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Recommended Citation

Dennis S. Aronowitz & Robert Volk, *Developments in Banking Law: 1980-81* , *in* 1 Annual Review of Banking Law 1 (1982).
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DEVELOPMENTS IN BANKING LAW 1980-81

EDITOR'S NOTE: *Each volume of the* Annual Review of Banking Law *will feature a section highlighting the important legal developments of the previous year that affect financial institutions. The intent of the "Developments in Banking Law" section of the* Annual Review *is to provide the reader with a summary of selected developments. No attempt is made to provide an exhaustive survey. In this, our first volume, the years 1980–81 are spotlighted; in the future, each volume will concentrate on a single year.*

OVERVIEW: 1980–1981

The years 1980 and 1981 were marked by a continuation and acceleration of change in the nation's financial institutions in general and in depository institutions in particular. Until recently, the banking and thrift industries have been unique in possessing the capacity to thrive in a changing economy without changing very significantly themselves. This phenomenon was largely attributable to a regulatory environment that protected depository institutions, minimizing competition from unregulated financial entities and imposing a form of organization that permitted institutions to thrive while conducting their activities in traditional ways. The advent of stubbornly high inflation and historically high interest rates in the late 1970's led to a series of innovations outside the regulatory scheme, and depository institutions faced competition in areas over which they had retained a virtual monopoly. The development and growth of money market mutual funds, the widespread use of commercial paper to replace bank financing, the growth of foreign bank entry into the United States, the creation of non-bank financial giants — these developments, combined with unprecedented technological developments, began a process that has left banks and thrifts faced with competition in spheres tradi-

tionally immune from challenge while they are effectively blocked by regulatory restraints from engaging in many of the lucrative activities open to their new competitors. This has led to unprecedented pressures to alter the regulatory structure.

After decades of a relatively stable regulatory environment, the late 1970's were marked by the enactment of major new banking legislation. The Financial Institutions Regulatory Act and the International Banking Act, both adopted in 1978, though adding to the existing regulation of depository institutions, were important because these enactments established an environment in which major legislative change became acceptable. The success of unregulated competition made deregulation inevitable and led to the enactment in 1980 of the Monetary Control and Depository Institutions Deregulation Act, a harbinger of what will assuredly be further change. By providing for a phase-out of deposit interest rate regulation, the Act represents the first significant loosening of the restrictions imposed in the aftermath of the Great Depression. In an era when Congress has substantially deregulated the transportation and communications industries, the environment is conducive to a significant reexamination of the regulatory restraints which, though proper in an earlier age, may no longer reflect economic reality.

RESTRICTIONS ON BRANCHING AND INTERSTATE BANKING

Perhaps the most controversial issue of the late 1970's and early 1980's has been the continued restrictions on branching both within states and across state lines. Although a number of states in recent years have relaxed their branching restrictions,[1] some states continue to prohibit branching entirely or permit it on a severely restricted basis.[2] Fundamental changes in the American banking industry, particularly the advent of new technology exemplified by automated teller machines and electronic funds transfer,

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[1] *See, e.g.*, FLA. STAT. ANN. § 658.26(b) (West Supp. 1981) (changed from total prohibition to a limit of two branches per county and then to statewide branching); GA. CODE ANN. § 13-203.1 (1975) (changed from restrictions within cities to restrictions within counties); N.J. STAT. ANN. § 17:9A-19 (West Supp. 1981) (changed from restrictions within counties to statewide branching).

[2] *See, e.g.*, KAN. STAT. ANN. § 9-1111 (1975); NEB. REV. STAT. § 8-157 (1977); W. VA. CODE § 31A-8-12 (1975).

have placed significant strains on these restrictions.[3] The McFadden Act's [4] goal of competitive equality in branching between national and state banks and the Douglas Amendment's [5] restriction on bank holding companies' controlling banks in more than one state have been the objects of increased criticism.

Congress recognized the importance of these issues when, in the International Banking Act of 1978,[6] it directed the President to conduct a study and render a report on the continued viability of the McFadden Act. The President's report was formally issued in January 1981 and included not only a study of the McFadden Act, but an examination of the broader issues under the Douglas Amendment as well.[7] The report supports a phased reduction of current restrictions on branching, primarily through relaxation of the prohibitions on bank holding companies' controlling commercial banks in more than one state. Although concluding that the McFadden Act is "ineffective, inequitable, inefficient and anachronistic," the report did not recommend its abandonment or modification.[8] Instead, the report urged states that impose restrictions on branching to reevaluate their policies in light of prevailing market forces and to liberalize restrictions on intrastate geographical expansion.[9]

The report did, however, recommend immediate legislative action to permit deployment of electronic funds transfer terminals across state lines, initially limited to the standard metropolitan statistical area in which an institution is located, but ultimately nationwide.[10] Finally, the report recommended that interstate acquisitions of failing banks by bank holding companies be permitted.[11] By the end of 1981, Congress had not yet implemented the report's recommendations. The House of Representatives took the only significant legislative action by approving the "Regulators' Bill," authorizing interstate and cross-industry mergers in instances of failing depository

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[3] *See* Comment, *E.F.T.'s and Competitive Equality?: A Doctrine That Does Not Compute,* 32 ARK. L. REV. 347 (1978); Note, *Effect of the Use of Customer-Bank Communication Terminals on Competition Among Financial Institutions,* 45 U. CIN. L. REV. 591 (1976).

