Commentary: Banking Law 1994--Problems and Prospects

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By Alvin C. Harrell

1. Introduction

For more than a decade Southern Methodist University School of Law and SMU Professor of Banking Law Joseph J. Norton have presented a comprehensive annual program covering current issues, developments and trends in banking law. The 1994 SMU Banking Law Institute ("the Institute") was held September 8-9, 1994 in Dallas, Texas. This Commentary focuses on many of the problems and issues discussed at the 1994 Institute, and references presentations made at the Institute. Of course these comments reflect the subjective observations of your author, which may differ from those of other speakers and attendees. In addition, citations are included to the full text of Institute papers and other works.

(Co-authored with Michael O. Neal)
persuasion exercised by the agencies, is an expression of the inherent powers they possess.172

Among banking agencies, the Memorandum of Understanding ("MOU") is, historically, the informal enforcement document most frequently used by the agencies. (The OTS uses the term "Supervisory Agreement.") The MOU was developed as a means of applying informal administrative action to institutions considered to be of supervisory concern but which have not deteriorated to the point where formal administrative action is warranted. An MOU may be the final step before initiation of cease and desist proceedings if the deficiencies noted in the MOU are not corrected. An MOU is a written memorialization of a verbal agreement between an institution or institution-affiliated party and an agency. An MOU is an agency-prepared document containing formal recitals and articles in the manner of a order to cease and desist. An MOU typically contains provisions which require the institution to establish a business plan to correct problems identified by the agency.173

Board resolutions are used to address minor deficiencies in well-run institutions. Board resolutions are passed by the board of directors of an institution in which certain deficiencies exist and contain provisions tailored to address those deficiencies. The content of most board resolutions is suggested by the agencies and presented to an institution's board of directors, along with a request that the board immediately pass the resolution.174

A commitment letter is usually initiated by an agency and sent to an institution's board of directors asking that the institution execute the letter undertaking certain commitments to correct deficiencies in the institution. Commitment letters are generally used in situations in good overall condition that develop minor problems in isolated areas of their operation.175

Compliance with an informal enforcement document is monitored by the agencies through both on and off site supervisory activity. The appropriate regulatory agency monitors compliance through review of Consolidated Reports of Condition and Income, progress reports filed by the institution pursuant to an enforcement agreement, and examinations and examinations. Each examination report must address compliance with any outstanding supervisory agreement on an article-by-article basis indicating substantial compliance, noncompliance or partial compliance.176

Once substantial compliance with an informal enforcement agreement's terms has been achieved, termination of the agreement should be granted by the agency. A request for termination should be made if this does not occur.177

On the other hand, noncompliance may have severe results, often triggering the formal enforcement actions discussed in this article.

174. Id. at 8 (0415).
175. Id. at 8 (0426).
176. Id. at 8 (0506).
177. Id. at 8 (0818).

Commentary: Banking
Law 1994—Problems and Prospects
(Continued from page 258)

II. The Regulatory Burden

The regulatory burden is real, pervasive and excessive. It has transformed the American financial scene. Institute Co-chair Dan Niederhoffer noted that in the space of 20 years consumer loans have become the most over-regulated transactions in all of history.

It is now more difficult to extend a $5,000 consumer loan than a $100 million commercial line of credit.

The results were predictable: Consultants, class action lawyers, and political activists have prospered, while community banks and other traditional...

(Continued on page 228)
APPENDIX

PROMPT CORRECTIVE ACTION STATUTORY AND REGULATORY PROVISIONS
FINDERS GUIDE

STATUTORY SOURCE OF PROMPT CORRECTIVE ACTION

REGULATORY SOURCES

National Banks (Primary federal banking agency: Office of the Comptroller of the Currency)

Prompt Corrective Action: 12 C.F.R. § 6.1 et seq. and §1 9.220 et seq.

State Member Banks and Bank Holding Companies (Primary federal banking agency: Board of Governors of the Federal Reserve System)

Prompt Corrective Action: 12 C.F.R. § 208.30 et seq. and § 263.201 et seq.

Nonmember State Banks (Primary federal banking agency: Federal Deposit Insurance Corporation)

Prompt Corrective Action: 12 C.F.R. § 308.200 et seq. and § 325.101 et seq.

Federal and State Savings Associations (Primary federal banking agency: Office of Thrift Supervision)

Prompt Corrective Action: 12 C.F.R. § 565.1 et seq.

Commentary: Banking
Law 1994—Problems and Prospects
(Continued from page 5)

3. (Continued from previous column)


tiff seeks to toll the statute of limitations. Application of the adverse domination doctrine is presumed if the allegedly culpable directors constitute a majority of the board of directors. Finally, the directors must have been more than merely negligent for the desired tolling period in order for the doctrine to be applied.

VII. Settlement

Believe it or not, the ticket to admission to settlement negotiations with the FDIC and the RTC is an individual’s last three years’ tax returns and a financial statement.

