1983

Developments in Banking Law 1982

Dennis S. Aronowitz

Robert Volk

DEVELOPMENTS IN BANKING LAW 1982

OVERVIEW: 1982

In 1982, the nation's depository institutions continued to cope with a difficult economic environment. Although the high interest rates of the early part of the year began a slow decline in the fall, commercial banks and thrift institutions continued to face stiff competition from alternative investment instruments for the depositor's dollar. Savings banks and savings and loan associations continued to have trouble remaining solvent in a difficult time. In 1982 both the Federal Deposit Insurance Corporation (FDIC) and the Federal Home Loan Bank Board (FHLBB) arranged a record number of mergers and acquisitions involving failing institutions.

Congressional assistance was forthcoming in late 1982 with the Garn-St Germain Depository Institutions Act of 1982 [1] (the "Act"). The Act directed the Depository Institutions Deregulation Committee (DIDC) to create an insured account "directly competitive" with money market funds. In response, the DIDC authorized depository institutions to offer an account with a minimum balance of $2,500 that had no interest rate restrictions and permitted limited check-writing privileges. In addition, the Act provided net worth certificates to buttress the sagging capital positions of ailing thrifts as well as troubled commercial banks.

The Act also created the first explicit congressional exception to the prohibition against interstate banking. During 1982, the FHLBB arranged a number of interstate mergers of savings and loan associations, culminating in the acquisition of California-based Fidelity Savings and Loan Association by Citicorp, the New York banking giant. In response to the growing need to arrange such mergers for failing

[1] Pub. L. No. 97-320, 96 Stat. 1469 (1982).

institutions, the Act legitimized the actions of the FHLBB by establishing a set of priorities for emergency cross-industry and interstate mergers and acquisitions.

1982 also saw one of the nation's largest bank failures, that of Penn Square Bank in Oklahoma. The failure was the result of imprudent loans to the energy sector, which was hard hit by the continuing recession. Many large money center banks suffered great losses because of their large participations in Penn Square-originated loans.

Finally, 1982 was a significant year for what did not occur. The Glass-Steagall Act continues to stymie the attempts of bankers to compete with the rapidly growing, full service financial giants, such as American Express/Shearson and Sears. Bans against interstate banking still prevent bankers from effectively tapping out-of-state retail markets. Although the due on sale clause is dead as far as new mortgages are concerned, thrift institutions are still burdened with may low-yielding investments. Nonetheless, as interest rates decline, bankers are in a better position to face the challenges of the coming years, especially with the new tools provided by Congress in 1982.

THE GARN-ST GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982

One of the most significant developments over the past year was the passage of the Garn-St Germain Depository Institutions Act of 1982 (Garn-St Germain Act).[2] The various provisions of the Act attempt to strengthen the ailing thrift industry (mutual savings banks and savings and loan associations) and provide certain additional powers to commercial banks. The overall thrust of the Act is to provide depository institutions with broader powers and place them on a more equal footing with other financial institutions. Notably, although the Act addresses competition between thrifts and commercial banks, it does not attempt to break the barrier imposed by the Glass-Steagall Act which prevents banks from entering the securities business by underwriting revenue bonds or offering mutual funds.[3]

Title I of the Act authorizes federal regulators to arrange inter-

---

[2] *Id.*

[3] *See* 12 U.S.C. § 24 (Seventh)(1976).

state mergers of banks and thrifts according to a specified list of priorities set out in section 116. According to that section, regulators can authorize mergers with reference to the following priorities:

(i) Between depository institutions of the same type within the same state;

(ii) Between depository institutions of the same type in different states;

(iii) Between depository institutions of different types in the same state; and

(iv) Between depository institutions of different types in different states.[4]

Furthermore, the regulators must give priority to offers from adjoining states when considering interstate mergers.[5] These guidelines will undoubtedly legitimize a preexisting merger policy which previously appeared to lack certainty or predictability.

Title III of the Act permits thrift institutions to invest up to 10 percent of their assets in commercial loans and to offer checking accounts to loan customers.[6] Although this change in thrift powers places thrifts in a more competitive position vis-a-vis commercial banks, it may also change anti-trust analysis. As savings and loans become significant participants in commercial lending, an area traditionally reserved to commercial banks, they may be deemed competitors in that line of commerce for the purpose of evaluating mergers and acquisitions under anti-trust laws.

The new Act also changed lending limits for national banks. Section 401 increases the lending limit for unsecured loans from 10 percent of capital and surplus to 15 percent for a single borrower. For loans secured by marketable collateral, the lending limit to a single borrower is 25 percent of capital and surplus.[7]

Certain provisions of the Act apply to both commercial banks and thrift institutions. For example, the first $2 million in reservable deposits held by any institution are now exempt from reserve re-

---

[4] Publ. L. No. 97-320, Title I, § 116, 97 Stat. 1469 (1982).

