Commentary: Banking Law 1995--An Agenda for State Law Reform

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I. The New Federal Banking System

Over the past six years the federal government has fundamentally changed the American banking system. Initially these changes came in response to the public outcry over the inactivity of the Federal Savings and Loan Insurance Corporation ("FSLIC"). Micro-regulation of banking institutions and increased banking consolidation were but two

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announced its intention to market the 
retirement CD, the insurance commis-
sioner of New Mexico initiated an admin-
istrative action against the bank. The bank 
sued to enjoin the administrative pro-
dure, and in February, 1995, the court 
ordered consent summary judgement in 
the bank's favor.16

In the year since the Blackfeet Na-
sional Bank and ADC launched the Re-
etement CD, the product has attracted 
considerable interest and scrutiny. 
In the OCC and FDIC deferred to the 
bank's plans to offer the product, the 
etirement CD became the subject of 
congressional examination. While the 
etirement CD appears to have survived 
these challenges, its creators must fend off 
legal challenges from state insurance 
officials. As with previous attempts by 
states to market insurance-related and 
mutual products, the field of challengers 
is growing.

1. Conclusion

The emerging ability of banks to sell 
insurance-related investment prod-
ucts will likely remain the subject of con-
stant litigation between banks seeking 
broader powers and new products and 
insurance agents, among others, who want to constrain them. Ongoing 
debates by Congress over major fi-
nancial services reform may ultimately 
provide some legislative guidance for 
bank insurance sales. As the courts and 
Congress deliberate, however, the banks 
will likely seek regulatory authority to 
sell other insurance-related insurance-related 
products. Banks, emboldened by the 
Supreme Court's recent permissive 
formulation of bank powers in the VALIC case, 
will certainly press their efforts to 
broader their products menu. 

As to which insurance-related products 
will next emerge, the past may provide 
some guidance to the future. The courts, 
in incrementally approving various 
types of insurance, have repeatedly 
examined the extent to which a particular 
product resembles or is related to 
traditional banking activity. For example, 
the courts have inquired as to whether a 
proposed insurance product is integral to 
extended credit, or has some investment 
feature. In the VALIC case, the Supreme 
Court acknowledged the sale of all types of 
annuities to be authorized without ge-
ographic restrictions because they are, 
from the consumer's standpoint, essen-
tially insurance products. The Court's 
reasoning is easily applicable to universal 
life products. Most importantly, with 
the subsequent legalization of court 
and agency decisionmakers, the market will 
continue to change to meet the demands 
of consumers for less costly and more 
convenient access to insurance and in-
vestment products.

From an analytical and functional 
standpoint, the judicially acknowledged 
legal tools are in place to allow banks to 
move more easily into insurance-related 
investment product areas that have hereto-
fore not been explored.

Commentary: Banking Law 1995–An Agenda for State Law Reform
(Continued from page 408)

of the ramifications of this change. Now, 
however, two additional public policy initiatives appear 
theorizing those changes.

The first is federal credit allocation. Despite 
the lack of federal regulations on CRA, 
LOA, HMDA, fair lending, and com-

2. See e.g., Robert Mericle, "Debt Collection: A Credit-Aggressive, 
Times, on CBA Renewal: Am. Banks. Feb. 1995, at 2; Gail de 
Schoden & Reiden, "D&O with a Long Memory," (CBA Am. 
Bull., May 2, 1995). These credit allocation efforts are 
well beyond the moral and traditional prohibitions against 
discrimination embedded in the Equal Credit Opportunity Act and 
Regulation B, and are contrary to the "effective" efforts to 
hold the potential to be used as a credit allocation device.

3. This was a role once filled by the credit industry. It was per-
haps inevitable that when the government of the time industry was 
(Continued on page 414)

3. Concerning future price controls.


5. Concerning future price controls.
tion. The proposed rules are quite restrictive in nature and assert certain positions which were contrary to those set forth in banking regulations. The NASD's proposed rules adopted many standards which were derived from the SEC's staff letter of November 24, 1993, addressed to Chubb Securities Corporation (the "Chubb Letter"). The Chubb letter was followed on February 15, 1994, by the Interagency Statement's issuance.

The proposed rules include very specific requirements encompassing substantive issues such as physical location of activities, signage, disclosures, compensation, solicitation and communications with the public. On January 3, 1995, NASD and the four federal banking regulators (OCC, OTS, FDIC and the Fed) announced an agreement to coordinate their examinations of banks' brokerage operations. The agreement also provides that the respective agencies would refer violations of law to the other agencies when observed (i.e., the NASD would refer banking violations to the OCC, etc. and vice versa). Apparently, there are also discussions regarding possible rule coordination.