[4] 12 U.S.C. § 36 (1976).

[5] 12 U.S.C. § 1842(d)(1) (1976).

[6] 12 U.S.C. § 3101 (Supp. II 1978).

[7] U.S. DEP'T OF THE TREASURY, REPORT OF THE PRESIDENT, GEOGRAPHIC RESTRICTIONS ON COMMERCIAL BANKING IN THE U.S. (Jan. 1981).

[8] *Id.* at 17.

[9] *Id.* at 18.

[10] *Id.* at 19.

[11] *Id.* at 20.

institutions under the supervision of federal regulators.[12]

The industry response to congressional inaction has been to develop techniques to ameliorate the effects of these restrictions. Although commercial banks have been unsuccessful in expanding their deposit-taking activities, a number of developments portend change in the near future. First and foremost has been a series of interstate mergers of federally insured savings and loan associations. In order to avoid the liquidation of failing institutions, the Federal Savings and Loan Insurance Corporation (FSLIC) has engineered the mergers of a number of financially healthy savings and loan institutions with troubled associations in other states.[13] In most instances, the FSLIC has provided financial incentives to offset some of the economic burdens undertaken by the healthy associations. The acquiring institutions, however, have absorbed a portion of the losses as part of the cost of expanding their deposit-taking operations to another state. The expansion by thrifts across the state lines and the likelihood that this expansion will continue have produced strong pressures to permit commercial banks to operate on an interstate basis as well in order to ameliorate a perceived competitive disadvantage. At the end of 1981, proposals were pending before Congress both to permit interstate takeovers by banks and to impose prohibitions on further interstate mergers by savings and loan associations.[14]

Perhaps the most important developments in the area of interstate banking were the actions taken in 1980 by South Dakota and in 1981 by Delaware. The legislatures of both states enacted statutes permitting out-of-state bank holding companies to establish limited-function banks within their borders.[15] The South Dakota statute was intended to attract the bank credit card operations of large money center banks located in states that impose below-market usury limits on open-ended consumer financing.[16]

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[12] H.R. 4361, 97th Cong., 1st Sess. (1981).

[13] *See First Interstate Subsidiary Takes Over Savings Bank,* Am. Banker, Mar. 16, 1982, at 1, col. 3; *Interstate Merger Creates Largest Federal S & L,* Am. Banker, Nov. 23, 1981, at 1, col. 2. The Federal Deposit Insurance Corporation has also announced that it would permit out of state banks to bid for failing mutual savings banks. *See FDIC to Let Out-of-State Firms Bid for Failing Savings Banks,* Am. Banker, Dec. 22, 1981, at 1, col. 3.

[14] H.R. 4095–4098, 97th Cong., 1st Sess. (1981) (interstate branching); H.R. 4102, 97th Cong., 1st Sess. (1981) (banks acquiring failing thrifts).

[15] S.D. CODIFIED LAWS ANN. § 51-16-40 (1980); DEL. CODE ANN. tit. 5, § 802 (1981 Interim Supp.).

[16] S.D. CODIFIED LAWS ANN. § 51-16-40 (1980).

Inasmuch as South Dakota does not impose interest rate ceilings on this type of loan, a national bank located in that state can impose any interest charge on credit card financing, regardless of where the cardholder resides or where purchases are made.[17] This legislation induced Citicorp to charter an institution in South Dakota and transfer its credit card operations to that state from its headquarters in New York.

South Dakota's initiative was followed by Delaware legislation that authorized out-of-state bank holding companies to establish state-chartered banks.[18] The Delaware statute, however, was more ambitious than South Dakota's in its attempt to attract some of the commercial banking activities of large money center banks in addition to their credit card operations. The principal incentive is a substantially lower tax on bank activities than that imposed by other states, particularly New York and Pennsylvania. The statute also removed the usury ceilings for credit card operations. To protect the purely local business of Delaware banks, the statute imposes limitations on the activities of these out-of-state-owned banks.[19] The effect of these initiatives has been to exert pressure on other states, such as New York, Pennsylvania and Maryland, to raise their permissible usury ceilings and to reconsider their systems for taxing bank assets, activities and income.

A second type of state initiative surfacing during 1981 that may have a major impact on interstate banking is the authorization for out-of-state banks to acquire or charter a bank within a state. At year-end, the legislatures of Maine and Alaska were giving serious consideration to proposals permitting some form of entry by out-of-state institutions without any requirement of reciprocity from other states. The adoption of these provisions could result in entry by large banking organizations from other states. The purpose of these proposals is to attract large money center banks to acquire banks in these states at a premium while other states continue to limit entry by out-of-state firms. Whether the activities of these two states portend a broader movement that will spread to other states is unclear at the present time.

Finally, a number of bank holding companies have recently adopted a strategy of positioning themselves for the expected relaxation of the Douglas Amendment. Typically, this is being accomplished by a holding company's purchasing less than 5 percent of the voting shares of a bank located in another state while also acquiring a sizeable block of nonvoting stock

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[17] *See* Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299 (1978).

[18] DEL. CODE ANN. tit. 5, § 802 (1981 Interim Supp.)

