## Recent Developments

**No Financial Services Modernization This Year**

The Financial Services Act of 1998 (H.R. 10) has no hope of passage this year as Congress wraps up its business for the current session. The major points of contention were the community lending provisions of the bill and provisions restricting the organizational structure of financial institutions with expanded powers.

The Federal Reserve Board and the Office of the Comptroller of the Currency are at odds over which activities national banks may conduct in their operating subsidiaries. The OCC would permit nonbanking activities to be carried out in direct operating subsidiaries of the bank, while the Board believes that nonbanking activities should be conducted through separate subsidiaries of the bank's holding company. H.R. 10, in its current form, affirms the Board's view on operating subsidiaries. President Clinton has promised to veto the bill, in its current form, citing support for the OCC's position.

The Financial Services Act contains provisions that would expand the scope and reach of the Community Reinvestment Act (CRA) of 1977. Under the Financial Services Act, a bank would need satisfactory CRA ratings in order for its holding company to expand into insurance and investment banking. In addition, CRA requirements would be extended to the newly created wholesale financial institution. A few Republican senators have taken a strong stance against the CRA provisions in the act and have successfully delayed consideration of the bill.

**Department of Justice Files Antitrust Suit Against MasterCard and Visa**

On Wednesday, October 7, the United States Department of Justice (DOJ) filed suit against MasterCard International and Visa U.S.A., charging them with anticompetitive practices in violation of Section 4 of the Sherman Act.

The DOJ contends that the duality...
agreement, in which banks are permitted to belong to both credit card networks, guarantees that Visa and MasterCard do not compete with each other. The DOJ also contends that duality has kept competing brands out of the credit card market by requiring all merchants who accept either Visa or MasterCard to accept both cards and by imposing higher fees on any merchant who uses another credit card issuer’s terminal. Visa and MasterCard have also prohibited their member banks from issuing competing cards, for example, Discover or American Express.

In its own defense, Visa cited the DOJ’s prior refusal to take the position that duality was anticompetitive. In 1971, Worthen Bank sued Visa’s predecessor, BankAmericard, which had insisted that Worthen drop its MasterCard membership in order to remain in the BankAmericard network. At that time, the DOJ would not issue a letter supporting BankAmericard’s position, and the credit card network chose to settle with Worthen.

The DOJ has outlined a number of possible remedies, including requiring that banks on the governing boards of the two networks be forced to choose only one network. In addition, the DOJ has proposed that banks offering MasterCard or Visa also be permitted to join competing networks.

**Pennsylvania Bank Protection Bill Moves Closer to Passage**

On Tuesday, October 6, 1998, the Pennsylvania House of Representatives passed S.B. 1157. One of the bill’s provisions would require an acquirer to receive the state banking secretary’s approval to purchase more than 5 percent of the voting shares of any bank that has its main office in Pennsylvania.

In its original form, the bill would have imposed this requirement on potential acquirers of banks with assets in excess of $10 billion, but the new bill extends the requirement to all banks. The original bill had scattered support and was not making significant progress toward passage. Now that the bill has been combined with another bill that has substantial support, passage has become much more likely.

**SUMMARY OF FEDERAL LEGISLATION**

**Enacted Legislation**

**Credit Union Membership Access Act (H.R. 1151).** Introduced by Representative LaTourette (R-OH) on March 20, 1997.


**Credit Union Membership.** The bill would divide credit unions into several categories. Single common-bond credit unions would be limited to members who have a common bond of occupation or association (such as the same employer or club). Members of a multiple-common-bond credit union could come from more than one group with a common bond of occupation or association. Community credit union members could either live in, or join an organization in, a well-defined local community, neighborhood, or rural district.

Multiple-common-bond credit unions would be limited to 3000 members, but the bill does allow exceptions to this membership limit. If the National Credit Union Administration (NCUA) determines that a group is incapable of supporting the efficient operation of a credit union or that it cannot operate a credit union in a safe and sound manner, it would be granted membership to an existing credit union. A credit union that has a group transferred to it as a result of a merger or acquisition recommended by the NCUA Board would be exempt from the size limit. Furthermore, the 3000-member limit could be waived if the people in the group come from an underserved area.

Furthermore, a grandfather clause permits any person currently a member of a credit union, or a member of a group currently served by that credit union, to retain membership in that organization.