[5] *Id.*

[6] Pub. L. No. 97-320, Title III, §§ 312, 325, 96 Stat. 1469 (1982) (the ten percent loan limit is to be phased in over a two-year period).

[7] Pub. L. No. 97-320, Title IV, § 401, 96 Stat. 1469 (1982).

quirements.[8] Further, Title II of the Act establishes a program of federally backed certificates for ailing thrifts and banks to strengthen their capital positions. Eligible institutions include thrifts and banks that hold 20 percent of their loan portfolio in mortgages; the amount of certificates provided depends upon the net worth of the institution.[9]

A significant provision which serves to make all depository institutions more competitive with other financial institutions is Section 327 of the Act, which requires the Depository Institutions Deregulation Committee (DIDC) to create a new depository instrument equivalent to money market funds.[10] DIDC has authorized these accounts and set a minimum balance of $2500 for this account. Should the balance fall below the minimum, the 5¼ percent ceiling on interest-bearing checking accounts applies. DIDC has further authorized three checks per month per account to a third party.[11] It is expected that this new account will help depository institutions in maintaining and attracting a deposit base.

THE CONTINUED PROBLEM OF TROUBLED FINANCIAL INSTITUTIONS

Although the Garn-St Germain Depository Institutions Act of 1982 promises some relief for ailing financial institutions, for many it is too late. As the economy has suffered, so have lending institutions. In August of this year, the Office of the Comptroller of the Currency stated that bank failures in 1982 thus far have exceeded anything experienced in the previous 10 to 15 years.[12]

Perhaps the most visible failure was the collapse of Penn Square National Bank of Oklahoma. The Comptroller of the Currency declared the bank insolvent on July 5, 1982, after bank examiners identified nearly $50 million in loan losses.[13] The Penn Square ordeal

---

[8] Pub. L. No. 97-320, Title IV, § 411, 96 Stat. 1469 (1982).

[9] Pub. L. No. 97-320, Title II, §§ 202, 203, 96 Stat. 1469 (1982).

[10] Pub. L. No. 97-320, Title III, § 327, 96 Stat. 1469 (1982).

[11] 47 Fed. Reg. 53,710 (1982).

[12] Am. Banker, Aug. 31, 1982, at 3, col. 3.

[13] *Id.*, Sept. 13, 1982, at 2; *See* 47 Fed. Reg. 47,677 (1982)(FDIC Notice).

has generated substantial legal controversy, leading initially to new requirements for banks to report on problem loans.[14]

Various banks which had engaged in loan participations with Penn Square are suing the Federal Deposit Insurance Corporation, challenging its policy of offsetting the losses of Penn Square depositors with the loans of those banks.[15] At stake are millions of dollars in loan participations. Other legal controversies include a derivative action brought under the securities laws against Continental Illinois Bank, seeking to establish the bank's liability for risky and imprudent loan participations with the failed bank while leading investors to believe in the financial soundness of Penn Square.[16]

Thrift institutions also suffered great financial difficulties over the past year resulting in supervised mergers. By early 1982, the Federal Home Loan Bank Board had already approved 35 mergers, occasionally combining institutions at geographic extremes of the United States.[17] Although the Independent Bankers Association lost its suit against the FHLBB to prevent such interstate mergers,[18] the Board can now rely on the guidelines set out in the new Garn-St Germain Act.[19]

In establishing criteria for determining the financial soundness of a federal savings and loan, an Illinois district court judge ruled that the definition of insolvency would be measured by the book value of the institution's assets and not according to market value.[20] The definition is important because the Federal Savings and Loan Insurance Corporation can assume a receivership position only when an institution's net worth equals zero.[21] Furthermore, this rationale

---

[14] Am. Banker, Sept. 8, 1982, at 1, col. 3.

[15] *See, e.g.*, Hibernia Nat'l Bank of New Orleans v. FDIC, No. CIV-82-1051-R (W.D. Okla., filed July, 1982); Chase Manhattan Bank v. FDIC; and No. CIV-82-1074-T (W.D. Okla., filed July, 1982).

[16] Mirochnick v. Continental Ill. Corp., No. 82-64712 (N.D. Ill., filed July 29, 1982).

[17] [Jan.-June] 5 WASH. FIN. REP. (BNA) A-14 (Feb. 1, 1982).

[18] Indep. Bankers Ass'n, of Am. v. FHLBB, No. 82-0508 (D.D.C., Aug. 4, 1982)(mem.).

[19] *See supra* text accompanying notes 4-5.

[20] Telegraph Sav. and Loan Ass'n v. FSLIC, No. 80C 2792 (N.D.Ill., Feb. 21, 1982).