[19] *Id.*

convertible to regular common shares if interstate restrictions are relaxed. Some of these arrangements also provide for options to purchase additional shares of the target bank.[20] These devices permit a holding company to acquire a "non-controlling" interest which can be converted into a controlling interest in the event interstate restrictions are modified.[21]

THE BANK HOLDING COMPANY ACT

In early 1981, the Supreme Court finally resolved the dispute over the Federal Reserve Board's regulation permitting bank holding companies and their nonbanking subsidiaries to act as investment advisors to closed-end mutual funds. In *Board of Governors v. Investment Company Institute*,[22] the Court held that the narrowly circumscribed regulation authorizing companies to engage in this activity did not violate the Glass-Steagall Act's proscriptions on securities activities of banks or the "closely related to banking" requirements contained in Section 4(c) of the Bank Holding Company Act.[23] The restrictions the Board has imposed upon a holding company wishing to engage in this activity suggest that the legal struggle may have been well out of proportion to the actual value banks can derive from this new activity. Under the regulation, the bank holding company may not have any ownership interest in, nor extend credit to, the investment company sponsoring the fund, and is prohibited from underwriting or otherwise participating in the sale or distribution of the investment company's securities.[24] Moreover, proposals currently pending before Congress to amend Glass-Steagall would, if adopted, grant banks as well as bank holding companies increased authority to sponsor and advise mutual funds.[25]

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[20] *See, e.g., Boston B.H.C. Buys Stock in Maine B.H.C.,* [July-Dec.] WASH. FIN. REP. (BNA) No. 49, at A-14 (Dec. 14, 1981); *NCNB Corp. Seeking Entry Into Florida Banking Market Despite Intent of Florida Law Prohibiting Acquisition by Out of State Banks,* Wall St. J., May 23, 1981, at 2, col. 2; *Banks Grab Footholds Out of State, Betting That Restrictions Will End,* Wall St. J., Feb. 3, 1981, at 35, col. 4.

[21] *See* 12 U.S.C. § 1841(a)2 (1976).

[22] 450 U.S. 46 (1981).

[23] 12 U.S.C. §§ 24(7), 377 (1976). (Glass Steagall); 12 U.S.C. § 1843(c) (1976) (bank holding company act). *See* Comment, *Bank Holding Companies Attempt to Enter a Forbidden Market*— Investment Company Institute v. Board of Governors of the Federal Reserve System, 1980 WIS. L. REV. 976.

[24] 450 U.S. at 52, (citing 12 C.F.R. §§ 225.125(f), (g), (h) (1980)).

[25] *See, e.g.,* S. 1670, 97th Cong., 2nd Sess. (1981); S. 1424, 97th Cong., 1st Sess. (1981).

An important decision of the Supreme Court in 1980 imposed major limitations on the authority of states to prohibit out-of-state holding companies from engaging in nonbanking activities in the state. In *Lewis v. B.T. Investment Managers*,[26] the Court invalidated a Florida statute that sought to prevent banks and bank holding companies from operating investment advisory affiliates in Florida.[27] This attempt to preserve these investment advisory business activities for Florida banks and trust companies was held to violate the Commerce Clause of the Constitution.[28] Of special interest was the Court's holding that Section 7 of the Bank Holding Company Act,[29] which secures to each state "such powers and jurisdiction which it now has or may thereafter have with respect to banks, bank holding companies, and subsidiaries there," preserves only that state authority that "operates within the boundaries marked by the commerce clause" and does not permit state legislation inconsistent with the provisions of the Bank Holding Company Act.[30]

The continuing decline in the stability of the thrift industry and the burden this has placed on the Federal Deposit Insurance Corporation (FDIC) and Federal Savings and Loan Insurance Corporation (FSLIC) has caused the Board of Governors of the Federal Reserve System (the Board) to indicate a willingness to reconsider its long-standing policy of not permitting bank holding companies to acquire thrift institutions.[31] In a letter to Chairman Isaacs of the FDIC, Chairman Volker of the Board of Governors expressed the Board's support[32] for the so-called Regulator's Bill, passed by the House in October 1981, permitting cross-industry and interstate mergers of failing thrift institutions.[33] In the event the Senate fails to act favorably, however, Chairman Volker indicated that "the Board would be prepared to consider, on a case-by-case basis, applications by a bank holding company for the acquisition of a failing thrift institution in instances where the possibility of such an acquisition would importantly reduce the costs and

[26] 447 U.S. 27 (1980).

[27] *Id.* at 49.

[28] U.S. CONST. art I, § 8, cl. 2.

[29] 12 U.S.C. § 1846 (1976).

[30] 447 U.S. at 49.

[31] *See D.H. Baldwin Co.*, 63 FED. RES. BULL. 280 (Mar. 1977).

[32] Volker Says Fed May Let Bank Holding Companies Buy Thrifts, [Jan.-June] WASH. FIN. REP. (BNA) No. 1, at A-11 (Jan. 4, 1982).

