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Recent Developments

FDIC Reviews Deposit Insurance

On August 8, the Federal Deposit Insurance Corporation (FDIC) released an options paper concerning potential modifications to the deposit insurance system. The paper addresses various options in order to open debate on a number of proposals, including the appropriate coverage level per consumer account, the merging of the bank and savings association insurance funds, the development of more accurate risk-based premiums for deposit insurance, and the timing and format of payment into the insurance funds.

The FDIC has taken a strong stand on the need to merge the two insurance funds but has remained uncommitted to any particular viewpoint concerning the remaining issues in the options paper. The paper discusses the potential adoption of risk-based pricing, which would result in more banks paying for insurance in addition to aligning banks' risk and their payments to the fund. At present, as a result of the deposit insurance funds being above target levels and the relatively strong capitalization of most banks, over 90 percent of financial institutions pay no premium for insurance. Another potential reform regards changes to the $100,000 deposit insurance coverage limit. Possible changes discussed in the paper include linking the coverage amount to an inflation index or simply instituting a one-time nominal increase.

Banking Industry Defeats ATM Surcharge Challenge in NJ Towns

On September 19, the Woodbridge, NJ, town council voted to rescind an ordinance that banned surcharging at ATMs located within the municipality. The ordinance, which was enacted just over seven months ago, had never been enforced. This was due to an injunction against the ordinance issued by a federal judge just days after the legislation was passed. The town council acted to revoke the anti-surcharging ordinance as part of a settlement with a banking industry trade group that had filed suit over the law. In northern New Jersey, the city of Newark, which had followed Woodbridge's lead in passing anti-surcharging legislation, is also expected to abandon its ordinance. Similarly, that city's ordinance had never been enforced because of a separate injunction issued by a federal district court.

While public opinion remains high

against ATM surcharging, most local efforts to curb the practice have failed. In addition to these two cities, the state of Connecticut and municipalities in California have all waged protracted high-profile battles against ATM surcharging with very little success. The courts have consistently ruled that any decision on the permissibility of national bank surcharging lies with the Office of the Comptroller of the Currency (OCC). Over the course of several court cases, the OCC has made public its opinion that surcharging is a legal and permissible activity for national banks. Since the courts have been reluctant to permit local authorities to enforce surcharging prohibitions, it is quickly appearing that any change to this practice would require federal legislation. While states theoretically retain the authority to prohibit surcharging by state-chartered institutions, it is unlikely that a state would do so given the competitive imbalance that would occur.

SUMMARY OF FEDERAL LEGISLATION

New Legislation

1. Access to Money Act of 2000 (H.R. 4812). Introduced by Representative Andrews (D-NJ) on July 10, 2000.

Status: Referred to the Committee on Banking and Financial Services.

This bill would prohibit the owner of an automated teller machine (ATM) from imposing a fee on a consumer if the terminal carries an advertisement for which the ATM owner has received compensation. The prohibition would not apply to public service announcements or to advertisements for products and services provided by the operator or one of its affiliates.

2. Community Reinvestment Modernization Act of 2000 (H.R. 4893). Introduced by Representative Barrett (D-WI) on July 19, 2000.

Status: Referred to the Committee on Banking and Financial Services and the Committee on Commerce.

Banks, Bank Holding Companies, and Financial Holding Companies. The bill would extend the Community Reinvestment Act (CRA) to nonbank subsidiaries of bank holding companies (BHCs) and financial holding companies (FHCs) that offer bank-like products or services, such as commercial loans, deposits, consumer loans, and mortgage loans. Additionally, banks would receive separate CRA ratings for each state and metropolitan statistical area in which they maintain an office, and any community in which the bank makes more than 0.5 percent of its total loans. Regulators would be required to take these ratings into consideration when evaluating applications from banks, BHCs, and FHCs. Also, the bill would require that at least one public meeting be held regarding every application for a bank merger, BHC acquisition, or FHC acquisition.

The bill would also expand the number of rating categories from four to five by deleting the Satisfactory rating and replacing it with either High Satisfactory or Low Satisfactory. Regulators would also be required to take into account the racial characteristics of a neighborhood as well as its income level when evaluating a bank's CRA performance. In addition, regulators would be required to treat "predatory lending practices"—defined as any practice by banks, BHCs, FHCs, and their affiliates that have a negative impact on a community—as negative factors when evaluating institutions for CRA purposes.