**Credit Union Expansion.** In general, the bill encourages the formation of separate credit unions whenever practical. However, the NCUA could permit existing credit unions to admit additional
members if the formation of a new credit union would not be consistent with safety and soundness.

The NCUA could also approve an application to expand a credit union under the following circumstances: (1) The credit union must be operating in a safe and sound manner for at least one year before the application. (2) It must be adequately capitalized. (3) It must have the administrative, financial, and human resources to serve the new membership group. (4) It must have been satisfactorily providing affordable services to all persons within the field of its current membership. (5) It cannot unduly harm an existing credit union.

The bill would also permit credit unions to convert to other types of depository institutions.

**Regulation.** All credit unions with total assets in excess of $10 million would be required to submit regular financial reports to the NCUA, and the reports must follow generally accepted accounting principles. Additionally, credit unions with total assets in excess of $500 million would be required to have annual independent audits.

The NCUA must also establish net worth and prompt corrective action regulations, similar to those for banks and thrifts.

**Other Provisions.** The bill would place a one-year freeze on new regulations pertaining to commercial lending by credit unions. The NCUA would also be required to make its examination reports available to Federal Reserve Banks.

**New Legislation**


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

This bill would amend the Federal Deposit Insurance Act by allowing each member of the Bank Insurance Fund (BIF) to be refunded all of its excess payments into the fund as long as the fund’s reserve ratio exceeds 1.5 percent. Currently, fund members cannot receive a refund in excess of the value of their semi-annual assessment for that period.


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

This bill would amend the Electronic Fund Transfer Act by making it illegal for a financial institution performing an international money transfer for a customer to use a currency exchange rate that differs by more than 5 percent from the previous day’s exchange rate in New York City as reported by the Wall Street Journal.


Status: Reported from Committee on Commerce on September 25, 1998, as H. Rept. 105-701. Discharged from Committee on Judiciary on September 25, 1998.

This bill would make it a federal crime for any person to provide false information to a financial institution to gain financial information about a customer of the institution. It would also be illegal to knowingly receive such financial information.


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

**Monetary Policy.** This bill would permit banks to be paid interest on reserves deposited at Federal Reserve Banks. The Department of the Treasury would make quarterly interest payments on these reserves at a rate that it determines.

**Improving Depository Institution Management Practices.** The bill would relax some restrictions on loans to insiders. Specifically, an executive officer of a branch would be able to receive a home equity loan of up to $100,000, although the total of all such loans to an individual could not exceed the value of the executive’s home. In addition, total loans to a single executive could not exceed 2.5 percent of the bank’s capital.

**Deposit Accounts.** The bill would permit depository institutions to pay interest on business checking accounts. It would also expand the number of monthly transactions permitted on interest-bearing accounts to 24. Some types of accounts, specifically money market depository accounts, are currently limited to six transactions a month.

**Supervision.** All federal banking agencies would be required to use “plain English” in all regulations published after January 1, 1999. The agencies would also be required to jointly develop a call report form that could be filed electronically and would be available for electronic access by the public. Financial institutions send call reports to their regulators quarterly to provide information about the institutions’ financial condition. The agencies would be required to streamline the call report and eliminate information that does not help promote safety and soundness or some other clear public purpose.

The bill would allow purchased mortgage servicing rights to be valued up...
to 100 percent of their fair market value for the purpose of calculating risk-based capital. Such servicing rights are currently counted in Tier II capital. The current maximum valuation for these assets is 90 percent of fair market value. This bill also eliminates minimum capital requirements on bank branches.

The bill would seek to conserve the confidentiality of supervisory information, such as examination reports, by stating that such information is the property of the banking agency.

**Acquisition.** National banks would be required to gain the approval of the OCC before becoming a subsidiary of a BHC. This would be in addition to any approval required by the Federal Reserve for the BHC to acquire the bank. Also, national banks would no longer be required to notify shareholders by registered or certified mail of a merger or consolidation, though notice is still required.

**Community Development.** The bill relaxes the requirements for satisfying the Housing & Community Development Act of 1974. A property would no longer need to be located in a community receiving concentrated development assistance to be counted as a community development loan. Loans made in a low- or moderate-income community or to a low- or moderate-income family would qualify.