Another hot area is that of derivatives. While beyond the scope of this article, it is noteworthy that the OCC has issued as part of its "Comptroller's Handbook" a booklet on the Management of Financial Derivatives (October, 1994). A review of the derivatives portion of the Handbook clearly reveals the serious approach which the OCC is taking to this controversial area.

IX. Conclusion

It seems nearly a foregone conclusion that banks will engage in some form of retail nondeposit investment product sales programs in the future. Yet to be decided are issues involving the precise types of products which banks will be permitted to sell, the nature of affiliated entities which will be permitted to engage in such sales, the extent to which securities regulators will become more involved and banking regulators less involved in monitoring such activities, and the extent of actual risk to which banks subject themselves when engaging in this activity.

Irrespective of the ultimate outcome of proposed regulatory or statutory changes which may be forthcoming, it is apparent that each institution which engages in any type of retail nondeposit investment program, whether it be direct or indirect, inclusive of sales or only referrals, must adopt a comprehensive written policy and audit procedures to govern the conduct of the program. The adoption of such policy and procedures can become a guideline for the bank in developing a program which is designed to protect the interests of its customers as well as the safety and soundness of the bank itself.

Commentary: Banking Law 1995—An Agenda for State Law Reform

(Continued from page 409)

second major policy goal is simultaneously being pursued. If micro-regulation is the 'stick' being used to assure compliance by bankers, this second policy initiative is the "carrot" that serves as a corresponding incentive for bankers to accept the new regulatory environment.

The second policy initiative is a broad array of regulatory and legislative reforms designed to facilitate bank expansion and the consolidation of banking institutions into large, interstate, full-service financial conglomerates with such economies of scale and financial market power as to assure high levels of profitability.7 This profitability will serve to protect the solvency of the federal deposit insurance system, and can also be harnessed for socially desirable purposes (including credit allocation), under the supervision of federal banking authorities. For many bankers this carrot is so appealing that the effects of regulatory micro-management and credit allocation fade into insignificance. After all, who can argue against "fair" lending, or serving the bank's community, especially when the demands can be met with a few showcase projects or by sharing a small part of a bank's massive profits and credit resources with select groups. No wonder some bankers are so insistently that "CIA is good business." Federal deposit insurance and bank regulation have been preserved, the banking industry is prospering, individual banks are growing through acquisitions, and consumer activist groups have reason to be pleased. It is a comfortable arrangement for nearly all concerned.

But not, of course, for everyone. Inevitably there are some losers. The victims include America's 200-year history of private, decentralized, community banking. There is probably no place in the new.

(Continued on page 410)
v. Concluding Observations

The development of international banking supervision standards is not an obscure and remote subject matter for Swiss genomes. It is an area that has had a profound impact over the last decade upon the U.S. regulatory approach to its risk-based capital adequacy and capital-based supervisory processes, to money laundering, to the treatment of foreign banks in the U.S., to NAFTA and its provisions on financial services, to derivative activities and even more generally to the competitiveness of the U.S. banking industry.

Commentary: Banking Law 1995–An Agenda for State Law Reform

(Continued from page 414)

ightly regulated banking system for the independent community bankers who might otherwise see their system vaporize by the prevailing wisdom within the federal banking agencies (whose jurisdiction in) includes just about everything within the purview of bank management. In past years it has often been independent bankers who fueled the creative energies of American society, and who saw the periodic financial crises by avoiding the excesses of those eager to follow the herd. In their absence, there will be a public policy price to be paid for the government’s new financial activity. Bank depositors may also pay a price, in the form of lower deposit interest rates.1

1 Mary would say that this is in the way it should be, that there is a place for independence in what is increasingly an adversarial, deliberately monolithic regulated industry. Bankers are new instruments of public policy and social change, administering public assets on behalf of the U.S. government. They are the primary issuers of financial intermediation. See, e.g., Mark Bilschiro. Regulating Financial Intermediation. See, e.g., Mark Bilschiro. Regulating Financial Intermediation. See, e.g., Mark Bilschiro. Regulating Financial Intermediation. See, e.g., Mark Bilschiro. Regulating Financial Intermediation. See, e.g., Mark Bilschiro. Regulating Financial Intermediation.