Banks and their affiliates would be required to report their small-business and agricultural lending in the same way that Home Mortgage Disclosure Act (HMDA) data are currently reported. That is, for each loan application received, the bank would report the race and gender of the applicant; the revenue of the farm or small business; the census tract where the small business is located; and the disposition of the application (i.e., whether the application was approved).

Insurance Companies. The bill would extend the CRA to insurance companies; the Department of Housing and Urban Development (HUD) would be the evaluator. HUD would be required to evaluate insurance firms on the number and distribution of customers throughout a community along with the dollar amounts of policies belonging to these customers. The evaluation would also grade the following: 1) the extent to which the company has adopted innovative and flexible marketing methods; 2) the company's record of community development investments; 3) the company's record of opening and closing offices; and 4) the extent to which the company has provided educational and financial counseling classes in low- and moderate-income areas. The insurance companies would be rated in these areas, much like banks are currently rated. Underwriting practices that "have a negative impact on the community" would reduce the company's rating. HUD would be required to notify the insurance regulator in each state in which a company that receives an unsatisfactory rating operates. In addition, HUD would be required to execute an agreement with that company on remedial measures. If a company fails to raise its rating, HUD could limit or prohibit purchases of that company's mortgage loans by Fannie Mae or Freddie Mac.

The legislation also includes the "Insurance Disclosure Act," which contains language similar to that contained in the Home Mortgage Disclosure Act (HMDA). It would require HUD to design a method for annually collecting data on the following: 1) the availability and affordability of each line of noncommercial insurance coverage by the census tract, race, and gender of the policyholders; 2) the location of the principal place of business of insurance agents; and 3) the census tract, race, and gender of agents that have been terminated. Covered insurance lines would include automobile, residential property, and annuities. Insurance companies would also have to report, by census tract, the total number of commercial real estate loans held in their portfolios, single-family mortgages, and commercial and industrial loans. The latter categories would have to be disaggregated by application so that the race and gender of the applicant and the disposition of the application can be reported. Finally, the legislation would extend HMDA to cover mortgage insurance providers.

Securities Firms. The bill would extend the CRA to securities companies, including brokers, dealers, and investment advisors. The Securities and Exchange Commission (SEC) would enforce the new law. The SEC would be required to evaluate securities firms on the following: 1) the number and distribution of customers throughout a community; 2) the dollar amounts of investments made by those customers; 3) the extent to which the company has adopted innovative and flexible marketing methods; 4) the company's record of community development investments; 5) the company's record of opening and closing offices; and 6) the extent to which the company has provided investment education and financial counseling classes in low- and moderate-income areas. Investment practices that "have a negative impact on the community" would reduce the company's rating. The legislation would produce a system for the tracking and reporting of investment firm activities similar to the HMDA system.

Mortgage Banks. The bill would extend both CRA and HMDA to cover mortgage banks. HUD would have enforcement authority. The bill would authorize HUD to limit or prohibit the purchase of loans by Freddie Mac or Fannie Mae from any company deemed to be in noncompliance with CRA.

3. Consumer Internet Privacy Enhancement Act (S. 2928). Introduced by Senator McCain (R-AZ) on July 26, 2000.

Status: Referred to the Committee on Commerce, Science, and Transportation.

This bill would prohibit a commercial web site operator from collecting personally identifiable information from a consumer unless the operator provides the consumer with the following: 1) the identity of third parties to whom the information may be disclosed; 2) the type of information to be collected; and 3) the measures taken to prevent the use of the information by unauthorized parties. The web site operator would also be required to provide to the consumer a means to limit the use or disclosure of his or her identifiable information.

4. Municipal Deposit Insurance Protection Act of 2000 (S. 3018). Introduced by Senator Torricelli (D-NJ) on September 7, 2000.

Status: Referred to the Committee on Banking, Housing, and Urban Development.

This bill would make the deposits of local governments 100 percent insured regardless of the amount. The deposit would have to be made in a local bank. Local banks include any institution either headquartered or with a branch in the same state as the municipality.

5. Consumer Credit Score Disclosure Act of 2000 (S. 3063). Introduced by Senator Schumer (D-NY) on September 18, 2000.

Status: Referred to the Committee on Banking, Housing, and Urban Affairs.

The bill would permit an applicant for a home equity or mortgage loan to request a copy of his or her most recent credit score from a credit reporting agency. The agency would also be required to provide the applicant with an account of the key factors affecting the score. Provisions of contracts that currently prohibit such disclosures would be made void by the bill.