[21] 12 U.S.C. § 1464(d)(6) (1976).

could apply in determining eligibility for federal assistance under Title II of the Garn-St Germain Act.[22]

MERGERS, ACQUISITIONS, AND ANTITRUST DEVELOPMENTS

For the first time, the Comptroller of the Currency considered thrifts to be in the same line of business as commercial banks for antitrust purposes in evaluating a proposed merger. In approving the acquisition of Connecticut National Bank by Hartford National Bank, the Comptroller applied an antitrust analysis which placed thrifts in the same competitive market as commercial banks.[23] The Comptroller reasoned that such treatment was appropriate because of Connecticut law authorizing thrifts to make commercial loans and offer deposit services and because of the expanded powers granted thrifts by the Monetary Control Act of 1980.[24]

The increased lending powers provided to thrifts by the Garn-St Germain Act support the Comptroller's reasoning.[25] The power to make commercial loans and offer checking accounts are functions which define a commercial bank.[26] In 1974, the Supreme Court refused to place savings and loans in the same line of commerce as commercial banks but noted that as savings and loans begin to participate in the marketing of traditional banking services, they may become indistinguishable from commercial banks for the purpose of antitrust analysis.[27]

The Supreme Court will decide another antitrust issue this term in *BankAmerica Corp. v. United States.*[28] Therein, the Court will decide whether interlocking directors between banking and insurance com-

---

[22] *See supra* text accompanying note 9.

[23] Connecticut Nat'l Bank, Office of the Comptroller of the Currency, March 26, 1982, *reprinted in* [Jan.-June] 14 WASH. FIN. REP. (BNA) T-2 (April 5, 1982).

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

[25] *See supra* text accompanying note 6.

[26] *See* 12 U.S.C. § 1841(c) (1976).

[27] United States v. Connecticut Nat'l Bank, 418 U.S. 656 (1974).

[28] United States v. Crocker Nat'l Corp., 656 F.2d 428 (9th Cir. 1981), *cert. granted sub. nom.* BankAmerica Corp. v. United States, — U.S. —, 101 S. Ct. 2294 (1982).

panies violates antitrust laws. The United States Court of Appeals for the Ninth Circuit has held that the Clayton Act prohibited such interlocks.[29]

SECURITIES ACTIVITIES OF BANKS AND SAVINGS & LOANS

Early in the year the Federal Home Loan Bank Board (FHLBB) sought comment on a controversial proposal that would have dramatically expanded the range of financial services offered by savings and loans through their service corporations.[30] Although the proposed activities included underwriting insurance, collecting debts, leasing consumer and business goods without restriction, and offering real estate brokerage services for third-party owners, the most controversial proposal was to allow service corporations to engage in securities brokerage activities.[31] The FHLBB stated that the securities activities would not violate the Glass-Steagall Act, even if the parent savings and loan were subject to the Act, the service corporation, which by law must be a separate organization, was not.[32]

Desite the FHLBB's argument, the proposal appears moot in light of the Garn-St Germain Act. The Conference Report states:

> The managers want to stress that by specifically approving certain expanded powers and activities for thrift institutions and by not authorizing the Federal Home Loan Bank Board to permit service corporations to engage in any new activities not previously authorized, the managers intend that henceforth the FHLBB should not approve, in absence of clear and specific Congressional authorization, any new regulation expanding activities of service corporations other than to permit service coroporations to engage in activities permitted for federal thrift institutions.[33]

Nevertheless, prior to any formal decision on its proposal, the

---

29 *Id.*

30 47 Fed. Reg. 9855 (1982).

31 *Id.* at 9857.

32 *Id. See also* Federal Home Loan Bank Board, Opinion of Counsel, *reprinted in* [Jan.-June] 19 WASH. FIN. REP. (BNA) T-1 (May 10, 1982).

33 H.R. Rep. No. 899, 97th Cong., 1st Sess. 88 (1982).

FHLBB approved the request of three savings and loan associations to engage in brokerage services through a joint service subsidiary corporation.[34] Under the plan, Coast Federal, California Federal, and Perpetual American Federal Savings and Loan Associations are permitted to own a joint subsidiary offering investment advisory and securities transaction services, as well as effectuating the purchase and sale of stocks, bonds, and shares in some money market funds.[35] In addition, Gibraltar Financial Corporation, a large California savings and loan holding company also under FHLBB supervision, announced early in the fall that it was establishing a securities brokerage subsidiary.[36]

Several national banks also established brokerage subsidiaries with the consent of the Comptroller of the Currency. For example, Security Pacific National Bank's proposal to establish Security Pacific Discount Brokerage Service, Inc. received Comptroller approval.[37] Fidelity Brokerage Services, Inc. of Boston established asset management and discount brokerage services in conjunction with eight banks. In all cases, the banks have received Comptroller approval, prompting a suit by the Securities Industry Association alleging that such activities violate the Glass-Steagall Act and the McFadden Act's restrictions on interstate branching.[38]

The new deposit account authorized by the Depository Institutions Deregulation Committee removes some of the impetus for banks to establish subsidiaries to offer mutual and money market funds.[39] Nevertheless, the Boston Five Cents Savings Bank, a state chartered mutual savings bank, intends to establish a money market fund operated through a subsidiary, having obtained approval from the FDIC[40] and the Securities and Exchange Commission.[41] The particular issue raised by such activity is whether Glass-Steagall proscriptions apply to state non-member banks so as to prevent the bank's ownership of a brokerage subsidiary. Whether ownership of a dis-

---

[34] [Jan.-June] 19 WASH. FIN. REP. (BNA) A-20 (May 10, 1982).