1 This is not surprising, this is not surprising, this is not surprising, this is not surprising, this is not surprising, because there are many cases in which actual and perceived differences from the status quo in terms of economic advantages are clear and obvious.

1 Obviously, the best (but all in all it is the most important) conclusion drawn is that there is a place for independence in the regulatory system, since the new regime significantly reduces the potential for conflict between ownership and control. The reasons for this are to be found in the ability of community banks to form and develop their own supranational organizations, which may, over time, develop into a genuine and independent organ of banking. See, e.g., Alan B. Hirsch, Bank Regulation and Community, 49 CONSUMER FEDERALISM 71 (1995).

1 For a detailed discussion of the impact of deposit insurance on the balance sheet of an independent community bank, see E. HANDEL, THE S & L INSURANCE WICKET REVISITED (1990), and E. HANDEL, THE S & L INSURANCE WICKET REVISITED (1990).

1 See, e.g., Terence D’Hara, The New Power Source: Ground Work for a New Banking Age, 48 Bank: April 1994, for a very persuasive argument that banks have been driven by the need to increase their capital ratios and to contain the risk of losing deposits.


1 This is true of the phenomenon. See, e.g., Michael Williams, and Margaret K. Ashworth. The Bunding of a Diversity Bank: The Case of the Community Development Bank, 49 430, 1991, at 14.

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an rescission upon tender of loan pro-

process of saving deposit insurance, Congress

did not fail to protect against political

gave the Depository Institutions Di-

Agenda for State Law Reform

the process of saving deposit insurance, Congress
and the regulators demonstrated that U.S. legal
depositors in order to recapitalize the banking

perhaps even private control of American banks.52

interests served the purpose of creating and ad-

in the eyes of some the U.S. Constitution and the basic fairness of the

and the Federal Deposit Insurance System

depositors and the FDIC by providing banks with an un-

ultimately may include the dual banking system51 and

in history has ultimately failed,50 but never before has a failure occurred

banks into a total loss. In the words of the late Sen. Edward M. Kennedy,

of deposit insurance system. The FDIC, in 

debtors and investors of millions of bank

that unprecedented spread between their cost of funds and

an institution as that of a federal dis-

and regulate the system. The victims ultimately

20. Senate Committee on Banking, Housing, and Urban Affairs, Report


While many of the most troublesome
cases can be traced to the Eastern District

of TILA. The disparity between the level of precision

and routine calculations for lenders has 
not been kept, and the responsibility to correct this remains with Congress.
to require that each consumer or the aggregate of all consumers take the test.

2. APR Refunds

The requirements of Section 32 regarding APR refunds need to be more fully explained by the FRB. As discussed in the prior article, the definition of the "actual method" required to be used by Section 32 for making refunds, called "APR refunds," in the above list of restrictions was incorporated by reference from another federal law. As indicated, it would seem best if the FRB provided additional explanation for this requirement. Based on your author's experience in explaining refund methods to persons unfamiliar with them, your author believes it is absolutely necessary for the FRB to provide examples of how the refund method operates and when the requirement for its use applies.

V. To Be Continued

Section 32 transactions will continue to be an area of concern for some time, as compliance efforts are planned, implemented, and maintained. Creditors who extend Section 32 credit should do all they can to bring problem areas to the attention of the Federal Reserve Board. The sooner the FRB can be made aware of problems, the more likely the proposed Commentary will address such issues.

Also, Congress is revisiting some Truth in Lending program areas. Some proposed legislation may indirectly affect Section 32 transactions, such as amendments regarding disclosure tolerances and rescission. Some proposed legislation might have a more direct effect, such as by giving the FRB sole authority to issue rules under RESPA and directing the FRB to simplify and harmonize related RESPA and Truth in Lending rules.

As usual, there are many issues that remain unresolved. Unless and until Congress fixes the legislative uncertainty that has been created, lenders may need to add a premium in the terms of their consumer credit contracts, to cover the regulatory and associated litigation risks.

Commentary: Banking Law 1995—An Agenda for State Law Reform

(Continued from page 445)

other hand, for proponents of private banking and state-chartered financial institutions, the federal government's banking policies also present a potential opportunity for the states and the private sector to reclaim a more significant role in the financial system.

III. A Record of State Failure

At this point many state governments seem so cooperating in their own demise as players in the financial system. While state banking departments typically are aware of the challenges they face, too many state legislators seem blinded by short-sighted political considerations and are falling, gullibly, into the traps being laid for them.