[33] *See* H.R. 4361, 97th Cong., 2d Sess. (1981); H.R. 4603, 97th Cong., 2d Sess. (1981).

risks involved. . . ." [34] This indicates that despite its prior holdings that savings and loan activities do not meet the "proper incident to banking" requirement of Section 4(c)(8),[35] the Board's view is that the Act itself does not prohibit acquisition of thrifts. This attitude is underscored by the Board's approval in 1980 of a New Hampshire holding company's acquisition of a stock thrift institution.[36]

USURY LAWS

The extraordinary rise in interest rates that began in the late 1970's resulted in a scarcity of funds for borrowers in states that imposed below-market interest ceilings on loans. Restrictive usury laws affected home mortgage and consumer loans in particular, with business and agricultural loans also becoming scarce in states that imposed similar restrictive usury ceilings on them. In 1980, Congress responded by adopting Title V of the Depository Institutions Deregulation Act (DIDA), which contains a permanent override of state usury limits on first mortgage residential loans, and a three-year override of usury limits on business and agricultural loans of $25,000 or more.[37] DIDA entirely exempted mortgage loans from any usury limits, but established a ceiling of 5 percent over the Federal Reserve discount rate for business and agricultural loans.[38] In both instances, Congress granted the states the authority to reject the federal overrides by expressly reinstating their usury limitations by statute or constitutional provision.[39] DIDA also created parity between national banks and state-chartered, federally insured depository institutions by permitting the latter to charge a maximum interest rate one percent over the discount rate on any type of loan.[40]

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[34] Fed. FDIC Exchange Letters on Possible Acquisition of Thrift Institutions by Bank Holding Companies [Jan.-June] WASH. FIN. REP. (BNA) No. 1, at T-1 (Jan. 4, 1982).

[35] *See* 12 U.S.C. § 1843(c)(8) (1976).

[36] First Fin. Group of N.H., 66 FED. RES. BULL. 594 (1980). In reaching this decision, however, the Board noted the unique nature of stock thrift institutions ("guaranty savings banks") in New Hampshire, and their traditional relationship with commercial banks in that state.

[37] 94 Stat. 161 (codified at 12 U.S.C.A. § 1735f-7(a) (West Supp. 1981)).

[38] *Id.*

[39] 12 U.S.C.A. § 1735f-7(b) (West Supp. 1981).

[40] 12 U.S.C.A. § 1831d(a) (West Supp. 1981). *See also* Samuels, *Usury Preemption, the Federal State Scheme,* 98 BANKING L.J. 892 (1981).

The DIDA overrides had little effect on consumer loans, including credit card transactions, that remained subject to state interest ceilings. A 1978 decision of the United States Supreme Court construing the usury provisions of the National Bank Act [41] authorized national banks to charge the maximum rate permitted by the bank's home state on credit card purchases by nonresidents of that state.[42] Bank holding companies that found the profits on their credit card operations seriously affected by limitations imposed by their home states began seeking a jurisdiction that did not impose usury limitations. The need was filled when Delaware [43] and South Dakota [44] adopted legislation permitting the chartering of limited-function banks by foreign holding companies. The result was the departure of the credit card operations of Citibank from New York to South Dakota and, similarly, the credit card operations of a number of Pennsylvania and Maryland banks from their home states to Delaware. This exerted considerable pressure on states to remove or raise their consumer loan rates and upon Congress to override the remaining state usury restrictions. At the end of 1981, bills were pending in Congress to achieve that result.[45]

THE DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980

One of the major objective of Congress in 1980 when it enacted DIDA was to permit depository institutions to compete with money market funds and other unregulated investment opportunities.[46] To achieve that end, the Depository Institutions Deregulation Committee was established "to provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts as rapidly as economic conditions warrant."[47] DIDA

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[41] 12 U.S.C. § 85 (1976).

[42] Marquette Nat'l Bank v. First of Omaha Serv. Corp., *supra* note 17, 439 U.S. 299 (1978).

[43] DEL. CODE ANN. tit. 5, § 802 (1981 Interim Supp.).

[44] S.D. CODIFIED LAWS ANN. § 51-16-40 (1980). *See* text accompanying notes 15–18, *supra.*

[45] *See* S. 963, 97th Cong., 1st Sess. (1981); S. 1406, 97th Cong., 1st Sess. (1981).

[46] *See* S. REP. No. 368, 96th Cong., 2d Sess. 3–5, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 237, 239–40.

[47] 12 U.S.C.A. § 3501(b) (West Supp. 1981).

directs the Committee, composed of the Secretary of the Treasury and the Chairmen of the Federal Reserve Board, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board and National Credit Union Administration, and, as a nonvoting member, the Comptroller of the Currency,[48] to accomplish an orderly phase-out of interest rate ceilings over a period not to exceed six years.[49] At the time Congress adopted DIDA, it was assumed that prevailing market rates would decline in the near future and that a gradual increase in permissible rates would be tolerable for the thrift industry. The persistence of inordinately high money market rates, however, led to serious opposition from thrifts and small banks to any further increase in or removal of interest ceilings. As a consequence, the members of the Deregulation Committee have disagreed over the proper course of action and have been the subject of criticism for their efforts to follow the statutory mandate and increase permissible rates. As 1981 concluded, proposals were rife for restricting or restructuring the Committee.[50]

In addition, in *U.S. League of Savings & Loan Associations v. Depository Institutions Deregulation Committee*,[51] the court held that the Committee's regulation lifting rate ceilings immediately on newly created four-year certificates and phasing out the ceilings on shorter term deposits over a period of four years was impermissible.[52] The court found that DIDA did not repeal Public Law 94-200, which requires that a quarter percent differential favoring thrift institutions be maintained on maximum interest rates of existing accounts unless otherwise approved by Congress.[53] This decision makes it virtually impossible for DIDA to eliminate interest ceilings on any existing forms of accounts prior to 1986. The response may be to create accounts of novel durations which presumably are not subject to the differential requirement, and which would be attractive alternatives to existing deposit instruments. At year-end, the members of the Deregulation Committee remained divided over how to proceed, and the only significant deregulation step that the committee took was to authorize depository institutions

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[48] 12 U.S.C.A. § 3502 (West Supp. 1981).

