficiency of the financial system and the allocation of resources.

VII. Conclusion

The current banking system is facing significant challenges, including changing economic conditions, technological advancements, and regulatory changes. The industry is adapting to these changes, but more work is needed to ensure a stable and efficient financial system.

Case Note: Bankruptcy Code Preempts State Law Grace Period

The Bankruptcy Code preempts state laws that provide longer grace periods than the federal law. This is a significant consideration for creditors and debtors alike, as it affects the timing of filing bankruptcy and the timing of payment of debts.
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Projections abound that the economy will improve next year, but growth in small business employment to take place. Nevertheless, the prospects for growth in the second and third quarters are improving, and the data suggest that the recovery will be stronger in the fourth quarter than in the first. However, the projections for growth in the fourth quarter are based on the assumption that the recovery will be stronger in the fourth quarter than in the first. However, the projections for growth in the fourth quarter are based on the assumption that the recovery will be stronger in the fourth quarter than in the first. However, the projections for growth in the fourth quarter are based on the assumption that the recovery will be stronger in the fourth quarter than in the first. However, the projections for growth in the fourth quarter are based on the assumption that the recovery will be stronger in the fourth quarter than in the first. However, the projections for growth in the fourth quarter are based on the assumption that the recovery will be stronger in the fourth quarter than in the first.