Two examples will illustrate this point. First, is the lamentable condition of the consumer credit laws in many states. Most states have failed to adopt legal reforms that would provide a simple, uniform national framework to govern consumer credit transactions. Instead, many states have embraced a punitive hedge-podge of consumer credit rules that are difficult to understand and implement. These disclosure limitations, and raise compliance costs. In addition these laws vary widely from state to state, creating almost impenetrable barriers for state-chartered interstate lenders. The federal government has provided a self-serving solution for federally-chartered institutions, by preempting many state laws and empowering the federal banking regulators to preempt many more. As a result, a federal charter has become almost a necessity for those seeking to do business across state lines. Many states have abdicated this push to federal preemption of state laws by eagerly piling on new layers of complex laws and regulations that can be avoided by use of the federal umbrella.

Second, the states have not failed to provide any viable alternative to the increasing federalization of banking law. This can be explained, and until recently could be justified, by the existence of the dual banking system: Virtually every state has a strong system of state-chartered community banks that enjoy the benefits of federal deposit insurance and to some extent federal preemption while retaining direct state regulation and supervision. The federal regulator is the FDIC, which as the deposit insurer has traditionally focused on safety and soundness issues and has been relatively

(Continued from page 446)


57. See supra note 26.
58. See supra note 28.
59. See supra note 29.
60. See supra note 30.
Fidelity's phraseology in loan documents was unclear. With respect to the second grounds asserted for recovery under the Act, the court found that Fidelity had adjusted the interest rate on the subject loan in a manner consistent with what the parties had bargained for. Therefore, summary judgment was granted to Fidelity on this issue.

As for the final contention, that Fidelity violated the Act by failing to provide new disclosures upon increasing the interest rate, the court refused to grant Fidelity's motion for summary judgment. The court noted that a lender is obligated to provide new disclosures where the interest rate is increased based on a variable rate feature not previously discussed or where the lender adds a variable rate to the obligation. In this case, Fidelity did change its method of selecting an index and did not provide new disclosures; therefore, Fidelity violated Regulation Z section 226.22(a).77

VIII. Conclusion

The most significant developments in the field of Truth in Lending clearly relate to defining what constitutes a finance charge. The Eleventh Circuit's decision in Rodash has created some uncertainty for lenders and has stimulated a new wave of Truth in Lending litigation. Thus, dealing with Rodash and its effects is one of the primary areas of concern for the foreseeable future. However, outside of Rodash, there do not appear to be any astonishing or radical developments in the area of Truth in Lending. Perhaps the most helpful bit of information which may be gleaned from recent case law is that lenders and their counsel should take great care in deciding whether to categorize fees as part of the finance charge or as part of the amount financed. As a general rule, if the subject fee is somehow related to the extension of credit and if it does not fit squarely within one of the finance charge exclusions, that fee might be categorized as a finance charge. Failure to make this determination in precisely the correct manner can have dramatically adverse consequences for the lender.

Commentary: Banking Law 1995–An Agenda for State LAW Reform

Continued from page 448

nonpolitical. This system has provided a strong disincentive for any state to rock the boat, and indeed in many instances it is state-chartered community banks that most stoutly resist any change in the status quo.

This may change, as more and more community bankers come to realize what is happening to them. With federal regulators promoting full interstate banking, increased concentration of banking assets, a diminishing role for state banking departments, a burdensome federal regulatory environment, micro-regulation of bank operations, increasing credit allocation pressures, and hair-trigger penalties for relatively minor and harmless infractions, community bankers may ultimately perceive that the status quo is no longer their friend. Still, until this day arrives, state community bankers are likely to be a primary source of opposition to efforts to restructure state financial systems through creative reform.

IV. An Agenda for State Financial Reform

A. Introduction

Deposit insurance is the anchor that ties control of the banking system to the federal government. It has become the tool that was the entire banking dog; the consideration that justifies any measure Congress or the federal regulators may take. In the long run, an independent state-chartered financial system cannot exist within the confines of this federal regime. Therefore, any effort to restructure a separate state financial system must deal with the issue of federal control over deposit insurance. The obvious solution is to provide an opportunity for development of a system of state-chartered and regulated depository institutions outside the confines of the federal deposit insurance system.