**Truth in Lending.** The bill would ease disclosure requirements for creditors. Creditors would have the option of making the statement that periodic payments on open-ended home equity loans may substantially increase or decrease. Currently, they must print tables showing the relationship between the annual percentage rate (APR) and the minimum monthly payment for a $10,000 loan over the past 15 years. The total number of installment payments would no longer need to be specified in advertisements for home equity loans that are not open ended.

This bill also establishes guidelines for television and radio ads for consumer credit. The ad must state the APR and whether it is variable. If there is an introductory rate, the ad must disclose the rate that will go into effect after the introductory rate expires. Finally, the ad must supply a local phone number for consumers to call for more information.

**Other Provisions.** The bill would allow depository institutions that are placed into receivership to seek judicial review after 30 days of being in receivership. Deposit brokers would no longer be required to register with the FDIC.

**Real Estate Transaction Privacy Promotion Act (H.R. 4395).** Introduced by Representative Rivers (D-MI) on August 4, 1998.

Status: Referred to Committee on Banking and Financial Services.

This bill would amend the Real Estate Settlement Procedures Act of 1974 by making it illegal for a lender to insist on unlimited access to a prospective borrower’s tax return information. Prospective lenders would be allowed access only to completed information from the two tax periods immediately prior to the settlement date of the loan.


This bill would increase the uniformity of treatment of defaulting parties in derivative contracts. It would amend the Bankruptcy Code and the Federal Deposit Insurance Act to strengthen the enforceability of termination and netting provisions of derivative financial contracts. A termination agreement refers to the conditions under which one party to the contract can terminate the contract. A netting agreement is one in which two parties with multiple offsetting contractual payments agree to transfer only the net amount owed.

**Credit Card On-Time Payment Protection Act of 1998 (H.R. 4410).** Introduced by Representative LaFalce (D-NY) on August 5, 1998.

Status: Referred to Committee on Banking and Financial Services.

This bill would amend the Truth in Lending Act and make it illegal for a creditor to penalize borrowers who pay their balance before the grace period ends. Currently, some credit card companies impose fees or penalties if consumers do not carry over balances.

**Small Bank CRA Exemption Act (H.R. 4445).** Introduced by Representative Bachus (R-AL) on August 6, 1998.

Status: Referred to Committee on Banking and Financial Services.

This bill would exempt depository institutions with total assets of less than $250 million from the Community Reinvestment Act.


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

Under this bill, the private mortgage insurance cancellation provisions of the Homeowners Protection Act of 1998...
would be extended to loans classified by Fannie Mae or Freddie Mac as high risk.

**Depository Institution Merger Pledge Enforcement Act (H.R. 4420).**
Introduced by Representative LaFalce (D-NY) on August 6, 1998.

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

This bill would set forth procedures for federal banking agencies to monitor depository institutions’ or their holding companies’ compliance with commitments made as part of a merger or acquisition application. The bill would require the agencies to notify the institution if it is found to be in noncompliance with any commitment, publish in the Federal Register any finding of noncompliance, and factor the incident of noncompliance into any future decisions about other applications filed by the depository institution.

**Pending Legislation**


Status: Senate passed H.R. 3150 in lieu of this bill on September 23, 1998. See Recent Developments. [See Banking Legislation and Policy, Second Quarter 1998, for a summary of the consumer bankruptcy provisions of S.1301.]


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**SUMMARY OF FEDERAL REGULATIONS**

**Board of Governors of the Federal Reserve System**

*Membership Requirements (7/13)*

Issued a final rule modifying current procedures for membership in the Federal Reserve System. The rule eliminates the requirement that banks publish a notice of membership application. In addition, the rule establishes expedited procedures for membership, so that applications will now be acted on within 15 days of the receipt of the application. The Board is eliminating pre-membership examination guidelines and instead will look at each application on an individual basis.

The rule reduces the public comment period for branch applications from 30 to 15 days, although the Board reserved the right to extend this period for an additional 15 days. Branch applications will now be considered approved within five business days after the close of the public comment period, unless the bank is notified that earlier approval has been granted or that it is ineligible for expedited review. Member banks that have received prior approval of a consolidated application for branches need only give notice to the Reserve Bank within 30 days of the actual opening of one of the branches. An insured state member bank that is closing any branch must notify both its customers and the Board.