A. The DOL and the PLS

Two divisions of the FDIC are known as the DOL ("Division of Liquidation") and the PLS ("Professional Liability Section"). The DOL is charged, generally, with liquidating assets including, but not limited to, such instruments as promissory notes and guarantees. If you are involved in a case where the FDIC is attempting to collect on the note or guarantee, it is likely that you are dealing with members of the FDIC who are a part of DOL.

The PLS handles O&D cases. In dealing with the PLS, assessment of settlement proposals need to be approved locally, regionally (usually Dallas for the Texas cases) and finally, in Washington, D.C.

The FDIC sometimes tells parties interested in settling that the FDIC will consider settlement proposals and will accept or reject the proposal, but the FDIC may or may not provide a counteroffer.

B. Why the Financial Statement?

One of the great government mysteries is why the IRS decides to audit the people the IRS audits. Add to that list of governmental mysteries, why the FDIC, particularly the PLS, needs such in-depth financial information and statements.

The reason that has been advanced by the FDIC is that the nature of the bureaucracy requires the financial information to rebut potential recriminations from Congress. The theory is that if the FDIC is suing a director over two failed loans in which the bank lost $400,000, the maximum actual damages the officer or director would be liable for would be $400,000. If the financial statements from the officer or director show unencumbered assets in excess of $400,000 any settlement under the $400,000 needs to be based on a very calculated analysis of the merits of the case and the costs of prosecution. On the other hand, if the financial statements show unencumbered assets well below the maximum liability, the settlement calculus for the FDIC is easier.

The financial statement requirement may be crumbling. In RTC v. Grant Thornton, the D.C. Circuit held that "the RTC lacks the statutory authority to subpoena financial documents solely to ascertain the cost-effectiveness of pursuing litigation..."10

VIII. Conclusion

Without insurance coverage on FDIC and RTC claims, financial institution officers and directors can find themselves at the brink of litigation peril and potential financial ruin. The FDIC and RTC have historically cast a broad net to encompass all potentially negligent actions. Thus, many highly viable, financially secure, community leaders, who have served as directors of banking institutions for little or no compensation, have found themselves at the mercy of a governmental institution unable to react quickly and beholden to various political interests.

As it stands now, the debate is continuing regarding the standard by which former officers and directors of financial institutions should be held liable. The difference between the standards of negligence and gross negligence will impact every suit, craft every summary judgment and motion to dismiss and guide every settlement. With different states having different standards for officer and director liability, and federal courts having different interpretations of 12 U.S.C. section 1821(k), the outcome of the debate may not be finally decided until the next wave of bank and other financial institution failures.
Regulation O has established that banks may lend amounts equal to 2.5% of capital and unimpaired surplus or $25,000, whichever is higher, but in no event more than $100,000.8

This, financial institutions should be aware of the potentially conflicting laws involving the amount of a bank's capital and surplus which may be loaned to a principal shareholder, director or executive officer in the event the transaction involves an affiliate or the transaction is a covered transaction. In such event, the transaction becomes subject to both Regulation O and the Federal Affiliates Act and possibly conflicting maximum loan amounts, in which case only the lesser amount should be made available to the principal shareholder, director or executive officer. Although the application of both requirements to one transaction may seldom occur, it is imperative to recognize the limitations and monitor loans in order to prevent possible violations of law and exposure to liability.

Additionally, the Federal Affiliates Act requires extensions of credit to a principal shareholder, director or executive officer to be aggregated with all other covered transactions with the same affiliate for purposes of applying the maximum 10% capital requirement, and that such transactions be aggregated with covered transactions with all affiliates for the 20% capital requirement. Therefore, it is possible to enter into a loan transaction with a principal shareholder which benefits an affiliate or which is collateralized by securities issued by an affiliate and have both the Federal Affiliates Act and Regulation O apply. In this event, the extension of credit to the principal shareholder which either benefits an affiliate or is collateralized by the stock of an affiliate would be subject to the 10% limitation contained in Section 23A of the Federal Reserve Act rather than the higher limitations contained in Regulation O.21

To further complicate compliance with these provisions, certain regulatory proposals remain outstanding at this publication. One such proposal is the Insider Transactions Rule proposed by the FDIC on July 30, 1991. The Commentary to the proposed Rule indicates that "[i]nsider fraud has accounted for over one-half of all the financial institution fraud and embezzlement cases brought by the FBI during the past several years."22 Further, a General Accounting Office study is cited as containing statistics that indicate that insider abuse was a contributor to the recent failures of a significant percentage of insolvent savings and loan associations and banks.23

The proposed rule would (1) require business dealings (other than extensions of credit) between an insured non-member bank and its directors, executive officers, principal shareholders and related interests of such persons ("Insiders") to meet an arm's length test; (2) require that covered business dealings be approved by the bank's board of directors in advance if the dollar value of the business dealings exceeds a certain aggregate figure; (3) require bank Insiders to disclose their conflicts of interest; (4) require that certain recordkeeping requirements be met; (5) require the bank's board of directors to adopt written guidelines which cover business dealings and (6) prohibit insured nonmember banks from investing in real estate in which any of the bank's Insiders has an equity interest.24

Bankers and their counsel should also be aware of the current requirements of the federal Bank Bribery Act and their responsibilities to make appropriate disclosures of proposed transactions subject to that Act.