B. Private Deposit Insurance and Enhanced Capital Standards

One potential solution is private deposit insurance, covering a new system of state-chartered depository institutions authorized to accept customer deposits without FDIC insurance. Alternatively, very high capital standards and other safeguards could be used as a substitute for, or in conjunction with, private deposit insurance. Until a private deposit insurance system has developed, high capital standards, in conjunction with the other safeguards discussed infra, would suffice. In any case, certain legal structure elements would facilitate the creation of a new system of depository institutions designed to revitalize an independent state financial system and achieve the twin goals of traditional banking policy: providing ample credit to the local community at reasonable cost and avoiding risk to taxpayers.

The feasibility of private deposit insurance has been amply demonstrated by extensive scholarly analysis and an observer examining the issues.

Continued on page 471
original conveyance must describe affected aircraft engine or propeller, its manufacturer, model and make, and its serial number. The instrument must also state that the engines and propellers meet the requirements of the Federal Registration and Recording Statutes pertaining to horsepower.

7. Assignments, Supplements and Releases

Assignments, supplements, releases, and satisfaction of liens and security interests recorded under the Federal Registration and Recording Statutes are also recordable under the Federal Registration and Recording Statutes.

II. Spare Parts

Specified instruments relating to spare parts are maintained by or for an air carrier licensed under Sections 44705 of Title 46 United States Code, "Transportation," also recordable under the Federal Registration and Recording Statutes. The instruments are also recordable against an aircraft engine, propeller, or appliance maintained for installation or use in an aircraft, aircraft engine, or propeller by such a carrier. The recordable instruments are leases, and instruments executed for security purposes including conditional sales contracts.

1. Effect of Recording

Until an instrument that is recordable under the Federal Registration and Recording Statutes is filed for recording, it is valid only against the parties to the instrument, their heirs and devisees, and parties having actual notice of the instrument. When the instrument is recorded, it is valid from the date of its filing against all persons, without other recordation.

Instruments recorded against a specifically described engine or propeller are valid without regard to instruments previously or subsequently recorded under the statutory provisions relating to engines and propellers that have not been specifically identified in the recorded instruments.

Instruments recorded against spare parts and engines and propellers that have not been specifically described are valid only for items at the location designated in the recorded instrument.


XVII. Summary and Conclusion

It should be noted that this article is intended to be a survey of the general aspects of registration and recording and is not intended to be exhaustive. A practitioner who plans to represent parties in a transaction involving the leasing, letting, releasing or financing of aircraft should study all of the provisions of the Federal Registration and Recording Statutes, as well as the regulations pertaining to the registration and recording of instruments. Unfortunately, despite the area of the law requires a knowledge of practices and procedures of the FAA which are not readily available from a few sources.

Commentary: Banking Law 1995–An Agenda for State Law Reform

(Continued from page 489)

...might well wonder why a rational system of state deposit insurance has not been tried before. Arguments in favor of such a system need not be repeated here; suffice it to say that it is a perfectly sound premise there is no risk to public funds and, long as there is life and conspicuous disclosure, depositors would be misled. At the very least thisuld give depositors an alternative to

...or models. In conjunction with the other reforms proposed,today, a rational system of state deposit insurance would provide the public in the option of a higher yielding deposit account.

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that as a practical matter would approach the safety of FDIC insured funds. However, even without deposit insurance, sufficient safeguards (including very high capital standards) could be built into the structure for an alternative model of state-chartered depository institutions to provide stability to the system and the people who use them. Either way, the result would be a highly flexible state-chartered financial system with more choice for the consumer. This system would improve service to the local credit markets now being underserved by regulated institutions, at the same time generating improved economic growth.

33. Copyrights and interest in the form of a savings and loan association.

C. Parameters of a Program for State Law Reform

(Continued on page 490)

Your author has no monopoly on ideas for a new system of state-chartered and state-regulated non-FDIC depository institutions. There are numerous competing ideas, and it is not the purpose of this paper to make any absolute statement. There are several principles that should be considered in any system.

As for the argument that previous state deposit insurance systems have failed, it should be sufficient to note that these failures were all built on the same fundamental model. Thus, it is not surprising that the failure of previous state government systems should然是 a much different system to work on a clean slate, avoiding the errors of the past.

