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SAVINGS ASSOCIATIONS AND THE NEW DEPOSITORY INSTITUTIONS Deregulation and Monetary Control Act

ROBERT W. BARTLETT*

On March 31, 1980, President Carter signed the Depository Institutions Deregulation and Monetary Control Act of 1980, one of the most significant pieces of financial legislation to pass the Congress since the 1930's. The legislation restructures the competitive relationship between financial institutions, and effects changes which may result in higher interest rates received by savers and paid by borrowers.

More specifically, the statute calls for a phase-out of savings rate control over a period of six years, provides broader investment, lending, and consumer services powers for thrift institutions, including the functional equivalent of an interest-bearing checking account (the so-called NOW account), imposes reserve requirements for thrift institutions similar to those required for Federal Reserve System members, preempts under certain conditions state usury laws, and establishes new rules governing Truth-in-Lending.

The following is intended to be a general overview of the major provisions of the new act insofar as they affect savings associations.

I. Phase-Out of Rate Control

The most controversial part of the legislation is its call for a gradual, orderly phase-out of savings rate control over a six-year period, with such control completely abolished as of March 31, 1986.

Interest rate controls fixing the maximum amount of interest which could be paid on deposits by financial institutions were first imposed in 1966 and had been extended eleven times since that date.

The current statutory basis for rate control was last extended to December 15, 1980. The new law extends the statute for a six-year period, repealing it effective March 31, 1986 and mandates a gradual phase-out of rate control over that six-year period. A new rate setting authority is created, the Depository Institutions Deregulation Committee (DIDC). This Committee succeeds to the rate-setting powers conferred on the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Federal

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Home Loan Bank Board (FHLBB), and the National Credit Union Administration Board.

In order to meet the goal of providing such an orderly phase-out, the Committee is directed not to “increase such limitations above market rates during the six-year period beginning on the date of enactment of this title.” In addition, the statute calls for each member of the Committee to report to the Congress annually the following information:

1. an assessment of whether the removal of any differential between the rates payable on deposits and accounts by banks and those payable by thrift institutions will adversely affect the housing finance market or the viability of the thrift industry;

2. recommendations for measures which would encourage savings, provide for the equitable treatment of small savers, and ensure a steady and adequate flow of funds to thrift institutions and the housing market;

3. findings concerning disintermediation of savings deposits from insured banks and insured thrift institutions to uninsured money market innovators paying market rates to savers; and

4. recommendations for such legislative and administrative actions as the member involved considers necessary to maintain the economic viability of depository institutions.

As explained in the Conference Committee Report, this is in accordance with the concern of that Committee that “the phase-out must be handled with due regard for the financial viability of depository institutions.”

Specific target dates are set, including a targeted increase of one-quarter percentage point in the permissible passbook rate within eighteen months after enactment. The legislation provides for additional targeted increases of 1/2 percent on all classes of accounts within the third, fourth, fifth and sixth years after enactment.

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5 Id. § 206, 94 Stat. 143-44.
7 Pub. L. No. 96-221, title II, § 205(a), 94 Stat. 143 (1980). Rates higher or lower than the targets may be set “consistent with the purposes of this Title.” Id. § 205(b). Presumably, this would include concern for orderly phase-out, implementation of corresponding, additional powers for savings associations and concern for the economic viability of savings associations. This is reflected in the Senate Banking, Housing, and Urban Affairs Committee's amending H.R. 4986 to embody the recommendations of the President's Interagency Task Force. The President had asked Congress to:

1. Phaseout regulation Q during a transition period during which all deposit interest rate ceilings would be permitted to rise in an orderly manner with regulatory flexibility to delay increases if economic conditions warranted or the safety and soundness of depository institutions was threatened;

2. Provide variable rate mortgage authority to Federal savings and loan associations to improve earnings and the ability to pay depositors market rates;

3. Permit Federal savings and loan associations to invest up to 10 percent of their
Much to the surprise of the thrift industry and despite the cautionary language in both the statute and the legislative history, the Depository Institutions Deregulation Committee set new ceilings for the 26-week money market certificates just eight weeks after the Committee was established and without any prior notice.\(^8\) The new ceilings, which in all cases are at least one-quarter of one percent higher than the rate established for the 26-week Treasury bills, eliminate any differential between banks and thrift institutions for the 26-week certificates when the Treasury bill discount rate is 7.25 percent or below, and when the rate is 8.75 percent or above. The new rate structure for the money market certificates is as follows:\(^9\)