[49] 12 U.S.C.A. § 3501(b) (West Supp. 1981). *See U.S. League May Sue DIDC Again Over "Absolutely Disappointing" Decisions*, [July-Dec.] WASH. FIN. REP. (BNA) No. 27, at A-21 (July 6, 1981). The National Credit Union Administration is not bound by the Deregulation Committee.

[50] *Cranston, Five Other Senators Push Bill for One-Year Moratorium on DIDC Actions* [July-Dec.] WASH. FIN. REP. (BNA) No. 47, at A-12 (Nov. 30, 1981); *id.* at A-28.

[51] No. 81-1666 (D.D.C. July 31, 1981) (unpublished).

[52] *Id.*

[53] *Id.*

to offer unregulated Individual Retirement Accounts.[54]

Congress in 1980 also passed the Monetary Control Act (MCA).[55] The MCA requires *all* depository institutions to maintain reserves against transaction and time deposits. Although the Federal Reserve Board exempted financial institutions with deposits of less than $2 million,[56] the provision, when fully operative, will place the same reserve requirements on institutions that are not members of the Federal Reserve System as those placed on member institutions. In addition to establishing parity between member and nonmember institutions, the measure will enable the Federal Reserve Board to better monitor and control the nation's money supply.

MERGERS, ACQUISITIONS AND ANTITRUST DECISIONS

In 1981, courts overturned on antitrust grounds three of the Board's decisions involving bank acquisitions by bank holding companies. In *County National Bancorp. v. Board of Governors*,[57] *Mercantile Texas Corp. v. Board of Governors*[58] and *Republic of Texas Corp. v. Board of Governors*,[59] the courts of appeals vacated Board orders that denied proposed acquisitions based on the Board's finding that consummation of the proposed acquisitions would lessen potential competition. The courts reversed the Board's determinations because the proposed acquisitions did not violate the Sherman or Clayton antitrust acts. The courts rejected the Board's argument that under the Bank Holding Company Act[60] it could deny an acquisition or merger if it finds anti-competitive effects that, though falling short of violating the antitrust laws, nevertheless thwart the convenience and needs of the community.[61] The decisions were significant not only because they limited the grounds upon which the Board could deny applications, but also because

[54] *DIDC Upholds Rate Deregulation, Abandons Move for Penalty Free Rollovers*, [July-Dec.] WASH. FIN. REP. (BNA) No. 47, at A-7 (Nov. 30, 1981).

[55] Pub. L. No. 96-221, tit. I, 94 Stat. 132 (1980) (codified in scattered sections of 12 U.S.C.).

[56] *NCUA Votes Final Deregulation of Credit Union Share Accounts*, [Jan.-June] WASH. FIN. REP. (BNA) No. 17, at A-6 (April 27, 1981).

[57] 654 F.2d 1253 (8th Cir. 1981).

[58] 638 F.2d 1255 (5th Cir. 1981).

[59] 649 F.2d 1026 (5th Cir. 1981).

[60] 12 U.S.C. §§ 1841 *et. seq.* (1976).

[61] *See* 12 U.S.C. § 1842(c) (1976).

they rejected the Board's assertion of discretion authoritatively to interpret this section of the Bank Holding Company Act. In light of the extreme deference the federal courts have traditionally afforded to the Board's construction of the statutes it administers, particularly the Bank Holding Company Act, these decisions represent a significant assertion of judicial authority over construction of the Act.[62]

Another interesting development in the merger area was the ruling that a bank lacks the requisite interest in the emergency acquisition of one of its competitors by a third bank to give it standing to challenge the Comptroller's plan arranging the takeover.[63] This decision, if read expansively and followed by other federal courts, could have the effect of insulating emergency takeovers from challenge except by the Justice Department.

INTERNATIONAL BANKING

Congress enacted the International Banking Act of 1978 [64] principally to promote competitive equality between foreign banks, which had been permitted multistate branching, and United States banks.[65] By grandfathering existing facilities of foreign banks, either in place or applied for as of July 1978,[66] the Act did not reduce the existing multistate presence of foreign banks. The Act did, however, foster competitive equality by limiting new deposit-taking facilities of foreign banks to a single state.[67] In addition, the Act prohibited foreign bank holding companies from acquiring American banks outside the state in which its lead bank is located.[68]

The effect of these provisions has not been to slow markedly the increase of foreign bank branches within the United States. By mid-1980, the Federal Reserve Board reported that 150 foreign banks operated 332

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[62] *See* Board of Governors v. Investment Co. Inst., *supra* note 22; 450 U.S. 46 (1981); Board of Governors v. First Lincolnwood Corp., 439 U.S. 234 (1978).