34. Copyrights and interest in the form of a savings and loan association.

35. See infra note 33.
V. A Few Modest Proposals for Improvement

Allowing an immediate appeal as a matter of right of significant orders dealing with major substantive issues would also preserve the rights of creditors and facilitate the reorganizations of debtors truly capable of rehabilitation. Orders granting or denying substantive consolidation of a debtor with another entity should, for example, be appealable since all too often the substantive rights of creditors of separate entities are ignored for the sake of expediency. A statutory computation scheme to lower the amounts of the bond required for an appeal of an order of confirmation of a plan of reorganization should also be implemented to better balance the equities between the creditors and the debtor.

IV. Summary

Adoption of these few modest proposals would improve the plight of creditors in the bankruptcy system or at least help solve the perception of unfairness that exists. Of course, many other changes are also needed. Until the bankruptcy system begins to make structural sense, the needs of creditors will appear to be ignored. The lack of uniformity and the absence of any cogent and articulated bankruptcy policy for the United States (other than those policies of the National Bankruptcy Conference) will continue to cast much doubt as to the efficacy of any bankruptcy reform process. Until these conflicting ideals are settled, meaningful reform will be impossible.

Commentary: Banking Law 1995–An Agenda for State Law Reform

(Continued from page 475)

approaches would be desirable. The ideas presented here merely explore one possible approach. This approach would have three traditional goals: (1) increased credit availability for the local community, (2) at no risk to taxpayers, (3) with full disclosure, reasonable safety, and an enhanced rate of return for depositors.

D. Increased Credit Availability

The first of these goals can be facilitated by creating a state credit–law environment, with maximum simplicity and minimal hurdles to market entry and credit availability. In the USC states the state credit–law environment is (for the most part) already reasonable. All that is needed is a new system of financial intermediaries to utilize deposits from the public as a source of funding for local credit needs. A new system of non-FDIC depositor institutions could be provided unlimited authority to invest in commercial and consumer loans, stocks, bonds, real estate, commodities, or anything else. Since there would be no safety and soundness implications for taxpayers, there would be no reason to arbitrarily define permissible investment strategies.

Unlike federally insured banks and thrifts, these institutions would not have their business plans drafted by Congress and the regulators. But if a major goal is enhanced local credit availability, why should such institutions be allowed to make high-risk investments in stocks, junk-bonds, real estate, or commodities? The answer is that allowing an institution to pursue a diversified lending and investment strategy, free of arbitrary regulatory restrictions, would help attract capital and would allow such institutions to diversify their risks, ultimately assuring a healthier industry. With no risk to the taxpayers, and with depositor risks handled by disclosure and other means, as described infra, there would be no reason to artificially restrain investment decisions or portfolio diversification.

Surely not many of these institutions (with, as noted infra, their heavy shareholder capitalization) would want to "bet the bank" on an unwarranted commodities speculation or excessive junk bond financing. But, given the safeguards described infra, if that is what the owners and managers want to do, and depositors will tolerate it, it ought to be their decision to make.

E. Constraining the Risk to Taxpayers

This one is easy. The absence of any government-sponsored deposit insurance or guarantee (specifically or implicitly) would mean that no loss could ever be shifted to the taxpayer. The absence of any system of state or federal activities regulation would further emphasize that investors are on their own. Taxpayers (and their representatives) would have no reason for concern for involvement with the affairs of these institutions.

F. Protecting the Depositors

This is the biggest of the issues considered here, reflecting a range of concerns that led to creation of the FDIC and ultimately to FIRREA, FDICIA, and the credit allocation and banking nationalization trend of the 1990s. Concern with depositor protection typically focuses on two matters: avoiding systemic-wide "runs" that could jeopardize the faith in the banking system, and (2) protecting individual depositors from loss. Neither of these issues represents a serious problem or a legitimate concern in the context of non-FDIC institutions.

First, the risk of a systemic run has been widely exaggerated; virtually every reputable study has shown an unwarranted risk of a very unlikely prospect." But in any event, this concern is irrelevant in the context of non-FDIC institutions, because a contagion involving such institutions would have no implications for FDIC insured institutions or the regulated banking system. So long as FDIC and non-FDIC institutions are clearly separated, an issue additionally discussed infra, there is no reason why events affecting one of these systems should directly affect the other. If the past insolvencies of state deposit insured systems have proved nothing else, they at least demonstrate this point.