[35] *Id.*

[36] Am. Banker, Sept. 9, 1982, at 1, col. 3.

[37] [Current] Fed. Banking L. Rep. (CCH) ¶ 99,284 (1982).

[38] Securities Industry Ass'n v. Conover, No. 82-2895 (D.D.C. filed Oct. 6, 1982).

[39] *See supra* text accompanying note 10-11.

[40] 47 Fed. Reg. 38,984 (1982).

[41] Am. Banker, Oct. 15, 1982, at 1, col. 3.

count brokerage by a bank holding company is permissible remains to be seen. BankAmerica Corp., the holding company for Bank of America, still awaits action by the Federal Reserve Board on its proposed acquisition of Charles Schwab & Co.

Courts have been wary of imposing securities law liability on banks in "borderline" securities-type activities. The Supreme Court held that large denomination certificates of deposit were not securities in *Marine Bank v. Weaver*.[42] This is in accord with the result reached by the Court of Appeals for the Seventh Circuit in *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*,[43] but reverses the decision of the Court of Appeals for the Third Circuit.[44] Similarly, Bankers Trust Company was granted summary judgment after being charged with violating federal securities laws in *Zicklin v. Breuer*.[45] Bankers Trust had been buying and selling stock for its customers' trust accounts and had issued descriptions of certain stocks to its customers which were later found to contain misstatements. In addition, the Court of Appeals for the Seventh Circuit, in *Board of Trade v. SEC*,[46] held that Government National Mortgage Association options are not securities.

In reversing the decision of the district court, the United States Circuit Court of Appeals for the District of Columbia ruled that a bank can underwrite large denomination, prime quality commercial paper to sophisticated investors without violating Glass-Steagall Act prohibitions on the underwriting of securities.[47] The court reasoned that the commercial paper of this type was more similar to a loan than to a security.[48] Another area of banking activity involving Glass-Steagall concerns is investment activities involving Individual Retirement Accounts (IRAs). Citibank received approval from the Comptroller of the Currency to commingle the assets of IRAs for investment in a common trust fund.[49] The funds will be registered with the SEC

---

[42] — U.S. —, 102 S. Ct. 1220 (1982).

[43] 615 F.2d 465 (7th Cir. 1980).

[44] Marine Bank v. Weaver, 637 F.2d 157 (3rd Cir. 1980), *rev'd*, 102 S. Ct. 1220 (1982).

[45] 534 F.Supp. 745 (D.C.N.Y. 1982).

[46] 677 F.2d 1137 (7th Cir. 1982).

[47] A.G. Becker v. Board of Governors of the Federal Reserve, No. 80-2258 (D.C. Cir. Nov. 2, 1982).

[48] *Id.*, slip op. at 28.

[49] Decision of the Comptroller of the Currency on the Application by Citibank,

under the Investment Company Act, as will the offerings of an interest in the funds.[50] Regulation Y of the Federal Reserve Board permits banks to act as investment advisors to investment companies, but only at arm's length. The bank may not become involved in the distribution of shares of the fund.

BANK HOLDING COMPANIES

The Federal Reserve Board made two major decisions on proposed bank holding company acquisitions over the past year. The Board approved the purchase of Scioto Savings and Loan by Interstate Financial Corporation, the holding company for Third National Bank & Trust of Dayton, Ohio.[51] Although the Board had previously ruled that a savings and loan association is "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act,[52] this was the first time the Board found a savings and loan to be a "proper incident" to banking.[53] The Board stressed that the savings and loan association passed the "public benefits" test of Section 4(c)(8) only because the thrift was failing and Interstate promised to infuse enough capital to keep it viable;[54] the decision was "limited to the particular facts and not to be considered a precedent."[55]

Despite the Board's limiting language, however, it later approved another bank holding company acquisition of a savings and loan, this time in the interstate context. The Board approved Citicorp's acquisition of Fidelity Savings and Loan of San Francisco, contingent upon numerous requirements primarily designed to as-

---

N.A., pursuant to 12 C.F.R. § 9.18(c)(5) to establish Common Trust Funds for the collective investment of Individual Retirement Account trust exempt from taxation under Section 408 of the Internal Revenue Code of 1954, October 21, 1982, *reprinted in* [July-Dec.] WASH. FIN. REP. (BNA) No. 17, at 816 (Nov. 1, 1982).

[50] *Id.*

[51] 68 FED. RES. BULL. 316 (1982).

[52] 12 U.S.C. § 1843(c)(8) (1976).