<table>
<thead>
<tr>
<th>Bill rate</th>
<th>Commercial bank ceiling</th>
<th>Thrift ceiling</th>
<th>Differential</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.75 and above</td>
<td>Bill rate + 25 basis points.</td>
<td>Bill rate + 25 basis points.</td>
<td>0</td>
</tr>
<tr>
<td>8.50 but less than 8.75</td>
<td>Bill rate + 25 basis points.</td>
<td>9.00</td>
<td></td>
</tr>
<tr>
<td>7.50 but less than 8.50</td>
<td>Bill rate + 25 basis points.</td>
<td>Bill rate + 50 basis points.</td>
<td>25 basis points.</td>
</tr>
<tr>
<td>7.25 but less than 7.50</td>
<td>7.75</td>
<td>Bill rate + 50 basis points.</td>
<td>25 basis points to 0.</td>
</tr>
<tr>
<td>Below 7.25</td>
<td>7.75</td>
<td>7.75</td>
<td></td>
</tr>
</tbody>
</table>

New ceilings were also set for the savings associations’ 30-month small saver certificates (SSCs). The new ceiling is the higher of the average 2¹/₂-year yield for United States Treasury securities or 9.50 percent. The existing “cap” of 12.00 percent was retained.\(^10\) The ceiling rate for commercial banks is now the higher of one-quarter of one percent below the average 2¹/₂-year yield for United States Treasury securities or 9.25 percent. The existing “cap” of 11.75 percent was retained.\(^11\) Thus, savings associations and the banks will be able to pay ceiling rates of 9.50 percent and 9.25 percent respectively, even where the Treasury bill rates fall below those yields.

This action of the DIDC is being challenged in federal court by the United States League of Savings Associations.\(^12\) The suit alleges that the regulation is invalid because: (1) there was no opportunity for notice and comment as required by the Administrative Procedures Act;\(^13\) (2) no annual report was presented regarding its effect on financial institutions; assets in consumer loans; and

(4) Permit all insured depository institutions, including savings and loan associations, to offer interest bearing transaction (or checking accounts) to individuals.

\(^8\) The “final” rule was adopted on May 28, to be effective June 2, but was not published in the Federal Register until June 5, 1980. 45 Fed. Reg. 37,803-04 (1980) (to be codified in 12 C.F.R. § 1204.104).
\(^10\) Id. at 37,804-05 (to be codified in 12 C.F.R. § 1204.106(b)).
\(^11\) Id. at 37,804 (to be codified in 12 C.F.R. § 1204.106(a)).
\(^12\) United States League of Savings Ass'ns v. Depository Institutions Deregulation Comm., No. 80-1486 (D. D.C., filed June 16, 1980).
(3) the statutory scheme for an orderly phase-out was ignored; (4) rates were set above the market rate; and, (5) the phase-out of Regulation Q was begun before thrift institutions were given new corresponding powers contemplated by Congress, such as NOW accounts. In the alternative, the suit seeks to have the statute declared unconstitutional.

In October of 1980, the DIDC also changed the giveaway regulations. The Committee made the following rules, to be effective December 31, 1980, concerning premiums, finders fees and prepayment of interest with respect to deposits subject to interest rate ceilings:

(a) Premiums, whether in the form of merchandise, credit, or cash, given by a depository institution to a depositor will be regarded as an advertising or promotional expense rather than a payment of interest if:

(1) the premium is given to a depositor only at the time of the opening of a new account or an addition to, or renewal of, an existing account;

(2) no more than two premiums per account are given within a 12-month period; and

(3) The value of the premium, or, in the case of articles of merchandise, the total cost . . . does not exceed $10 for deposits of less than $5,000 or $20 for deposits of $5,000 or more.14

The cost of merchandise must be certified by an executive officer of the institution and must include shipping, packaging and handling expenses. Averaging of the prices of various premiums will not be permitted. The rule as to finders fees is as follows:

Any fee paid by a depository institution to a person who introduces a depositor to the institution must be paid in cash when paid for deposits subject to interest rate ceilings, and will be regarded as a payment of interest to the depositor for purposes of determining compliance with interest rate ceilings, except that a depository institution may pay bonuses in cash or merchandise to its employees for participating in an account drive, contest, or other incentive plan, provided such bonuses are tied to the total amount of deposits solicited and are not tied to specific, individual deposits.15

II. PREEMPTION OF STATE USURY LAW

Regardless of the outcome of the United States League suit, one thing is clear: under the new statute, savings rates will eventually be governed by the marketplace rather than by government-imposed limits.

15 Id. at 68,643-44 (12 C.F.R. § 1204.110). However, those institutions which already offered finders fees were allowed to phase out their programs over an eighteen month period to end on June 30, 1982. They are not permitted to externally advertise their programs during the phaseout period.
It is only reasonable that, in the interests of symmetry and the basic soundness of financial institutions, government restrictions on loan interest rates would also be removed. This is particularly true with respect to state-imposed limits on home loans which tend to be much lower than rates imposed on other types of loans. Indeed, in the past such limits were often so much below the market rate that financial institutions simply could not afford to make home loans in their own state. Funds were thus diverted to states which had less restrictive loan limits.10

Public Law 96-221 attempts to solve this problem by preempting, under certain conditions, state usury laws. Effective April 1, 1980, all state laws which limit “the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved” are preempted as to any loan which is secured by a first lien on residential real property, condominium stock, or a mobile home and made after March 31, 1980.17 Preempted also are state usury ceilings on business and agriculture loans of $1,000 or more for a period of three years.18 Such loans are subject to a new ceiling rate of five percentage points above the discount rate including any surcharges thereon on ninety day commercial paper.

Finally, there is a general override with respect to any loan made by insured banks, commercial savings banks, mutual savings banks, savings associations and credit unions. A new rate is established equal to one

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10 When Usury Laws Backfire Against Borrowers, BUSINESS WEEK, August 17, 1974.

17 Pub. L. No. 96-221, title V, § 501(a)(1), 94 Stat. 161 (1980). Such laws had been preempted for loans made before March 31,1980 but on or after December 29, 1979 under a temporary usury override, Pub. L. No. 96-161, 93 Stat. 1233 (1979) which expired on March 31, 1980. While the residential loan preemption is self-executing, it has been implemented by Board regulation. Residential real property includes both single and multiple family dwellings, with no owner-occupancy requirement. Since residential real property is defined under new Regulation 590.2(f) as real estate “improved or to be improved by a structure... designed primarily for dwelling,” (45 Fed. Reg. 24114 (1980)) the preemption appears to apply to loans to acquire raw land with the intention to build residences on it. See Opinion of General Counsel FHLBB, June 2, 1980. Under proposed FHLBB regulations, wraparound mortgages on residential real estate would also be considered to be secured by a first lien and thus covered by the mortgage usury preemption. 45 Fed. Reg. 86,500 (1980). The fact that the residential usury law preemption applies only to first liens will also have the practical effect in many states of inhibiting federal savings and loans from implementing their new authority to make home loans secured other than by a first lien. Usury laws applicable to mobile homes were not to be preempted until and unless the FHLBB issued regulations including certain consumer safeguards. Those regulations were issued April 3, 1980. 45 Fed. Reg. 24,112-15 (1980) (to be codified at 12 C.F.R. § 590.4).

18 Pub. L. No. 96-221, title V, §§ 511-512, 94 Stat. 164 (1980). Originally, the exemption was limited to loans of $25,000 or more. The Housing and Community Development Act of 1980, Pub. L. 96-399, 94 Stat. 1614, lowered the amount to $1,000. Such loans had been exempted under the Act of Oct. 29, 1974, Pub. L. 93-501, 88 Stat. 1557, which expired July 1, 1977. In determining whether a loan is a business or agricultural loan under the preemption statutes, at least one court has held that “a lender should be able to rely on the sworn statement of a borrower as to his intended use of the loan proceeds...” Briggs v. Capital Savings & Loan Ass'n, 597 S.W.2d 600, 603 (Ark. 1980).
percent above the discount rate or the maximum rate applicable in the jurisdiction in which the institution is located.  