Banks with CAMEL ratings of 1 or 2 can invest in their premises an amount up to 150 percent of their perpetual preferred stock, common stock, and related surpluses without giving the Board notice. A well-rated and well-capitalized bank wishing to invest more than 150 percent needs to give the Board 15 days prior notice.

In addition, the rule allows banks to vote the shares of stock in which they are acting as fiduciary. The Board will also have the option of using period-end total assets as opposed to average total assets for defining total assets. This rule became effective October 1, 1998. For further information, see 63 Federal Register p. 37665. (Regulation P)

**Security Procedures (7/13)**

Issued a final rule eliminating Regulation P, which established security procedures to discourage robberies for state-chartered member banks. These requirements are currently incorporated in Regulation H. This rule became effective October 1, 1998. For further information, see 63 Federal Register p. 37630-59. (Regulation H)

**Federal Reserve Bank Stock (7/13)**

Issued a final rule regarding the procedures for issuing, modifying and canceling Federal Reserve Bank Capital Stock (FRBCS). Currently, de novo state member banks receive their shares when all requirements for membership have been met. The rule clarifies that even after all requirements have been met, FRBCS will be issued as of the date the de novo bank opens for business. This will bring the Fed's FRBCS policy for the state member banks in line with that for national member banks.

To simplify and unify regulations for member banks that are no longer operating, the Board has declared that all such banks shall promptly file for cancellation of Reserve Bank stock; thus, the timing of the cancellation will no longer depend on the reason for the bank’s closing.
Continuing current practice for domestic involving electronic fund transfers.

Issued a final rule that reduced the time available to financial institutions to investigate situations of alleged fraud. The institution must resolve the claim no later than 45 calendar days after receipt of the original notice. For point-of-sale (POS) or foreign-initiated transactions, the institution has 90 calendar days to complete the full investigation, but the bank now has 10 days to settle the claim or offer provisional credit, rather than 20 days. For new accounts, the institution must extend provisional credit after 20 business days, rather than the previous 10 business days, if the claim has not been resolved. The institution retains the 90-calendar-day period to complete a full investigation. This rule became effective September 24, 1998. For further information, see 63 Federal Register, pp. 37659-65. (Regulation I)

**Truth in Savings (9/29)**
Issued a final rule to modify the Loan Application Register (LAR) and instructions to prepare for Year 2000 data systems. Dates will now be reported as MM/DD/CCYY. Furthermore, institutions are no longer required to submit the name and address of their parent company.

**Federal Deposit Insurance Corporation**

**Deposit Insurance (7/17)**
Proposed a rule that would amend current deposit insurance regulations. The FDIC has proposed to eliminate step one of the two-step joint-account coverage process. The effect of this amendment is to ensure equal treatment of all depositors, whether their savings are held in individual or joint accounts. In the case of a joint account owned by two persons, for instance, the maximum coverage would increase from $100,000 to $200,000.

The amendment would also add siblings and parents to the list of qualifying beneficiaries. Currently, spouses and children are the only eligible beneficiaries. Payable-on-death accounts are insured according to the number of qualified beneficiaries. The inclusion of parents and siblings in this group will eliminate confusion without abandoning the principle that insurance is based on a “per qualifying beneficiary” basis. Comments were due on October 15, 1998. For further information, see 63 Federal Register, pp. 38521-4.

**Risk-Based Capital (9/1)**
Together with the Federal Reserve Board and Office of Thrift Supervision, issued a final rule with regard to valuation of held equity securities. Depository institutions would be able to include up to 45 percent...
of the pretax net unrealized holding gains on available-for-sale equity securities in Tier 2 capital. This would bring the agencies’ treatment in line with the Basle Accord. This rule became final on October 1, 1998. For further information, see 63 Federal Register pp. 46517-24.