[53] *Id.*

[54] 68 FED. RES. BULL. 316, 317 (1982).

[55] *Id.* at 318.

sure the separate, independent operations of the two institutions.[56] This marked the first time the Board had approved an interstate takeover of a savings and loan by a bank holding company and served to underscore its interpretation of Section 4(c)(8) in the Scioto Savings acquisition.

The Federal Reserve Board also approved an application by J. P. Morgan & Co. to act as a futures commission merchant for financial instruments through its bank holding company subsidiary, Morgan Futures Corporation.[57] The Board did not, however, amend Regulation Y to permit such activity; other bank holding companies must continue to make individual applications to the Board to be determined on a case-by-case basis.[58]

The Board revised Regulation Y [59] to allow bank holding company subsidiaries to offer consulting services to non-bank depository institutions, such as thrifts and credit unions. The new regulation authorizes the subsidiaries to give management consulting advice to unaffiliated non-bank depositories, as well as advice on bank operations and personnel and consumer credit.[60] The Board found that the availability of such advice would be a public benefit because it would allow thrifts to more efficiently utilize their expanded powers.[61] Regulation Y previously allowed BHC subsidiaries to give such advice to non-affiliated banks.

In response to growing equity investments by bank holding companies in out-of-state banking organizations, the Board issued a policy statement outlining its criteria for determining whether such investments are consistent with the Bank Holding Company Act.[62] In anticipation of statutory changes that might make interstate banking permissible, bank holding companies have been increasing their interstate equity positions, acquiring options to convert nonvoting stock to voting stock, and entering into merger and acquisition agree-

---

[56] *Id.* at 656 (1982).

[57] *Id.* at 514 (1982).

[58] *Id.*

[59] 12 C.F.R. § 225 (1981).

[60] 68 FED. RES. BULL. 553 (1982) (to be codified at 12 C.F.R. § 225.4(a)(12)).

[61] [Jan.-June] 11 WASH. FIN. REP. (BNA) A-13 (March 15, 1982).

[62] Policy Statement on Non-voting Equity Investments by Bank Holding Companies, Board of Governors of the Federal Reserve System, *reprinted in* [July-Dec.] 39 WASH. FIN. REP. (BNA) 72, 74 (July 12, 1982).

ments all predicated upon the approval of interstate banking. The Board stated that investments of relatively moderate size in nonvoting equity instruments, which are to become voting stock upon approval of interstate banking, are permissible. Other arrangements which serve to substitute contractual rights for those normally achieved through voting shares or which control the ultimate disposition of shares or policies of the potential acquiree are deemed the equivalent of control and are impermissible.[63]

RESTRICTIONS ON BRANCHING AND INTERSTATE BANKING

Federal and state bank regulators steadily eased restrictions on bank branching. The Federal Deposit Insurance Corporation (FDIC) proposed a streamlined application procedure for the establishment and branching of banks.[64] Under the proposal, banks would no longer be required to fill out lengthy FDIC application forms or publish intent to branch notices. Most applications would be decided within one week.[65] The FDIC move followed a General Accounting Office report recommending that the Federal Reserve Board and the FDIC streamline their branching review procedures, especially for the establishment of automatic remote facilities, and impose an exception-based review system with calendar-day processing deadlines.[66]

Some state legislators have begun to follow the federal lead in removing barriers to interstate branching. New York State approved a bill which permits banks to establish New York branches if their home states give reciprocal privileges to New York banks.[67] It is not expected to have an immediate impact on the banking system, however, inasmuch as Maine is the only other state to enact such legislation.[68]

---

[63] *Id.*

[64] 47 Fed. Reg. 29,554 (1982)(to be codified at 12 C.F.R. pts. 303, 304, 347).

[65] *Id.*

[66] GENERAL ACCOUNTING OFFICE, FEDERAL REVIEW OF INTRASTATE BRANCHING APPLICATIONS CAN BE REDUCED (1982).

[67] Banks — Acquistion by Out-of-State Bank Holding Co., Ch. 417, 1982 N.Y. Sess. Laws. 1025–29 (McKinney).

[68] *See* N.Y. Times, June 8, 1982, at D12, col. 3.

DUE ON SALE CLAUSE

The Supreme Court has settled the dispute between some state [69] and federal courts[70] as to the enforceability of "due on sale" clauses included in mortgage contracts by federal savings and loan associations. A due on sale clause requires a mortgagee to pay the entire unpaid balance of a mortgage upon sale of the mortgaged property. Thus, a purchaser of the property may not assume the existing mortgage. In *Fidelity Federal Savings & Loan Association v. de la Cuesta,*[71] the Court held that such clauses are enforceable and that Federal Home Loan Bank Board regulations [72] promulgated pursuant to the Home Owners Loan Act,[73] preempt state regulations on the exercise of these clauses.[74]