6. Fair Debt Collection Practices Act Amendments of 2000 (H.R. 5321). Introduced by Representative Latham (R-IA) on September 27, 2000.

Status: Referred to the Committee on Banking and Financial Services.

Debt collectors filing suit against consumers are currently required to file in the judicial jurisdiction in which the consumer currently lives or where the relevant contract was signed. In cases of real property, the action must be brought in the jurisdiction in which the property is located. This bill would clarify that a debt collector that has won such a judgment may use any court of competent jurisdiction, regardless of physical location, to enforce that judgment.

Pending Legislation

1. Medical Financial Privacy Protection Act (H.R. 4585). Introduced by Representative Leach (R-IA) on June 6, 2000.

Status: Reported from the Committee on

Banking and Financial Services on July 20, 2000. Referred to the Committee on Commerce on June 6, 2000.

This bill would require a financial institution to obtain the consent of the consumer before disclosing individually identifiable health information. Individually identifiable health information is defined as any information created or received by a health care entity that relates to the mental health, physical health, or health care of an individual and could be used to identify the individual.

The institution would need to give consumers notice of the types of information that would be disclosed. Financial institutions that obtain information about a consumer's personal spending habits by providing payment services would be barred from disclosing that information without the consumer's consent. The consumer would also have the right to review and dispute individually identifiable medical information held by a financial institution. Parties receiving disclosed information would be required to obtain the consumer's permission before disclosing the information to another party. All prohibitions also extend to aggregate lists of consumers.

Consumers would have to consent to the use of individually identifiable medical information by any financial institution deciding whether and on what terms to produce a loan or credit. The financial institution could not seek such consent from the customers of affiliates unless it also seeks consent from the customers of nonaffiliates.

2. Internet Gambling Funding Prohibition Act (H.R. 4419). Introduced by Representative Leach (R-IA) on July 20, 2000.

Status: Reported from the Committee on Banking and Financial Services on July 20, 2000. Referred to the Committee on the Judiciary on May 10, 2000. (See *Banking Legislation and Policy*, Second Quarter, 2000 for a summary of H.R. 4419 as introduced.)

SUMMARY OF FEDERAL REGULATIONS

Board of Governors of the Federal Reserve System

Financial Holding Company Activities (8/3/00)
The Board, in consultation with the Secretary of the Treasury, proposed a rule determining that acting as a finder be considered an activity that is financial in nature and, thus, permissible for a financial holding company. Acting as a finder would entail the bringing together of buyers and sellers of products or services for transactions that the buyers and sellers themselves negotiate and finalize. A finder's role is more limited than that of a broker, since a finder lacks the authority to negotiate on behalf of either party or to bind a party to the terms of a transaction. Comments were due September 5, 2000. For further information, see 65 *Federal Register*, pp. 47696-701. (Regulation Y).

Electronic Fund Transfers (7/18/00)
The Board proposed a rule codifying amendments to the Electronic Funds Transfer Act made by the Gramm-Leach-Bliley Act. The Board is proposing that financial institutions include in the initial disclosures made to consumers in connection with a contract for EFT services a statement informing the consumer that ATM operators may impose surcharges. The proposed regulation would also require ATM operators to disclose the amount of any fee that may be imposed on the consumer on the screen or on a paper printout before the consumer is locked into the transaction. ATM terminals that are not compliant would be prohibited from imposing a surcharge. Comments were due August 18, 2000. For further information, see 65 *Federal Register*, pp. 44481-4. (Regulation E).

Office of the Comptroller of the Currency

Consumer Protections (8/21/00)
The OCC, together with the Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, proposed a rule codifying consumer protection statutes related to insurance sales enacted by the Gramm-Leach-Bliley Act. The act contains several passages aimed at helping consumers navigate potentially confusing issues that may arise as depository institutions begin to engage more freely in insurance sales.

To these ends, depository institutions are required to disclose the following before the completion of the sale of an insurance product: 1) that the product is not guaranteed by the institution or an affiliate; 2) that the FDIC does not insure the product; 3) that the product may have investment risk; and 4) that the purchase of an insurance product from the institution is not a condition for receiving a loan. In most cases, these disclosures must be made both orally and in writing, and the depository institution must obtain a written confirmation from the consumer, indicating that he or she received the disclosure. The proposal also allows for electronic delivery of the disclosures if the consumer consents to such a format.