The residential loan preemption is absolute, that is, no new rate is established, while the business and agriculture loan exemption and the general loan exemption establish a new federal usury limit which would apply unless, of course, the state limit is higher. The agriculture and business loan exemption is only for a three year term, while the residential mortgage loan exemption and the "general" loan exemption are permanent unless the state adopts a law on or after April 1, 1980 and before April 1, 1983 stating explicitly and by its terms that such state does not want the provisions of the federal preemption to apply with respect to loans made in the state. Thus, it is possible that a financial institution in any given state may find that while it must pay the market rate on savings, it cannot obtain a market rate for loans if the state votes to override the federal preemption statute.

Generally, the alternate usury ceiling provided for "all loans" made by insured financial institutions of one percent above the federal discount rate will not provide much relief. However, that statute also allows the institution to charge the highest rate allowed by the laws of the state in which the institution is located. This "most favored lender" provision already existed with respect to national banks in section 85 of the National Bank Act. In construing that section, the courts have consistently held that national banks are permitted to charge interest rates up to the highest rate allowed for particular types of loans to any type of lender in the state, regardless of whether or not the applicable state statute expressly includes such banks in the class of lenders receiving such favorable treatment. The holdings of these cases are codified in an interpretive ruling of the Comptroller of the Currency.

While some have believed that this "most favored lender" status of national banks results from a combination of two of the three separate override provisions in section 85 (one of which is not contained in section 522 of Public Law 96-221), the more persuasive case law supports the interpretation that the most favored lender status of national banks can rest solely on the "allowance clause" of section 85 which is virtually identical to the "allowance clause" in section 522.

In view of these circumstances, it is believed that most courts would

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be inclined to interpret the "allowance clause" of section 522 as section 85 has been interpreted for national banks, i.e., as permitting insured savings and loan associations to charge the highest rate allowed to any class of lenders for particular transactions in the state. Thus, under such an interpretation, an association could make any loan at the same rate which is permitted for, say, small loan companies in that state.

The penalty for violating the new federal usury law ceilings is the forfeiture of the entire interest, or if the interest has already been paid, an amount equal to twice the interest. However, this penalty only applies when interest in excess of the amount allowed is taken "knowingly."\(^{23}\)

The residential mortgage loan exemption is the most favorable to financial institutions since there is no alternate federal ceiling established. For the most part this preemption is fairly straightforward, but there still remains considerable doubt whether state laws which restrict various kinds of charges would be preempted. The statute on its face would appear to preempt all such charges, for it includes "discount points, finance charges or other charges."\(^{24}\) It seems that Congress intended a narrower construction, however. The Senate Committee Report states:

> In exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers.\(^{25}\)

This language is repeated in the FHLBB's implementing regulations.\(^{26}\) State laws restricting the right of state-chartered associations to exercise due-on-sale clauses would also appear to be not preempted, although limiting the amount of interest or fees which can be charged upon assumptions does appear to be covered by the federal preemption statute.\(^{27}\) In this regard, however, it should be recalled that federal associations are already exempt from state law limiting the amount of prepayment or late charges under such cases as *Meyers v. Beverly Hills Federal Savings & Loan Association*\(^{28}\) and *Conference of Federal Savings & Loan Associations v. Stein*,\(^{29}\) since they are subject only to the federal regulations governing such charges.\(^{30}\) It should also be noted that while states only have three years in which

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\(^{24}\) See text *supra* at note 17.


\(^{26}\) 45 Fed. Reg. 24,114 (1980) (to be codified at 12 C.F.R. § 590.3 (c)).

\(^{27}\) See Opinions of General Counsel FHLBB April 11, 1980 and March 27, 1980.

\(^{28}\) 499 F.2d 1145 (9th Cir. 1974).

\(^{29}\) 604 F.2d 1256 (9th Cir. 1979).