[63] Marshall & Isley Corp. v. Heimann, 652 F.2d 685 (7th Cir. 1981), *petition for cert. filed,* 50 U.S.L.W. 3467 (U.S. Nov. 20, 1981) (No. 81-964).

[64] Pub. L. No. 95-369, 92 Stat. 607 (1978) (codified as amended in scattered sections of 12 U.S.C.).

[65] International Banking Act of 1978, § 3(b), 12 U.S.C. § 3103(b) (Supp. III 1979). *See generally Regulation of Foreign Banks in the United States,* 1980 ILL. L.F. 1.

[66] International Banking Act of 1978, § 5(b), 12 U.S.C. § 611(a) (Supp. III 1979).

[67] *Id.,* § 5(a)(1–4), 12 U.S.C. § 3103 (Supp. III 1979).

[68] *Id.,* § 5(a)(5), 12 U.S.C. § 3103 (Supp. III 1979).

branches and agencies in the United States with assets of $123 billion.[69] Foreign bank holding companies have also completed a number of sizeable domestic acquisitions, most notably Hong Kong and Shanghai Banking Corporation's acquisition of Marine Midland Bank, and Midland Bank's acquisition of Crocker National Bank.[70] Whether the Act will ultimately slow foreign bank activities in the United States is not clear. In any case, the loss of the ability to expand into multistate deposit-taking can be expected to account for some diminution in the level of foreign banks' interest in the United States market.

Perhaps the most significant new development in this area since the passage of the International Banking Act was the Federal Reserve Board's adoption of regulations authorizing the establishment in the United States of international banking facilities (IBF) and treating them as if they were located offshore.[71] These IBF's will be permitted to accept deposits when the funds involved are to be used primarily for foreign transactions.[72] These facilities will enable domestic banks to compete with offshore operations because deposits in IBF's will not be subject to reserve requirements or Regulation Q interest rate limits.[73] In 1981, Congress amended Section 3(1)(5) of the Federal Deposit Insurance Act to ensure that IBF deposits would be exempt from deposit insurance requirements.[74] Permitting United States banks to establish IBF's will enable domestic banks to shift offshore operations from subsidiaries located in foreign countries, such as Singapore, the Bahamas and the Cayman Islands, to the United States.

A suit brought by the Conference of State Bank Supervisors and the New York Attorney General challenged the Comptroller's power to charter and to approve federal branches and agencies of foreign banks operating in the United States.[75] The U.S. District Court for the District of Columbia upheld the Comptroller's authority granting the states a veto power over

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[69] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, [1980] ANNUAL REPORT 228 (1981).

[70] *See* Remarks of H.C. Wallich, Member of the Board of Governors of the Federal Reserve System, *Perspectives on Foreign Banking in the United States,* Conference on Foreign Banking in the United States (Mar. 1, 1982.).

[71] Amendments to Regulations D and Q for International Banking Facilities, 46 Fed. Reg. 32,426 (1981).

[72] *Id.* at 32,427.

[73] *Id.*

[74] 12 U.S.C.A. § 1813(1)(5) (West Supp. 1981).

[75] Conference of State Bank Supervisors v. Heimann, [Current Binder] FED. BANKING L. REP. (CCH) ¶ 98,900 (D.D.C. Sept. 30, 1981).

foreign entry only if "the type of operative the foreign application seeks is . . . itself prohibited."[76]

PROBLEMS OF FEDERALISM — THE DUE-ON-SALE CLAUSE

Perhaps the most dramatic conflict between federal and state law arose over the validity of due-on-sale clauses contained in mortgages issued by federally chartered institutions. A due-on-sale clause requires the mortgagor to pay the entire balance due on the mortgage if the property subject to the mortgage is transferred. Thus, a subsequent purchaser cannot assume a mortgage containing a due-on-sale clause without the permission of the lender. Since 1978, the California courts have held that due-on-sale clauses interfere with the free alienation of property and are unenforceable by lenders.[77] The California Court of Appeals has applied this ruling to federally chartered savings and loan associations despite a Federal Home Loan Bank Board (FHLBB) regulation[78] authorizing the use of due-on-sale clauses.[79] Courts in a number of other states without specific legislation on the subject have considered the enforceability of due-on-sale clauses with differing results.[80] Bankers argue that the FHLBB regulations authorizing use and enforcement of due-on-sale clauses by federal savings and loans

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[76] *Id.*

[77] Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 970 (1978). Previously, the court had held due-on-sale or similar clauses enforceable only on installment sales. *See* Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974); La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864. 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

[78] 12 C.F.R. §§ 545.6-11(f),(g) (1980).

[79] *See* De la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981).

[80] A number of courts have held that a due-on-sale clause is unenforceable. *See, e.g.,* Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471 (Minn. 1981) Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978).

Conversely, a number of courts have held that the clause is enforceable. *See, e.g.,* Dunham v. Ware Sav. Bank, 1981 Mass. Adv. Sh. 1607, 423 N.E.2d 998 (1981); Stith v. Hudson City Sav. Inst., 63 Misc. 2d 863, 313 N.Y.S.2d 804 (Sup. Ct. 1970); People Sav. Ass'n v. Standard Indus., 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970).