16. This is a fact that apparently has been largely ignored by policymakers. See, e.g., Harold B. March, in Market experience in terminating federal deposit insurance and operating uninsured deposit insurance, 12 (Ad Hoc Blum 1996); and other commentators support this view. See, e.g., Cato Inst. Commentary on FDICIA, in The Real FDICIA, 45 Consumer Fin. L.Q. Rep. 2 (1999).
XI. Summary

The New Jersey Division of Consumer Affairs must promulgate regulations to implement the Leasing Act. The Division must also implement a "consumer awareness program." The Leasing Act may yet change again. Those dealers and sales finance companies in the motor vehicle leasing business should immediately immerse themselves in the new law. For now, it appears that New Jersey motor vehicle leasing law is still going in circles with a straightaway on the horizon.

Commentary: Banking Law 1995—An Agenda for State Law Reform

(Continued from page 500)

The second concern is for the interests of individual depositors. This concern can be addressed in the following ways: (1) Disclosure, (2) private deposit insurance, (3) cross-guaranty arrangements, (4) very high capital standards, (5) state banking department examinations, and (6) independent audits. A combination of these elements would reduce depositor risk to manageable levels, without bothering the depositary institutions.

The first element is disclosure. Every customer opening an account or depositing funds in a non-FDIC depositary institution should receive a prominent disclosure that the account is not "FDIC-insured. There should be no question that the customer knows that he or she is beyond the protection of the FDIC. Advertisements should contain a similar, prominent disclosure. Similar requirements are being imposed with regard to bank sales of mutual funds and similar uninsured investment products and there is no reason why they cannot work effectively in this context as well."

Second, state law should facilitate development of private deposit insurance systems. It is likely that such systems would ultimately develop if state law were to facilitate the creation of new non-FDIC depositary institutions. Applying normal insurance industry practices and underwriting standards, a private deposit insurance system would impose premium charges commensurate with the risk profile of an insured institution. This would not only protect individual depositors, it would constrain risk behavior by increasing the insurance premium's cost of such behavior. For example, an institution that specialized in commodities speculation or invested heavily in junk bonds or derivatives would likely pay a very high deposit insurance premium and would have to pay very high deposit interest rates. In other words, that such a high deposit insurance premium would spread the risk of failure to a much broader deposit base.

Third, private deposit insurance could be supplemented by a system of cross-guarantees between non-FDIC depositary institutions. While probably unnecessary in the sense of being redundant, this would provide back-up protection in the event that the insurance underwriting system fails. This cross-guaranty arrangement has already been eloquently described in this journal, and the discussion need not be repeated here. Suffice it to say that the resultant restraints on unsafe or unsound practices, and the increased protection provided to depositors, would provide some incremental diminution in depositor risk. The cross-guarantee approach was originally offered as a substitute for federal deposit insurance. This is unlikely to ever be implemented at the federal level although the elimination of restraints on the ability of the FDIC to raise deposit insurance premiums in the event of a crisis may diminish this feature to some extent. However, a state system of non-FDIC institutions would offer an ideal platform to demonstrate the benefits of a cross-guarantee arrangement as a substitute for federal regulation and deposit insurance.

The fourth means of protecting depositors would be imposition of extremely high capital standards. This is an area where most regulatory policy directly contributed to the insolvency of the FSLIC. As thrift capital ratios declined during the 1970s and 1980s, federal regulators repeatedly reduced required capital ratios and artificially "pumped up" stated capital using less "regulatory accounting standards," greatly contributing to the insolvency of the FSLIC. While a strong capital ratio may not be sufficient to entirely offset some risk-taking activities, it is the single easiest measure of safety and soundness. A state-chartered system of non-FDIC institutions should be required to maintain capital levels at least three to four times higher than those required by the FDIC, e.g., something in the range of 15-20% of assets. This single requirement would make these institutions, as a whole, far more salable than FDIC-insured institutions.

Fifth, these non-FDIC depositary institutions would be regulated by the state banking department and subject to the same level of safety and soundness scrutiny by state bank examiners as are FDIC-insured state banks. Despite occasional pretensions to the contrary at the federal level, there is no evidence that state bank examiners are any less capable than their federal counterparts. Indeed, in many states examiners tend to be more consistent, and less attuned to shifting national political considerations than their federal counterparts. Regular safety and soundness examinations by the same regulators who examine FDIC-insured institutions would add to the security of the non-FDIC institutions.

Finally, these institutions should be required to submit annually to an audit by an independent CPA firm, and should be required to make copies of the full audit report available to the public. This would promote widespread, continuing, professional analysis of the institution's accounting standards and financial position as the audit reports are circulated to interested parties. It would probably lead to the development of more explicit standards of independent rating agencies, which could use these audit reports as a basis for various financial ratings that would then be made available to the institution and the public. Audited financial reports would also provide some protection against irregular accounting practices and inadequate accounting systems or internal controls.