The ongoing responsibility to disclose potential conflicts of interest under federal law must be carefully reviewed and met. Additionally, state law requirements dealing with insiders, affiliates, and employee transactions may be more restrictive than federal law provisions, and should also be considered.

Commentary: Banking
Law 1994—Problems and Prospects
(Continued from page 287)

and HUD, and the banking regulators, defending their fair lending initiatives as more efforts to enforce the laws against lending discrimination. But this simple statement is not consistent with the elaborate, creative, and far-reaching credit allocation measures these agencies have sought to impose on financial institutions under the guise of fair lending.9

9. These initiatives seem to be predicated on the assumption that "It is not enough to just treat all applicants equally. See3. 8. 12 C.F.R. § 213.5. For rules applicable to state nonmember banks, see 12 C.F.R. § 337.3(c)(2).


To all of this an attendee at the 1994 Institute, an experienced banker, objected, opining that the speakers were overstating the problem and would only encourage bankers to overreact. The estimated settlements cases (Cherry Chase, First National Vicksburg, Blackstone State Bank, Decatur Federal, etc.) suggested, were nothing more than political show cases, designed largely for public consumption, and the affected banks

(Continued on page 904)
new approach will be at least as effective in promoting a sound banking system as the more conventional approaches to banking supervision, but at lower efficiency costs to the banking system, and at a reduced risk to the New Zealand taxpayer. The Reserve Bank is satisfied that the new approach to banking supervision, and the Bank's role within it, is fully consistent with the Bank's undertakings in respect of the Basle Concordat.

It is expected that the new regime will be implemented in late 1995.

**Commentary: Banking Law 1994—Problems and Prospects**

(Continued from page 302)

...but sacrificing banks. Soon it would all blow over. Political winds would shift, and the remaining 1960s banks would be little affected. This, no doubt, is a view born of long-term experience with such matters, and represents an interesting counterpart to other views noted above."

Which of these views will prove correct? Is the fall in the speculative branch leaps beyond its normal bounds in an effort to control private economic decisions? Or is it that beside the point because racial discrimination is such a pervasive and overriding evil that it must be destroyed, even at considerable social and economic liberties? Or is it all a temporary political fad, an American version of political show trials that can be easily handled by the majority of banks by adopting a few new policies and procedures?

Each of these views has its adherents. Apparently at 1994 focus on racial discrimination meant that a fundamental shift, toward credit allocation, was underway. Even in watered-down 1995 form, the CRA proposals will provide evidence of this trend. Yet, the initial wave of publicized enforcement actions seems to have subsided, and changes in Congress seem even more unlikely for the industry. It appears that the match toward credit allocation has been at least temporarily slowed. Perhaps banking institutions will continue to be sufficiently profitable to accommodate a small measure of credit allocation costs through doing business, while otherwise continuing with business as usual. If something like the status quo is maintained, all that will be lost is the concept of banking as an essentially private enterprise, and with ample profits to spread around, they will be few terms ahead over more principle.

William H. Isaac, former chairman of the FHC, recently suggested that the status quo is quite satisfactory, that the CRA is not broken and does not need to be fixed. "This seems quite attractive in view of the 1994 CRA proposals but, with all due respect to Mr. Isaac, CRA is broken and does need to be fixed. Along with related laws and regulations, it creates unnecessary (and counterproductive) burdens on banks, is a drag on lending and the economy, and does little to benefit those it was designed to help. It also creates an invisible bias toward regulatory credit allocation, and provides regulators a highly discretionary lever to use against innocent banks. Nonetheless, true reform of CRA may be a battle that all sides will wish to avoid in 1995, if so Mr. Isaac's suggestion may ultimately gain acceptance. But there should be no illusions: at the micro-economic level the elasticity of demand for credit allocation is firmly in place, and absent dramatic action by Congress these elements will transform the American banking system.

**IV. Banks As Utilities**

Banks are now public utilities. The developments noted above, along with the extraordinary regulatory compliance and enforcement powers created by FIRREA and FDICIA, mean that federally regulated banking institutions are now the functional equivalent of a national utility. While Congress and the regulators may promote and publicize various regulatory reform measures, the reality, like micro-regulation of credit allocation, is not open to question. This, oddly, is the legacy of the ineptitude of the Federal Savings and Loan Insurance Corporation.

As Steve Sheehan pointed out at the 1994 Institute, banking and consumer credit regulation is well-set in a democracy. In some cases it is also popular with large institutions and their consultants, who may view the heavy regulatory burden as a way to minimize competition and enhance their own status and income. As a result there is no broad constituency that understands the need for meaningful reform or significant banking deregulation.