See Finch, *Due-on-Sale Clauses in Debt Instruments and Market Realties,* 98 BANKING L.J. 300 (1981).

preempt conflicting state law.[81] As 1981 ended, the issue of whether state or federal law would prevail was headed for the Supreme Court for an ultimate decision.[82]

BANK SECURITIES ACTIVITIES AND SECURITIES LAW DECISIONS

The securities activities of banking organizations have become an important focus of bank regulators in the past two years. As commercial banks and thrifts have encountered greater competition from non-banks, particularly money market funds and other liquid investment vehicles, the restraints imposed by the Glass-Steagall Act[83] have become more burdensome.[84] At the end of 1981, proposals were pending before Congress to eliminate or modify many of the Act's restrictions on banks' securities activities. These include permitting banks or bank holding companies to underwrite revenue bonds, offer money market funds and provide broker-dealer services. What, if anything, will emerge is difficult to predict since the competing interest groups — banking industry against securities industry,

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[81] 12 C.F.R. § 545.8-3(f) (1979) provides the following:

> Due-on-sale clauses. An association continues to have the power to enforce, as a matter of contract between it and the borrower, a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. Except as provided in paragraph (g) of this section with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract and all rights and remedies of the association and borrower shall be fixed and governed by that contract.

In addition, 12 C.F.R. § 556.9 (1976) sets forth the FHLBB's policy statement on the validity of due-on-sale clauses.

[82] De la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, *supra* note 79, *prob. juris. noted,* 50 U.S.L.W. 3591 (U.S. Jan. 25, 1982) (No. 81-750). Petitioner argues that both the Federal Home Owners Loan Act of 1933 12 U.S.C. §§ 1461–1470 (1976) and FHLBB regulations preempt California law prohibiting enforcement.

[83] 12 U.S.C. § 24 (Seventh) (1976).

[84] *See* Clark & Saunders, *Judicial Interpretation of Glass-Steagall: The Need for Legislative Action,* 97 BANKING L.J. 721 (1980); Lowenstein, *The Commercial Paper Market and the Federal Securities Laws,* 4 CORP. L. REV. 128 (1981).

large banks against smaller banks, commercial banks against thrifts — could thwart legislative efforts to deal with the apparent imbalance.

In addition to the Supreme Court's approval of bank holding companies' offering advisory services to closed-end mutual funds,[85] the Federal Reserve Board has approved the sale by banks of third-party commercial paper to institutional investors. In authorizing banks to engage in this activity, the Board held that commercial paper is not a "security" and therefore Section 16 of the Glass-Steagall Act [86] does not prohibit banks from underwriting third-party commercial paper. A district court, however, has overturned this construction of the Glass-Steagall Act and held that banks may not underwrite commercial paper.[87]

The United States Supreme Court decided two cases concerning the application of federal securities law to banking activities. In one case the Court upheld the SEC's determination that a pledge of stock as collateral for a loan is an "offer or sale" of a security as defined by federal securities laws.[88] This permits the borrower to seek redress against the lender for violation of Section 17(a) of the Securities Exchange Act of 1934.[89] At the end of 1981, the Court was also about to consider whether a pledged certificate of deposit is a security under the 1933 and 1934 securities acts.[90]

CHARTERING

In October 1980, the Senate Banking Committee released a majority staff study on "Chartering of National Banks: 1970–1977."[91] The study was highly critical of the Comptroller's chartering practices. In particular, the study found that the Comptroller's "chartering policy was overly restrictive

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[85] Board of Governors of the Fed. Reserve Sys. v. Investment Co. Inst., 450 U.S. 46 (1981). *See* text accompanying notes 22–25, *supra.*

[86] *See* Letter from Theodore Allison, Secretary of the Board, to John Lifton, Esq., and Harvey Pitt, Esq. (Sept. 26, 1980), *reprinted in* [1980 Transfer Binder] FED. BANKING L. REP. (CCH) ¶ 98,435 (Nov. 31, 1980).

[87] A.G. Becker v. Federal Reserve Sys., 519 F. Supp. 602 (D.D.C. 1981).

[88] Rubin v. United States, 449 U.S. 424 (1981).

[89] 15 U.S.C. § 71(q) (1976).

[90] In Marine Bank v. Weaver, No. 80-1562 (U.S. March 8, 1982), the Court held that a certificate of deposit was not a security, based on the existence of the bank regulatory scheme and federal deposit insurance.

[91] STAFF OF SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 96TH CONG., 2D SESS., CHARTERING OF NATIONAL BANKS: 1970–1977 (Comm. Print 1980).

. . . [and] more interested in protecting existing banks during this period than in promoting competition in meeting the banking needs of the public."[92] The Staff also concluded that the Comptroller's published standards were vague and provided the Comptroller with "unbridled discretion" in the chartering process.[93]

Shortly after publication of the report, the Office of the Comptroller of the Currency (OCC) issued revised regulations covering the chartering process.[94] The new regulations address some of the same issues raised by the Senate study and explain in greater detail the factors and procedures being followed by the OCC. More important, the new regulations provide that "[i]t is not the policy of the Office to ensure that a proposal is without risk nor to protect existing competitors from competition a new bank will provide."[95] This statement appears to meet partially the objection that existing institutions have been protected from the competition of new entrants that are willing and able to establish a new national bank, although the objection is not fully overcome by this statement because the OCC still requires that "the proposed bank will have a reasonable likelihood of success. . . ."[96] If this requirement entails an assessment of the proposed institution's chances of surviving in a competitive environment, then the Comptroller could use this standard to protect existing banks by finding that a community is "overbanked" and to deny applications for new charters on this ground.