Finally, the proposed rule would place limitations on the physical location of insurance sales within a depository institution branch. In addition to physically keeping insurance activities and deposit-taking activities separate, a depository institution is required to clearly delineate and distinguish its insurance sales area from its retail deposit-taking area. Bank tellers would be permitted to refer customers to the institution's insurance sales area. However, any compensation paid to the teller for this service must be a one-time, fixed dollar amount per referral, and the fee cannot be conditioned on the customer's purchasing insurance from the institution. Comments were due October 5, 2000. For further information, see 65 *Federal Register*, pp. 50881-902.

Lending Limits (9/22/00)
The OCC proposed a rule that would create new lending limit exceptions for certain small community banks making small-business loans or residential real estate loans on one- to four-family dwellings. To be considered eligible, a bank must be well capitalized and have a rating of 1 or 2 under the Uniform Financial Institutions Rating System. The institution would also be required to have at least a 2 rating for the management component of the rating system. The exceptions would be valid only for national banks with main offices located in states where the lending limits are higher than the current federal limits. Finally, eligible banks would be required to apply to the OCC for permission to use the exceptions.

Current lending limits to individual borrowers would be increased by 10 percent of an institution's capital and surplus. The total additional loans made by an institution to an individual under this proposal would be capped at $10 million. Total loans made under the exception could not exceed 100 percent of the institution's capital and surplus. Comments must be received by November 21, 2000. For further information, see 65 *Federal Register* pp. 57292-6.

Federal Deposit Insurance Corporation

Securitized Assets (8/11/00)
The FDIC made final a rule restricting its right as conservator of failed institutions to repudiate securitization or participation agreements. The Federal Deposit Insurance Act gives the FDIC, when acting as conservator or receiver of an insured depository institution, the power to repudiate any contract that the FDIC determines to be burdensome or if repudiation would promote the orderly administration of the institution's affairs. Securitization and participation agreements entered into before the receivership or conservatorship would be exempted.

To be considered exempt, securitizations must meet all conditions for sale accounting treatment under generally accepted accounting principles. It must also be clear that the transaction was a true sale and not some form of secured borrowing done for accounting purposes. This rule became effective September 11, 2000. For further information, see 65 *Federal Register*, pp. 49189-92.

Risk-Based Capital Guidelines (9/27/00)
The FDIC, together with the Federal Reserve System, Office of the Comptroller of the Currency, and the Office of Thrift Supervision, proposed a rule addressing the capital requirements for residual interests in asset securitizations and other transfers of financial assets. The proposal would eliminate the difference in capital requirements for low-level recourse obligations and recourse obligations in which the dollar value of the residual interest exceeds the capital the bank is required to hold against the transferred assets.

For example, an institution could offer credit enhamcement of a $100 million subprime credit card loan securitization with a $15 million recourse agreement. Current capital guidelines effectively act as a cap. The institution is required to hold only $8 million in capital against the $100 million securitization. In actuality the institution retains a residual interest exposure of $15 million. Should the asset be written down from $15 million to $5 million, the $8 million in capital would be insufficient to cover the full loss of $10 million. The proposed regulation would require the institution to hold a dollar-for-dollar requirement so as to adequately reflect the institution's $15 million exposure. Regulators would retain the right to impose higher requirements on a case-by-case basis.

The proposed rule also seeks to place limits on the amount of residual interest that can be used in determining the Tier 1 capital of an institution. Current regulations include a 25 percent Tier 1 capital sublimit on nonmortgage servicing rights and purchased credit card relationships (PCCRs). The rule would include residual interest in calculating the 25 percent sublimit. Any amount of residual interest that exceeds the 25 percent sublimit would be deducted from Tier 1 capital for purposes of calculating leverage and risk-based capital ratios.

Finally, the proposal would seek to include residual interest in the aggregate limit on servicing assets. Current regulations limit the aggregate amount of mortgage servicing assets, nonmortgage servicing assets, and PCCRs to 100 percent of an institution's Tier 1 capital prior to certain deductions. An institution's residual interest value would be included in this aggregate. Comments are due December 26, 2000. For further information, see *Federal Register* pp. 57993-8011. (Regulations H and Y).