As noted by Scott Sheehan at the 1994 Institute, this is all part of a grand social experiment, a 20-year crusade to provide a lender, gender (and more heavily regulated) financial system to protect the naive consumer who supposedly doesn't understand the nature of contractual obligations. Banking is thus to the tools for social change, administrators of a public trust, charged with following enlightened directives from public policy makers and regulators wielding awe-inspiring enforcement powers.

Utility-model regulation, of course, assumes the assured income of an oligopoly, to be administered pursuant to a social contract with the regulators. The regulators are doing their part, as diminished competition and relatively low deposit interests have created massive banking profits to be divided up by savvy bankers and politically influential groups. The appeal is so irresistible that we may fairly assume this form.

(Continued on page 307)


15. For a recent perspective on the law's role in the public utility context, see supra note 14.
There is no explicit penalty applicable to mortgage bankers or finance companies. Also, under the 1994 Act there appears to be no private enforcement provision for a borrower. This could be helpful protection for lenders and servicers, because flood disasters unfortunately produce uninsured victims of flood devastation. Such victims have been known to consider private damage claims against lenders for not having required flood insurance. Notwithstanding these apparent safeguards, mortgage bankers and finance companies should not ignore the 1994 Act because of the absence of penalties. Such a course runs the risk of exposure should the court create a penalty or permit private litigation.

IX. Conclusion

The House-Senate Conference Committee when it presented the 1994 Act for final congressional approval that it intended to improve compliance with the mandatory purchase requirements of the National Flood Insurance Program and to provide added income to the National Flood Insurance Fund and to help decrease the financial impact of flooding on the federal government, its taxpayers and victims of floods. The Conference Committee intended that the borrower or the servicer require the purchase of flood insurance at origination or at any time thereafter during the life of the Covered Loan.

While new flood insurance regulatory burdens have overflowed, lenders and servicers seeking to navigate the treacherous waters of the 1994 Act should immediately study current flood insurance procedures and prepare for anticipated regulatory changes by FEMA and other federal regulators.

Commentary: Banking Law 1994—Problems and Prospects

(Continued from page 302)

of nationalization to be an inevitable result of a federalized banking system.

V. The Next Crisis

As James Sexton noted at the 1994 Institute, "Regulators can't see around corners." He also noted that he would never have adjoined this while he was a regulator. The basic point is that the regulators cannot foresee the next crisis. Therefore they can be forgiven for focusing largely on past crises and short-term political considerations. That when the next crisis arrives, it will be the banker (and his or her lawyer) who will be blamed for the lack of foresight, even if they were merely following an regulatory mandate. This is essentially what happened to the thrift industry in the 1980s. There is probably too much to avoid it, except to hope that the crisis can be postponed until someone else's watch.

In any event, it is obvious that one cannot rely on the regulators to protect the safety and soundness of individual banking institutions. Indeed, as with the thrift crisis of the 1980s, regulatory fashions may be a major factor undermining loan and investment underwriting standards. Banking profits may have been partially socialized through CRA, but losses still fall first on the banks (and ultimately their owners, officers, directors and other "affiliated parties"). When things fall apart the banker (and the bank's lawyers) will be scapegoats, whether culpable or not. At the 1994 Institute, James Sexton commented that bank regulation should be consistent with a long-term horizon, rising above the political trends that swirl around it. Today, that is a faint hope.

Perhaps there is nothing new. As the 1993 Institute President Steve Halper noted that banking has always been political. Still, the new regulatory powers, especially with a federal mandate to micro-manage banking operations, have created a new dimension to this political equation. For e.g., suppose


20. Although the New Zealand experience suggests otherwise, see Banking Authority: New Zealand Adopts A New Approach to the East, The Economist, July 22, 1994, p. 80.

21. Heighten competition is one way to try to bring about a greater risk of retail lenders. Am. Bank, Feb. 28, 1994, p. 3. It is interesting to compare the number of retail lenders' ratios of the FDIC, as noted in the table, with the rate of non-performing assets.

22. This strategy is nothing new. As the 1993 Institute President Steve Halper noted that banking has always been political. Still, the new regulatory powers, especially with a federal mandate to micro-manage banking operations, have created a new dimension to this political equation. For e.g., suppose


24. The authors call for a review of the New Zealand banks regulatory scheme, with particular attention to the New Zealand Adopts A New Approach in the future.
principal, interest, or shared equity is payable only after the transfer of the dwelling, the death of the consumer or if the consumer ceases to occupy the dwelling as a principal resident. A reverse mortgage generally provides for future payments to the customer based on the customer's equity in the real estate. Guidelines are set for making disclosures on the basis of certain assumptions.

IX. Further Review

The Act requires the FRB to report to Congress within two years from enactment, but not before 180 days, regarding recommendations for further regulation of open-end home equity loans and a possible substitute for the interest index used to trigger the new requirements described above.