The Court found that the regulation preempted state law because the Board intended to preempt conflicting state law and acted within the scope of its delegated authority.[75] The majority opinion, written by Justice Blackmun, left open the question of whether the Board's regulations wholly occupied the field of regulating savings and loans,[76] although Justice O'Connor, concurring, thought that the regulation did have this broad preemptive effect.[77] Justice Rehnquist, dissenting, focused upon both the Federal Home Owners Loan Act and the Federal Home Loan Bank Act [78] and reasoned that the Board's statutory authority did not authorize it to intrude so far into state property and contract law.[79]

---

[69] *See* de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n., 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981), *rev'd,* — U.S. —, 102 S. Ct. 3014 (1982); Panko v. Pan. Am. Fed. Sav. and Loan Ass'n, 119 Cal. App. 3d 916, 174 Cal. Rptr. 240 (1981); Holiday Acres No. 3 v. Midwest Fed. Sav. and Loan Ass'n., 308 N.W.2d 471 (Minn. 1981).

[70] *See, e.g.,* Glendale Fed. Sav. and Loan Ass'n v. Fox, 459 F. Supp. 903 (C.D. Cal. 1978), *partial summary judgment made final,* 481 F. Supp. 616 (1979), *rev'd on other grounds,* No. 79-3573 (9th Cir., Sept. 24, 1981).

[71] — U.S. —, 102 S. Ct. 3014 (1982).

[72] 12 C.F.R. § 545.8-3(f) (1981).

[73] 12 U.S.C. §§ 1461–1470 (1976 and Supp. III 1979).

[74] — U.S. at —, 102 S. Ct. at 3030.

[75] *Id.* at 3023.

[76] *Id.* at 3025, n. 14.

[77] *Id.* at 3031–32.

[78] 12 U.S.C. §§ 1421–1449 (1976 and Supp. III 1979).

[79] — U.S. at —, 102 S.Ct. at 3033.

Justice Rehnquist's concern with state contract law is highlighted by *Bleeker Associates v. Astoria Federal Savings & Loan Ass'n.*[80] In that case, a federal district court held that the federal regulations authorizing the use of due on sale clauses in mortgage contracts did not preempt related state laws if the savings and loan was state chartered at the time the mortgage contract was made but was subsequently acquired by a federally chartered institution.[81]

Although the opinion in *de la Cuesta* focused upon the preemptive powers of Federal Home Loan Bank Board regulations, the result reached — the preemption of state due on sale law affecting federal savings and loans — has been codified by the Garn-St Germain Depository Institutions Act of 1982. Section 341 of the Act preempts state prohibitions on due on sale clauses, but gives states three years to reimpose such prohibitions on state chartered institutions.[82] If state due on sale prohibitions are reimposed within the three-year period, the scenario in *Bleeker Associates* is likely to re-occur.

USURY

Controversy in the area of usury has continued notwithstanding the congressional override of state usury laws in 1980.[83] Most of the controversy surrounds the use of the 360/365 day method, or "banker's rule," to calculate interest. The method operates by taking the stated annual interest rate of a loan, dividing that rate by 360 to calculate a per diem rate, and multiplying by 365 to arrive at an effective annual rate, which is greater than the stated annual rate.[84]

The 360/365 method presents a usury issue when the stated interest rate is within usury limits but the effective yield is not. In 1974, the Court of Appeals for the Ninth Circuit determined that such a practice constitutes a usury law violation.[85] In a recent deci-

[80] 544 F.Supp. 794 (S.D.N.Y. 1982).

[81] *Id.* at 798–99.

[82] Pub. L. 97-320, Title III, § 341, 96 Stat. 1469 (1982).

[83] *See* 12 U.S.C.A. § 1735(f)(7)(A) (West Supp. 1981).

[84] For example, a loan bearing 16% stated interest per annum would yield 16/360, or .04444% interest per diem, and .04444 × 365, or 16.22% effective interest per annum, under this method.

[85] American Timber and Trading Co. v. First Nat'l Bank of Oregon, 511 F.2d 980 (9th Cir. 1974).

sion, however, the Hawaii Supreme Court held that this practice did not violate usury laws.[86] Another challenge to the 360/365 method was made in *Federal Home Loan Bank Board v. Gulf Federal Savings and Loan Association.*[87] In that case, borrowers challenged the 360/365 method as an unsafe or unsound banking practice within the meaning of section 5(d)(2)(A) of the Home Owners Loan Act.[88] The United States Court of Appeals for the Fifth Circuit ruled that it was not unsound or unsafe to use the 360/365 method.[89]

TAXES ON DEPOSITORY INSTITUTIONS

Recently, a number of banks have challenged the method of computing bank share taxes imposed by various state statutes.[90] The banks have argued that in assessing the value of bank shares to include federal obligations held by the bank, the respective states have violated 31 U.S.C. § 742, wherein Congress prohibited state methods of taxation which consider, directly or indirectly, federal obligations or interest thereon.[91]

The Montana Supreme Court held that its state bank share tax authorized a method of computation which "considered" federal obligations in violation of 31 U.S.C. § 742.[92] In contrast, courts in Texas,[93] Georgia,[94] and Tennessee,[95] ruling on similar statutes, have

---

[86] THC Financial Corp. v. Managed Investment Corp., 64 Haw. 491, 643 P.2d 549 (1982).