Office of the Comptroller of the Currency

Risk-Based Capital Guidelines (8/10)
Together with the Federal Deposit Insurance Corporation and the Office of Thrift Supervision, issued a final rule that would count 90 percent of the fair value of all servicing assets (i.e., mortgage and nonmortgage) and purchased credit card relationships (PCCR) toward capital. The total amount of all servicing assets and PCCRs included in capital cannot be more than the depository institution’s Tier 1 capital. In addition, the total amount of nonmortgage servicing assets and PCCRs cannot exceed 25 percent of Tier 1 capital. Furthermore, all other intangible assets (i.e., goodwill) must be deducted from Tier 1 capital. This rule became effective October 1, 1998. For further information, see 63 Federal Register pp. 42668-79. (Regulation H and Y)

Management Interlocks (8/11)
Together with the Federal Reserve Board, Office of Thrift Supervision, and the Federal Deposit Insurance Corporation, proposed rules that revise the regulations regarding management interlocks. A management official of a depository organization with assets exceeding $2.5 billion dollars is not allowed to serve as a management official of any depository organization whose total assets exceed $1.5 billion. The thresholds would be periodically adjusted.

For smaller banks in the same market, the agencies would have the authority to exempt an institution from restrictions on management interlocks if any of the following four situations exist: 1) The depository organization primarily serves low or moderate-income areas. 2) The depository organization is controlled or managed by members of a minority group or women. 3) The depository institution has been chartered for less than two years. 4) The depository organization is deemed to be in “troubled condition.”

The proposal would also exempt institutions that on a combined basis would control less than 20 percent of the deposits in a community or relevant MSA. Comments were due on October 13, 1998. For further information, see 63 Federal Register, pp. 43052-8. (Regulation L)

Examinations (8/28)
Together with the Federal Deposit Insurance Corporation and the Federal Reserve Board, issued an interim rule that makes U.S. branches and agencies of foreign banks eligible for an 18-month examination schedule, instead of the current 12-month schedule. The branch or agency would have to meet several eligibility requirements. It must have total assets of less than $250 million, have received a composite ROCA (Risk management, Operational controls, Compliance, Asset quality) supervisory rating of 1 or 2 at its most recent examination, not be subject to formal enforcement action, and not have experienced a change in control during the preceding 12-month period. The branch or agency must also meet specified minimum capital adequacy provisions.

The banking agencies would reserve the right to examine a U.S. branch or agency of a foreign bank as frequently as deemed necessary. This interim rule became effective August 28, 1998. Comments were due on October 27, 1998. For further information, see 63 Federal Register pp. 46118-22. (Regulation K)

Office of Thrift Supervision

Electronic Operations (8/13)
Gave supplemental notice of a proposed rule to require every savings association to notify the OTS before the association establishes a transactional web site, and to require compliance with any additional requirements that the regional OTS office imposes as a direct result of the web site. The OTS is also proposing that savings associations report the types of transactions carried out on these web sites. Transactional web sites are Internet sites where financial transactions, such as accessing an account, obtaining an account balance, transferring funds, processing bill payments, opening an account, applying for or obtaining a loan, or purchasing other products or services, take place. Comments were due on September 14, 1998. For further information, see Federal Register pp. 43327-30.

Directors and Executive Officers (8/31)
Issued a final rule stating that certain savings associations must give the OTS at least 30 days notice before making changes in top management. This rule generally applies to savings associations that do not comply with all specified minimum capital requirements or are in troubled condition. Savings and loan holding companies in troubled condition must also give notice. This rule became effective on September 25, 1998. For further information, see 63 Federal Register pp. 51272-5.
SUMMARY OF JUDICIAL DEVELOPMENTS

On July 23, 1998, the Court of Appeals for the Federal Circuit (Court) overturned a lower court ruling that Signature Financial Group could not patent a financial product. In this case, State Street Bank & Trust Co. v Signature Financial Group, Inc. (U.S. FedCir No. 96-1327), the Court ruled on State Street’s contention that Signature’s patented Hub and Spoke mutual fund administration system was unenforceable because it was a “business method.” This ruling was consistent with existing precedent.

However, the Appeals Court found that the District Court of Massachusetts ruled in error when it found for State Street under the business method exception. The Court ruled that as a result of the 1952 Patent Act “… business methods have been, and should have been subject to the same legal requirements for patentability as applied to any other process or method.” The effects of this ruling could be very far reaching because financial products have not traditionally received patent protection.

SUMMARY OF THIRD DISTRICT DEVELOPMENTS

New Jersey

On September 14, 1998, Assemblymen Christopher Bateman (R) and Neil Cohen (D) introduced A2393. The bill would simplify certain banking procedures. Among other provisions, it redefines automatic teller machines to be consistent with the definition of ATMs in federal laws, allows banks to insure land titles, and simplifies rules regarding the appointment of bank officers.