CONSUMER CREDIT

The major legislative development in the field of consumer credit during the past two years was the Truth-in-Lending Simplification and Reform Act.[97] Since its passage in 1965, the Truth-in-Lending Act[98] (TiLA) has been the subject of numerous suits and administrative rulings which have created a confusing body of law. The Simplification Act reduced the com-

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92 *Id.* at 2.

93 *Id.* at 4.

94 12 C.F.R. § 5.20 (1981).

95 12 C.F.R. § 5.20(c) (1981).

96 *Id.* This criterion finds its roots in the Federal Deposit Insurance Act, 12 U.S.C. §§ 1814(b), 1816 (1976).

97 Pub. L. No. 96-221, tit. VI, 94 Stat. 132 (1980).

98 15 U.S.C. §§ 1601–13, 1631–41, 1661–65 (1976).

plexity and length of disclosures, particularly in closed-end credit transactions. In addition, the Simplification Act amended the liability provisions for statutory damages, limiting class action liability generally, and imposing liability only for failures to make material disclosures. Coverage of TiLA was also amended to exclude agricultural credit and to include mobile home transactions.[99] The Federal Reserve Board has undertaken a revision of Regulation Z [100] to comply with the Simplification Act.

In addition, the Supreme Court has ruled on various provisions of TiLA in the last two years. In *Ford Motor Credit Company v. Milhollin*,[101] the Court held that a creditor need not disclose to the consumer the creditor's right to accelerate the maturity of a consumer's debt.[102] More important than its specific holding, however, was the Court's admonition to lower courts that they follow the interpretations of TiLA provided by Federal Reserve Board staff. The Court stated that "[u]nless demonstrably irrational, Federal Reserve staff opinions should be dispositive. . . ."[103] Following the spirit of *Milhollin,* and relying on Board interpretations, the Court, in *Anderson Brothers Ford v. Valencia*,[104] held that an assignment of unearned insurance premiums does not create a "security interest" that must be disclosed under TiLA.[105] Finally, in *American Express Company v. Koerner*,[106] the Court held that an individual using a business credit card for business purposes is not entitled to TiLA protections.[107] These decisions, together with the passage of the Simplification Act, indicate a trend away from the strict application of consumer protection measures evident in years past.

In 1978, Congress passed the Electronic Funds Transfer Act [108] to clarify relationships of participants in electronic funds transfers systems and, in 1980, the Federal Reserve Board adopted Regulation E under the

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[99] *See generally* Boyd, *The Truth-in-Lending Simplification and Reform Act — A Much-Needed Revision Whose Time Has Finally Come,* 23 ARIZ. L. REV. 1 (1981); O'Connor, *Truth-in-Lending Simplification, Esquire,* 36 BUS. LAW. 1161 (1981).

[100] 12 C.F.R. § 226 (1981).

[101] 444 U.S. 555 (1980).

[102] *Id.* at 560–61.

[103] *Id.* at 564.

[104] 452 U.S. 205 (1981).

[105] *Id.* at 222–23.

[106] 452 U.S. 233 (1981).

[107] *Id.* at 241–42.

[108] 15 U.S.C. § 1693 (Supp. III 1979). *See* Brandel & Schellie, *Electronic Funds Transfer Act,* 35 BUS. LAW. 1275 (1980); Note, *The Electronic Funds Transfer Act — A Departure from Articles 3 and 4 of the Uniform Commercial Code,* 1980 WIS. L. REV. 1007.

Act.[109] Regulation E, which is applicable to all electronically initiated consumer fund transfer transactions, requires that financial institutions provide their customers with a disclosure statement containing a description of the customer's rights and potential liabilities as well as the rights and liabilities of the institution itself.[110] The regulations also require that financial institutions provide documentation of transfers [111] and notice of the effectuation of preauthorized transfers,[112] and limit a consumer's liability, for unauthorized transfers.[113] Of primary importance are the provisions concerning error resolution.[114] After a customer gives notice of an error, the financial institution must promptly correct the mistake and recredit the account.[115] Regulation E is an attempt by the Board to balance the needs of the customer and the financial institution in a rapidly changing area and, therefore, the Board has been flexible in its requirements.[116]

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[109] 12 C.F.R. § 205 (1981). *See* Connors, *The Implementation of the Electronic Funds Transfer Act — An Update on Regulation E,* 17 WAKE FOREST L. REV. 329 (1981).

[110] 12 C.F.R. § 205.7 (1981).

[111] 12 C.F.R. § 205.9 (1981).

[112] 12 C.F.R. § 205.10 (1981).

[113] 12 C.F.R. § 205.6 (1981).

[114] 12 U.S.C. § 205.11 (1981).

[115] *Id.*

[116] *See* Connors, *supra* note 109, at 358.