[87] 651 F.2d 259 (5th Cir. 1981).

[88] 12 U.S.C. § 1464(d)(2)(A) (1976 and Supp. III 1980).

[89] Gulf Federal Sav. & Loan Ass'n, 651 F. 2d at 265.

[90] *See, e.g.*, Bartow County Bank v. Tax Assessors, 248 Ga. 703, 285 S.E.2d 920 (1982); Montana Bankers Ass'n v. Dep't of Revenue, 177 Mont. 112, 580 P.2d 909 (1978); Memphis Bank & Trust Co. v. Garner, 624 S.W. 2d 551 (Tenn. 1981), *prob. juris. noted*, — U.S. —, 102 S. Ct. 2005 (1982); American Bank & Trust Co. v. Dallas County, 615 S.W.2d 823 (Tex. Civ. App. 1981), *cert. granted*, 51 U.S.L.W. 3339 (U.S. Nov. 2, 1982) (No. 81-1717).

[91] *See* 31 U.S.C. § 742 (1976).

[92] Montana Bankers, 177 Mont. 112, 580 P.2d 909 (1978).

[93] American Bank & Trust Co. v. Dallas County, 615 S.W.2d 823 (Tex. Civ. App. 1981), *cert. granted*, 51 U.S.L.W. 3339 (U.S. Nov. 2, 1982)(No. 81-1717).

[94] Bartow County Bank v. Tax Assessors, 248 Ga. 703, 285 S.E.2d 920 (1982).

[95] Memphis Bank & Trust Co. v. Garner, 624 S.W. 2d 551 (Tenn. 1981), *prob. juris. noted*, — U.S. —, 102 S. Ct. 20005 (1982).

upheld the method of computation, reasoning that Congress did not intend to withdraw its "consent" to such tax plans. The Supreme Court has agreed to hear the appeal in a Tennessee case [96] and has granted certiorari in a Texas case [97] to decide the issue of whether 31 U.S.C. § 742 requires the deduction of federal obligations in the computation of bank share taxes.

Another development potentially affecting the overall tax obligations of banks is a proposal by the Treasury Department to modify the minimum corporate income tax. Under the proposal, the following items would be treated as tax preferences in calculating the corporate alternative minimum tax: (1) deduction for debt to carry tax-free exempt securities; and (2) the excess of deductions generated over cash invested in "leveraged losses."[98] Should the proposed plan become law, it could result in greatly increased taxes for many banks.

INTERNATIONAL BANKING

In 1982, the Federal Reserve Board amended Regulation K [99] to allow Edge Act corporations to give investment advice and manage investment portfolios.[100] The rule change was made under the mandate of the International Banking Act of 1978 [101] which directed the Board to make Edge Act corporations competitive with foreign banks with branches in the United States.[102] The amendment, however, does not permit Edge Act corporations to engage in asset manage-

---

[96] *Id.*

[97] American Bank & Trust Co. v. Dallas County, 615 S.W.2d 823 (Tex. Civ. App. 1981), *cert. granted* 51 U.S.L.W. 3339 (U.S. Nov. 2, 1982)(No. 81-1717).

The impact of the Court's decisions in *Memphis Bank & Trust Co.* and *American Bank and Trust Company* will be substantial as other states have bank share tax statutes similar to those challenged in Texas and Tennessee. *See, e.g.,* LA. REV. STAT. ANN. §§ 47:8 (West 1970) and 47:1967 (West Cum. Supp. 1982); NEV. REV. STAT. §§ 367.020 to 367.070 (1981); OHIO REV. CODE ANN. §§ 5709.04, 5711.01(B)(3) (page 1980); PA. STAT. ANN. tit. 72, §§ 11-3-14, 11-2-14a (Purdon 1974).

[98] Am. Banker, Mar. 1, 1982, at 1, col. 3.

[99] 12 C.F.R. § 211 (1981).

[100] 68 FED. RES. BULL. 237 (1982).

[101] Pub. L. No. 95-369, 92 Stat. 608 (1978) (codified as amended at scattered sections of 12 U.S.C.).