In addition, the FRB is directed to hold public hearings within three years and regularly thereafter regarding the home equity market and the need for further regulation in the area. The Act encourages the FRB to seek input from consumers, their representatives on the committees, creditors, and other interested parties. No doubt the FRB will receive much pressure from consumer groups to take a more activist stance with regard to further changes.

X. Conclusion

The Act should be viewed from two perspectives. On the one hand, it is part of the fair lending battle against "reverse red-lining." Other examples of fair lending activity are the recent rulings on "overages" and the proposed Community Reinvestment Act ("CRA") rules. To the extent that the aim is to require fair treatment of consumers, it is always hard to do a cost-benefit analysis that weighs the cost of added regulation against abuses to the public.

On the other hand, it seems that our policy makers have lost sight of the negative effect on consumers from added disclosures that overwhelm consumers and are either ignored or cause them further confusion. The requirements of the Act, coupled with the disclosures required for subordinate lien transactions under RESPA, create a stream of paper for customers seeking mortgage loans or home improvement sales.

In addition, by singling out one class of creditors and creating the high-rate, high-fee category, Congress may, in fact, reduce competition in the high credit risk mortgage market and provide a niche for creditors who would not otherwise compete. It is likely that many creditors, for sound business and legal reasons, will not want to make or purchase transactions in this area.

It may make good business sense to not make or purchase covered transactions, because of either the added cost of compliance or the potential for litigation regarding ambiguities if the FRB does not issue rules with greater specificity. But, even more importantly, creditors may just not want to have their proverbial fifteen minutes of fame that results from being labeled a high-rate, high-fee creditor.

It is suggested that a thorough analysis of all the disclosures presently being made could result in disclosures that are more useful to consumers, and less of a stigma to creditors. It is hoped that, as with the last round of Truth in Lending simplification, creditors, consumer groups and federal agencies can look at consumer disclosures in a wider context and work to develop new, creative approaches. The aim should be to avoid "overdisclosure," not discourage entry into high risk credit markets, and take reasonable steps to protect consumers who are subject to abuse.

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Commentary: Banking

Law 1994—Problems and Prospects

VI. Transvestite Banking

Regardless of how the federal regulators sugarcoat it, they don't like charter flips, especially when institutions they regulate are trying to escape that regulation they seem to view efforts to enter their jurisdiction as significantly more enlightened. The result appears to be a regulatory trend toward discouraging even precluding some charter flips.

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24. See, e.g., William M. Jenkins, Adjunct Chair of the Credit Union National Association, Am. Bar Ass'n, Oct. 8, 1994, at 2. The OEC has recently issued "standardized" procedures for loans involving a flip to a different charter, but only banks with no significant regulatory problems are eligible to use the new rules.

25. Sometimes this involves denial of applications with implications on the basis of subjective CRA evaluations. See, e.g., Bank of America Nat'l Trust & Sav. Ass'n v. FHLB, 453 F.3d 781 (7th Cir. 1995); In re Chicago Mercantile Exchange Corp., 25 F.3d 1239 (7th Cir. 1994); Allied Bank, Bank of America Nat'l Trust & Sav. Ass'n, 858 F.2d 603 (7th Cir. 1988).
The Judicial Climate

Creditors are doing everything they can to get these cases, whether individual suits or class actions, into federal court. Antifraud suits are piling up all the time. Federal Truth-in-lending claims are being passed over in favor of state common law fraud claims. Creditors are facing the unhappy choice of not seriously attacking as certification because of the very real fear that defeat of a class only opens a creditor to multiple lawsuits on the same issue. Brought by different attorneys and plaintiffs. Further, the venue of such unknown future claims may be in worse insidescność than that in which the current class action case is pending.

The number of cases that have been led on the various issues is too numerous to recount. In companion cases of *Jones v. First Franklin (Sic)* and *Nobels Associates Corporation of North America* (one in state court and one in federal court), the number of named defendants now exceeds 40. Including national, regional and local finance companies and retailers. The defendant list reads like a "Who's Who" in the consumer finance industry.

The plaintiffs' bar is well organized, and they share information with one another. Certain lawyers are specializing in non-filing insurance cases, while others are taking on the credit insurance overrun cases. The specialization has gotten to be quite sophisticated. With the liberalization of Alabama's advertising rules, and the fact that a referring lawyer in Alabama need not perform any legal services in order to share in a contingency fee (with the client's consent), the stage has been set for a wide area network. Of course, the extraordinary damages awards have everything to do with the litigation climate.

V. Lessons and Conclusions

The sad reality for the financial services industry in Alabama is that, until the climate changes, doing business in this state is fraught with peril. Even the suggested response of ceasing to do business in certain Alabama counties has its problems.

So, what is the answer? There are several. First, and foremost, a change in the judiciary, and the way that the judges and justices are elected, would be of tremendous benefit. The amount of money being directed to judicial campaigns is frightening. A limitation on contributions, a different method or manner for selection of judges other than popular vote, or even term limitations, would help.