G. What Would These Institutions Be?

Issues remain regarding the nature and characterization of the proposed non-FDIC depositary institutions. It would be desirable if the names of these institutions would distinguish them from...
FDIC-insured institutions; on the other hand, uninsured banks now sell uninsured investment products, and there is no reason why wholly uninsured "banks" could not do so as well, provided that adequate disclosures are given. So a definitively different charter or use of a name other than "bank," probably is not essential. But one must anticipate that the existing banking industry would vigorously oppose creation of any new type of financial intermediary calling itself a "bank," so the politics likely would be easier if the institutions could be given a different label. Fortunately, there are several attractive options available.

Your author's personal favorite is the moniker "Savings and loan association," which is rapidly being discarded by much of the thrift industry. Since the proposed non-FDIC depository institutions would be barred from Federal Reserve membership and hence would have only limited access to the payments system, they would have to rely primarily on savings deposits as a source of funds much like the thrift industry before NOW accounts were authorized in 1980. Therefore it would make some sense to include the word "Savings" in the name. Furthermore, the proposed non-FDIC depository institutions, with their broad investment powers and operational flexibility, would very much resemble the savings and loan industry that existed (and prospered in this country before that system was federalized in the 1930s). Perhaps this article is proposing little more than a renaming by the states of their traditional thrift industry.

Of course there are numerous alternative labels. The institutions could be called "State Financial Corporations" (e.g., "First State Financial Corporation"), or "thrift and loan" companies (e.g., "First Thrift and Loan"), or "building and loan associations," or "Savings and loan" companies, or "mortgage and investment" companies, etc. The possibilities are endless, and many of these monikers would help identify the institutions as representing an investment alternative to FDIC-insured banks.

The policy risks are minimal, and the potential opportunities significant. For states: the taxpayers, investors, depositors, and society at large. All that is needed is a little leadership at the state level, and perhaps some cooperation by state bankers who realize that someday they too may wish to conduct their traditional banking business outside the Federal deposit insurance system.

IV. Summary and Conclusion

All of this would work best in states that have a simple and workable system of state consumer credit laws, because state-chartered institutions will not have the benefit of any federal preemption. The USC states are obvious candidates. States that seek to repeal the economic malaise of the 1990s by returning to the tax policies of the 1980s may find that reducing taxes is not enough. A state that wants to take control of its economic destiny in the 1990s will have to provide a viable financial sector to fund the credit needs of local consumers and businesses. No longer can the states rely solely on the federal government to perform this function. States that persist in crafting laws as though financial services providers are out-of-state monopolies, to be punished and hobbled time and again while always coming back for more, may impose an increasing penalty on their citizens, given the failure of the federally-regulated financial system to fully perform its traditional functions. The lack of a viable local alternative will be sorely felt.

In contrast, a state that moves forward to facilitate a new system of locally chartered, uninsured or privately-insured depository institutions will likely find itself becoming a new financial mecca, as an innovative new banking system emerges not only to promote local economic growth but to draw emerging credit and deposit customers from elsewhere who are not being adequately served by traditional banking sources. Pawnshops, check-cashing services, rent-to-own operations, finance companies and other consumer financial services providers would be tempted to use the new charter to fund expansion into full-service lending operations. The resulting increase in competition might do more to revitalize the cities and expand financial services for the poor than any CRA reform could ever hope to achieve. Such a system could exist side-by-side with federally insured and regulated banks, giving new meaning to the concept of a dual banking system.

Articles Solicited on Small-Dollar Consumer Financial Transactions and Other Issues

The Quarterly Report is soliciting articles for publication relating to consumer financial services providers who offer small-dollar financial services. Examples of such providers would include small-loan companies, pawn shops, rent-to-own, check-cashing services, Western Union wire transfers, money-order companies, and perhaps used car dealers and seller-financing retailers.

Articles may describe relevant operational needs and concerns, the basic legal environment, characteristics of the markets being served, prospects for the future, and/or proposals for reform. Both state and federal law issues are appropriate. Articles focusing on business as well as legal issues are welcome.

In addition the Quarterly Report is soliciting articles on RESPA, CRA and fair lending, bank regulation and reform, high-cost mortgages, credit insurance issues, state debt collection laws, credit and debit cards, and consumer litigation.

Interested parties should contact the editor of the Quarterly Report.