[102] 12 U.S.C. § 611a (Supp. II 1978).

ment.[103] Edge Act corporations may only give investment advice to foreign customers or on the foreign investments of United States customers, because of the requirement that an Edge Act corporation's activities be internationally related.[104]

CONSUMER CREDIT

1982 marked the first year of implementation for revised Regulation Z,[105] reflecting the changes brought about by the Truth-in-Lending Simplification and Reform Act of 1980.[106] The impact of the amendments on one issue indicates that the new provisions are having the desired effect. Before the 1980 amendments to the Act, the courts of appeals had split on the question of whether each joint obligor in a credit transaction could recover damages for a single Truth-in-Lending Act violation.[107] In a decision applying the 1980 Act, however, the Court of Appeals for the Seventh Circuit reversed an earlier decision [108] and held that only one recovery per violation is permitted.[109] In reaching its result, the court noted that the 1980 amendments added a provision to the original act which limited recovery among joint obligors to a single amount.[110] The court found that the provision was designed to remove the confusion surrounding the issue of recovery for joint obligors.[111]

In 1982, the Court of Appeals for the Ninth Circuit considered two cases brought under the Equal Credit Opportunity Act (ECOA)[112] involving claims founded on allegations of discrimination

---

[103] Fed Expands International, Domestic Powers of Banks, [Jan.-June] 11 WASH. FIN. REP. (BNA) A-12 (March 15, 1982).

[104] *See* 12 U.S.C. § 615(a) (1976).

[105] 12 C.F.R. pt. 226 (1982).

[106] Pub. L. No. 96-221, 94 Stat. 132.

[107] Recovery permitted: Davis v. United States, 551 F.2d 971 (5th Cir. 1977); Mirabal v. General Motors Acceptance Corp., 537 F2d 871 (7th Cir. 1976). Recovery denied: Milhollin v. Ford Motor Credit Co., 588 F.2d 753 (9th Cir. 1978), *rev'd on other grounds*, 444 U.S. 555 (1980); Mason v. General Fin. Corp., 542 F.2d 1226 (4th Cir. 1976); Hinkle v. Rock Springs Nat'l Bank, 538 F.2d 295 (10th Cir. 1976).

[108] Mirabal v. General Motors Acceptance Corp., 537 F.2d 871 (7th Cir. 1976).

[109] Brown v. Marquette Sav. and Loan Ass'n, 686 F.2d 608 (7th Cir. 1982).

[110] *See* 15 U.S.C. § 1640(D)(Supp. IV 1980).

[111] Brown v. Marquette Sav. and Loan Ass'n, 686 F.2d at 615.

[112] 12 U.S.C. § 169 (1976).

based on marital status. In *Anderson v. United Finance Co.*,[113] the court held that a creditor violated ECOA by requiring the signature of a spouse in a situation where the applicant qualified individually under the lender's standards of creditworthiness.[114] In *Miller v. American Express Co.*,[115] the court held that the American Express Company's policy of automatically cancelling supplementary credit cards upon the death of the basic cardholder violated ECOA.[116] Although American Express argued that its policy applied equally to all supplementary cardholders, whether husband, wife, daughter or son, the court found that the policy clearly violated ECOA's prohibition on marital status-based discrimination.[117] These decisions may signify a trend, at least in the Court of Appeals for the Ninth Circuit, toward more vigorous enforcement of the marital status provisions of ECOA.

The first major settlement for a violation of the Electronic Funds Transfer Act (EFTA)[118] occurred in 1982. Late in 1981 a customer of Citibank, which maintains an extensive system of automatic teller machines (ATMs) successfully sued the bank for negligently failing to warn the customer about a scam involving the machines.[119] As the customer inserted his access card into the ATM and punched in his identification number, a thief, while ostensibly operating an adjacent ATM, surreptitiously observed the transaction and learned the customer's identification number. The thief then told the customer that the bank's customer service representative advised him to try another customer's card in the "faulty" ATM. The customer agreed, after which the thief inserted the card into the ATM and returned the card to the customer. After the customer departed, the thief completed the transaction by withdrawing funds from the customer's account through use of the customer's identification code. The court found that because Citibank knew of the widespread scheme and took no

---

[113] 666 F.2d 1274 (9th Cir. 1982).

[114] *Id.* at 1226. The court relied on a provision of Regulation B that prohibited this action. *See* 12 C.F.R. § 202.7(d)(1) (1982).

[115] 688 F.2d 1235 (9th Cir. 1982).

[116] *Id.* at 1240.

[117] *Id.* The dissenting judge agreed with American Express that the policy was applied neutrally and, therefore, was not discriminatory. *Id.* at 1241-42 (Poole, J., dissenting).

[118] 15 U.S.C. §§ 1693 *et seq.* (Supp. III 1979).

[119] Ognibene v. Citibank, N.A., 112 Misc. 2d 219, 446 N.Y.S. 2d 845 (N.Y. Civ. Ct. 1981).

measures to prevent it, the bank was liable.[120] The court based its decision on EFTA, which provides that a cardholder need not bear the loss for an unauthorized transfer.[121] In late 1982, the New York Attorney General and Citibank agreed to a $500,000 settlement of a suit brought by the state official on behalf of hundreds of Citibank customers who had been victims of the same scam, the first reported settlement of its kind.[122]

---

120 *Id.*

121 *See* 15 U.S.C. § 1693a(11) (1976).

122 Am. Banker, Dec. 10, 1982, at 1, col. 1.