Statutory changes are also vitally needed. Alabama's fraud statutes should be overhauled to require strict proof with respect to the state of mind of each person claiming to be defrauded. Fraud is not the real concern. The Louisiana court has said that the legislature in Alabama should act to rescind Alabama's statutory prohibition against the enforcement of pre-dispute arbitration clauses. The law of Alabama should encourage alternative dispute resolutions in consumer litigation. It should not promote massive fee-generating class action litigation.

Constitutional tort reform is vitally needed. Alabama's earlier effort failed to address the constitutional issues. A statute permitting creditors to rely on opinions of regulators is needed. Beyond these specific recommendations, there needs to be comprehensive reform to bring sense and predictability to the laws governing consumer credit transactions.

What has happened in Alabama is just a sample of what can happen anywhere. Finally, creditors may simply have to abandon some consumer credit markets as well as some measures such as non-filing insurance, unless and until the law is clarified.

Commentary: Banking

Law 1994—Problems and Prospects

It will be unfortunate if this trend continnues. For one thing, as James Sexton noted at the 1994 Institute, sometimes the regulators are simply unreasonable and overbearing. In such cases the usual advice is "to work it out with the regulator," can be a cruel joke. Moreover, the banking agencies sometimes seem to go all the way against anyone who crosses them, and they are sometimes very hesitant to admit their own errors. Banks may have legitimate reason to prove regulatory relief and appeal processes with skepticism, and to feel that they have no effective legal recourse in a dispute with their regulator.

Note that is except to change matters. If that right is taken away, institutions will be totally at the mercy of their regulator. They will, moreover, be stuck in a regulatory time-warp, unable to seek a charter that conforms to the evolution of the institution. The result will be trans-state institutions, forced to musesoede as something they are not in order to fit the shape of their regulatory peg. Already we have credit unions...
mortgagee had a policy in place whereby a computer printout was produced at the end of each month showing all policies which had expired by the end of that month or which would expire by the 15th of the following month. A report was issued on April 29, 1983, but it did not indicate that the particular policy was about to expire because the scheduled policy expiration date was more than 15 days from the date of the report. At the time of the next report at the end of May, 1983, the insurance policy had lapsed and the property had been destroyed by fire.

The insurer defended on the basis that the mortgagee had followed its customary procedure and that there was no error or accidental omission involved in connection with the procedure; rather, the procedure itself was defective. The mortgagee alleged that the insurance policy should be construed broadly enough to include errors in the mortgagee’s procedure as well as errors in the execution or performance of such procedure. The court agreed with the mortgagee, holding that the errors and omissions policy was ambiguous in that it was capable of being interpreted to insure only against actual deviations from customary procedure or to insure against inherent defects in procedure as well as deviations from procedure, and that this ambiguity must be resolved in favor of the mortgagee.

V. Selection of Remedies

It can thus be seen that the mortgagee, when confronted with this type of situation, will have three possible options. The mortgagee can pursue the fire and casualty insurer, based upon the allegation that the policy was not effectively cancelled as to the mortgagee. Alternatively, the mortgagee can pursue the mortgagee’s errors and omissions insurer on the basis that the failure to keep the property insured constituted an error or accidental omission, giving rise to coverage. As a third alternative, the mortgagee could elect to sue both insurers, alleging that one of them must be liable to the mortgagee.

Whichever option is chosen, the mortgagee should be mindful of possible statutory provisions concerning entitlement to attorney’s fees. Such a statute may provide that an insurer must submit a written offer of settlement or rejection of a claim within a certain number of days after receipt of proof of loss. Further, under Oklahoma law, upon a judgment rendered to either party in a case brought concerning such a loss, costs and attorney’s fees shall be awarded to the prevailing party. For the purposes of the Oklahoma statute, the prevailing party is the insurer in those cases where the judgment does not exceed the written offer of settlement. In all other judgments the insured is the prevailing party. If the insured is the prevailing party, the court in rendering judgment must add interest on the verdict at the rate of 15% per year from the date the loss was payable pursuant to the provisions of the policy to the date of the verdict.

Thus, if the mortgagee is sure that it can prevail against one insurer or the other, that insurer should be pursued. If the mortgagee sues both insurers, there may be the practical benefit of having the insurers agree among themselves to split the loss. However, if the mortgagee ends up having to litigate with both insurers, the mortgagee runs the risk of recovering its fees against one insurer but paying the fees of the other insurer.

VI. Conclusion

If a mortgagee learns after the fact that its real property collateral has been damaged or destroyed by fire or other casualty and that the fire and casualty insurance policy was purportedly cancelled prior to the loss, the mortgagee may nevertheless have remedies to recover the loss. The mortgagee and its counsel should carefully review the provisions of the fire and casualty insurance policy with respect to the cancellation notice which must be given by the insurer to the mortgagee. Likewise, the mortgagee and its counsel should carefully review its commercial general liability policy for the presence of a Mortgagee’s Errors and Omissions Endorsement and, if such an endorsement is contained therein, should carefully review the language to determine if the failure to keep the collateral insured may have resulted from an error or accidental omission within the meaning of the language as used in such endorsement. Under either or both of these types of policies, the mortgagee stands a good chance of recovery.