Office of Thrift Supervision

Repurchase of Stock (7/12/00)
The OTS approved an interim rule—with request for comment—that eliminates restrictions on stock repurchases by converted savings associations after the first year following the conversion from mutual to stock ownership. Prior to the interim rule, converted savings associations were not permitted to repurchase any of their outstanding stock within the first year of conversion and were allowed to purchase only 5 percent of stock in any 12-month period within the next two-year period. The rule also allows mutual holding companies to waive dividends provided they notify the OTS of their intent to do so. The interim final rule became effective July 12, 2000. Comments were due October 10, 2000. For further information, see 65 *Federal Register*, pp. 43088-91.

Securities and Exchange Commission

Fair Disclosure (8/10/00)
The SEC made final Regulation FD, which mandates public disclosure of any material information disclosed to selected individuals. The rule explicitly lists four categories of persons to whom selective disclosures can no longer be made. With a few specified exceptions, including "temporary insiders"—such as investment bankers—the rule would prohibit selective disclosure to the following: 1) broker-dealers and their associates; 2) investment advisers, institutional investment managers and associates; 3) investment companies, hedge funds and associates; and 4) any holder of the security for whom it is reasonably foreseeable that the holder would engage in trading the security on the basis of the information. Firms can still make selective disclosures to customers, reporters, and rating agencies.

The rule recognizes that some disclosures may be inadvertent. It defines a disclosure as intentional when the issuer making the disclosure knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic. In such a circumstance, simultaneous public disclosure must be made. If the disclosure was unintentional, the issuer is responsible for publicly disseminating the information as soon as is reasonably practicable—but not later than 24 hours after a senior official becomes aware of the disclosure of material nonpublic information.

Regulation FD does not apply to disclosures made during a public offering; public offerings are subject to a host of regulations under the Securities Act. This rule became effective October 23, 2000. For further information, see 65 *Federal Register*, pp. 51715-51740.

SUMMARY OF JUDICIAL DEVELOPMENTS

On July 6, 2000, the U.S. Court of Federal Claims rejected a damage claim of $175 million by Bluebonnet Savings Bank against the government. This decision (*Bluebonnet Savings Bank v. U.S.*, Fed. Cir., No. 95-532C, 7/6/00) is another in the line of cases brought against the United States by savings associations claiming damages as a result of passage of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) in 1989. FIRREA revoked many of the special forbearance agreements and treatments that purchasers of troubled savings and loans had secured from the Federal Home Loan Bank Board (FHLBB). These agreements were designed to attract new capital for thrifts that had failed during the savings and loan crisis of the 1980s.

The FHLBB had given the acquiring group several forbearances. For example, Bluebonnet was granted a forbearance that would allow it to maintain capital levels lower than those required by regulation for the next 10 years. The plan also allowed Bluebonnet to pay up to 50 percent of its retained earnings as cash dividends so long as prescribed capital levels were maintained.

What distinguishes this case from others is that the court declined to award Bluebonnet a damage award, in contrast to earlier cases following the 1996 Supreme Court decision (*U.S. v. Winstar Corp.*, 518 U.S. 839) holding the U.S. government liable for damages arising from the breach of a similar agreement between Glendale Federal Savings Bank FSB and the government. The court focused its discussion on Bluebonnet's estimated losses. The Court explained that under the expectation damage theory, plaintiffs are required to meet three standards: 1) their damages must have been reasonably foreseeable at the time the parties entered into the contract; 2) the breach must have been a substantial factor in causing their damages; and 3) they must have proven the extent of their damages with reasonable certainty.

In its opinion, the court found that at the time the agreement with Bluebonnet was signed, the FHLBB could have foreseen that a breach would cause Bluebonnet to fall out of capital compliance and ultimately result in an inability to declare dividends. The court also found that the breach resulted in an increased cost of financing the Bluebonnet acquisition. However, the court found that the plaintiffs failed to prove the amount of their damages with reasonable certainty. This is a potentially significant ruling because calculating expected losses with any degree of precision is likely to be difficult in cases such as these. As a result of the plaintiff's failure to prove the damage amount, the court ruled in the government's favor.

SUMMARY OF THIRD DISTRICT DEVELOPMENTS

New Jersey
On July 13, 2000, Governor Whitman signed into law A2179. Among other changes, the new law, Chapter 67 of Public Laws of 2000, allows a savings bank's management board to consist of as few as five members. The prior minimum membership requirement was nine managers. Chapter 67 also requires that within a de novo savings bank's first five years of operation, no less then two-thirds of the savings bank's board members be New Jersey residents. Previously, the two-thirds residency threshold was applied perpetually.

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