Commentary: Banking
Law 1994—Problems and Prospects

VII. Bank Lawyers in The 1990s

Banking lawyers obviously have a unique role to play in sorting all of this out. While disagreement on politically touchy issues is to be expected, lawyers who represent banks might be expected to be in the forefront of the battle against what many view as the de facto nationalization of the American banking system. And so it has been in many cases, as noted banking lawyers have courageously written and spoken out against concerns and noises that bankers themselves are unable to articulate. Yet there are also many exceptions, banking lawyers who quietly welcomed the
ties are designed to create a free market economy. Reforms initiated by Gaidar’s government and continued by Chernenko have drastically changed life in Russia. Necessarily such changes have created hardships for some people.

But despite all of the hardships, and the shock therapy, and all of the mistakes in implementing the reforms, we can see significant positive results:

- The ruble, which was fully devalued on the eve of the reforms, has stabilized and has become more convertible and attractive, especially within the C.I.S.

- There has been mass privatization of state property (from a 2 1/2% share of the private sector in 1991 to 60% in 1993).

- The market is well supplied with consumer goods and lines have disappeared.

- Inflation rates have been reduced to 4.5% in late 1994.

- Stocks and other investment funds of Russian citizens have increased.

All these factors help to counterbalance the continuing difficulties in the military and industry, lifestyle problems of a significant part of the population (especially those in pensions), and provide promising signs of economic stabilization.

Continuation of the economic policy of the Russian government over two to three years will not only reverse the recent decline but will contribute to future growth. Talking about the decline in production in Russia, we must take note that it happened in large part due to the decline in military industry, a change which is overall helpful to the economy, because it involves conversion of military industry to the production of civilian goods.

Unemployment figures were much lower in 1993 than in 1989, in spite of a 50% industrial decline in some sectors. Unemployment was lower than in any post-communist country and many Western European countries. So Russian reforms did not cause mass unemployment as feared and as usually happens in such situations.

Talking about goals, we have to mention the following tasks: to increase investment in, and the modernization of, existing enterprises and the creation of new ones, development of regional projects, and completion of the formation of a market economy infrastructure. We’ve already done a lot but we need to improve our industrial and commercial laws, including tax and customs regulations, decentralize the system of managing basic areas of the economy, provide financial stability, and cut down the budget deficit. Again, these goals may sound familiar to many in the West. Social changes are targeted to rearrange the social concepts and goals of part of the population. A priority is to overcome the philosophy of dependency and resulting bad work habits, especially to overcome the conception that “the state pretends that it pays salaries and employees pretend they are working.”

The ultimate goal is to create a flexible system of social guarantees and social support for that part of the population that cannot adjust to the new conditions of life, without destroying the productive potential of the remainder of society.

So, current Russian reforms are focused on the evolutionary, slow changes appropriate to a society that has smoothly emerged from years of communist rule without confrontation or civil war. Remember Solzhenitsin’s apt remark: “We all found ourselves under the wreckage of communism.” And this is true. Today we still have the remains of the old system in institutions and structures and, even more important, the old work habits. But at the same time we are embracing new structures, new ideas oriented toward the future. One western journalist wrote a book on Russian reforms named “Forward to the Past.” This is misleading. Consider the things which have disappeared from our life in the last three years: a communist monopoly in politics, a state property monopoly in the economy, and a class approach in the social sphere. One has to realize that Soviet Russia or Russia of the pre-revolutionary period cannot come back. Russia’s future can be seen in the assertion of normal human values of a democratic society with the principles of a free market economy, Christian morality, and integration with European and global political and economic processes. With only a few years left before the turn of millennium, Russia is confident and firm that the problems it has to face will be resolved and that it will enter the 21st century overcoming all difficulties left over from the 20th century. In this respect Russia may be ahead of other countries that have not yet confronted the errors of their 20th century policies.

Commentary: Banking
Law 1994—Problems and Prospects
(Continued from page 326)

(Continued on page 327)
Quart. Rep. 342

the issue by reference to cases involving the priority of a right of set-off as against a garnishment summons. There is indeed an exception to the general rule regarding the priority of set-off, allowing a right of set-off to be exercised after the bank has received notice of a competing garnishment. However, this exception generally does not extend to priority as against competing security interests. As noted, Winter Park represents a minority view on this issue.

The Winter Park court also suggested, as an alternative basis for its decision, that the language in the CD prohibiting transfer may have prevented American Pioneer from achieving perfection against it as an instrument under Article 9. This raises again a wide range of issues relating to nontransferable CDs, as discussed supra with regard to Latin Investment. The Winter Park court recognized Florida precedent favoring the transferrability of "nontransferable" CDs, but questioned the basis for this position. All of which serves as another reminder of the need for statutory clarification in this area of the law. Hopefully the forthcoming Article 9 revisions will provide such a clarification.

Commentary: Banking Law 1994—Problems and Prospects

In the aftermath of FIRREA and FDICIA, the banking agencies have been able to install in many bank lawyers a sense that they must represent the interests of the agencies as well as those of their banker clients. Thus, some believe that the modern role of the bank lawyer is to act as a kind of mediator in negotiations between the bank and the regulator, and ultimately to help the banks accept the inevitability that the regulator will prevail, to face the facts that legal resistance is futile. As one banking law specialist said to your author, "It is now against the law to represent your bank client."

Some banking lawyers have quietly, and in some cases even eagerly, accepted the effective nationalization of the industry. Perhaps this should come as no surprise; rather, the surprise is that so many other banking law professionals have had the courage to risk their careers by standing up to object to an apparently lost cause.

VIII. Summary and Conclusions

History may record that the insolvency of the Federal Savings and Loan Insurance Corporation was resolved by the effective nationalization of the American banking system. Perhaps this was inevitable, consistent with long-term trends in the United States and accepted public policy in many other countries. Yet appeal and, as noted supra, banking and consumer credit regulation apparently remain popular with the American public. Moreover, serious deregulation initiatives would surely be met with references to the insolvency of the FDIC, which remain a popular rallying cry. Absent a truly revolutionary change in American public policy, it appears the most that can be hoped for at the federal level is a temporary, temporary reduction in CRA and fair lending initiatives, and a movement towards further legislative enhancements of regulatory authority. If the regulatory agencies can satisfy the industry by reducing a few fees and streamlining a few procedures, while otherwise maintaining their awesome discretion powers, American banking will have been permanently nationalized.

(Continued on page 35)

(Continued from page 325)
VII. Reimbursement, Credit Unions, and Other Issues

The ECOA permits the lender to require that the applicant pay for the cost of the appraisal report before a copy is provided. The FRB Regulation B rule reflects this, and also allows the lender to require reimbursement for the costs of photocopying and postage, unless prohibited by other law. Credit unions are exempted from the FRB Regulation B appraisal rule, if they are subject to and comply with the regulations of the National Credit Union Administration requiring copies of appraisals to be made available on request.

The FRB also revised Regulation B section 202.14(b) to reflect the FIDICIA revisions to ECOA section 706, requiring that the federal regulatory agencies refer suspected patterns or practices of discrimination to the Department of Justice for prosecution. In addition, referrals to the Department of Housing and Urban Development must be made when there is reason to believe that any violation of the ECOA has occurred that may also violate the federal housing laws.

The FRB estimated that the new appraisal rule will increase the annual paperwork burden of state-chartered FRB member banks by about 23,000 hours. This does not include the compliance efforts of other types of financial institutions that are subject to the new rules but are directly supervised by other regulatory agencies.

Despite this implementation burden, the Regulation B revisions are for the most part yet another example of the FRB staff seeking to provide reasonable implementing regulations for a vague and unnecessarily burdensome statute. One can only shudder to think what may happen if the FRB staff ever ceases to perform that function.

Commentary: Banking

Law 1994–Problems and Prospects

(Continued from page 42)

But the United States still has a relatively open econometric system, and this means that the new, federally constrained banking system will face substantial competition from nonbank competitors. Moreover, state banking systems remain viable and, in many instances, receptive to productive reform. The states, as always, will be the innovators for financial regulatory experiments and reforms not possible at the federal level. The result is likely to be a continued expansion of state-chartered nonbank financial institutions, nurtured by creative state laws. Federal banking regulation may be largely a closed case, but as the result of the nature of the financial system is again in play and, despite the 1994 election, the best prospects for reform are at the state level.

The New Zealand approach, explored elsewhere in this issue, offers an intriguing potential model for such reform. This model clearly addresses the problems created by modern American banking regulations.

There is no reason, absent a lack of political will, why the states could not create a system of state-chartered, highly capitalized and uninsured nonbank depository institutions on the New Zealand model. Indeed, very modest experiments are currently underway at the state level that bear a striking resemblance to the New Zealand reforms. The success of these experiments, along with experience with the New Zealand reforms, may well serve to point the way toward the next generation of banking innovation. Stay tuned—these and related issues will be considered further in this Symposium and in future issues of the Quarterly Report.

Lender Wins RESPA “Fee” Ruling

By Edward A. Gledgowd

(Continued from page 297)

A federal district court in San Francisco held, in Robinson v. Nantucket Bank, the RESPA did not require disclosure of the “settlement” cost at loan origination; rather, both are “back-end” (post-settlement) fees taken at payoff. The ruling is helpful on other grounds. The plaintiff had alleged violations of sections 4 and 8 of RESPA. But section 4, which sets forth a lender’s disclosure obligations, does not create a private right of action. And section 8, which prohibits fee splitting and kickbacks, requires proof that the fee was shared with a third party. No such allegation was made in Robinson.