\(^{30}\) See Opinion of General Counsel FHLBB, March 11, 1980.
to override federal usury law with respect to the amount of interest that can be charged on a residential loan, the state at anytime may vote to override the law insofar as it applies to points and other charges.\textsuperscript{81}

In any event, commitments entered into prior to the date the state takes such action will still be exempt from the usury laws. In addition, any interest rate increase pursuant to a provision in the mortgage document or loan note that provides that the interest rate to the original borrower could be changed through the use of a rollover provision will still come within the usury exemption if the original loan was made or committed to be made prior to the date the state took action.\textsuperscript{82}

An assumption of the loan where the interest rate is changed would be treated as a new loan. Therefore, if a loan made during the preemption period was then assumed subsequent to a state repeal of the preemption, the new interest rate would not be covered. Conversely, a loan made prior to the effective date of the preemption statutes which was later assumed while the statutes were still in effect would come within the preemption, as long as the interest rate was changed.\textsuperscript{83} Counsel to associations would be well advised to make sure their associations are making binding commitments for loans particularly if their state is one which is able to repeal the federal preemption.

III. New Powers for Federal Associations

A. NOW Accounts

Part of the rationale for the phase-out of rate control was the corresponding new powers given to thrift institutions, perhaps the most significant being the authority to offer NOW accounts nationwide, effective December 31, 1980.\textsuperscript{84} The reader is directed to the other articles in this symposium for a detailed explanation of the legal ramifications of this new power.

B. Credit Card—Trust Powers

NOW account and related line of credit authority is only one of the new powers conferred on federal associations by Public Law 96-221. The power “to issue credit cards, extend credit in connection therewith, and otherwise engage in or participate in credit card operations” is also granted, subject to FHLBB regulations.\textsuperscript{85} Such authority was implemented by the Board effective July 10, 1980. The regulations simply repeat the statutory authorization and impose no restrictions.\textsuperscript{86}


\textsuperscript{82} 45 Fed. Reg. 24,114 (1980) (to be codified at 12 C.F.R. § 590.3(b)).

\textsuperscript{83} Opinion of General Counsel FHLBB, March 27, 1980.


\textsuperscript{85} Pub. L. No. 96-221, title IV, § 402, 94 Stat. 155-56 (amending 12 U.S.C. § 1464(b)).

\textsuperscript{86} 45 Fed. Reg. 46,339 (1980) (to be codified at 12 C.F.R. § 545.4-3). Federals already had limited authority to offer credit cards prior to the enactment of the statute. See FHLBB Memorandum R-43, April 19, 1978.
The FHLBB is also "empowered to grant to federal associations, by special permit . . . , the right to act as trustee, executor, administrator, guardian, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with [federal] associations are permitted to act under the laws of the State in which the association is located." Investments in service corporations which are engaged in trust activities are also permitted.37

On November 26, 1980 the FHLBB implemented its new trust authority with regulations effective January 1, 1981.38 Generally, the regulations follow very closely those issued by the Comptroller of the Currency40 and grant to federal associations and their service corporations the ability to offer the same kinds of trust and other corporate fiduciary services which state-chartered banks, trust companies, and other corporations in the state may offer. A special permit must first be obtained from the local supervisory agent whether the trust powers are to be exercised by the federal association or its service corporation. Of particular interest to association counsel is that the Board, in passing upon an application for a permit, will consider "whether the association has available legal counsel to advise and pass upon fiduciary matters wherever necessary."41

While state-chartered associations must look to their own state law to determine what their trust powers are, an FHLBB policy statement "urged" insured state-chartered associations to follow the federal standards, particularly the self-dealing prohibitions.42 Generally, the investment of trust funds must be made in "accordance with the instrument establishing the fiduciary relationship and local law."43 In addition, the

38 Id. This legislation in effect moots National State Bank of Elizabeth, New Jersey v. Smith, 591 F.2d 223 (3rd Cir. 1979) dealing with the question of whether a federal savings association's service corporation could acquire an interest in a national banking association which engaged in strictly trust services.
41 45 Fed. Reg. 82,165-66 (1980) (to be codified at 12 C.F.R. § 550.2). The other criteria are:
(1) The financial condition of the association, provided that in no event shall trust powers be granted to an association if its financial condition is such that the association does not meet the financial standards required by state laws of state-chartered corporate fiduciaries;
(2) the needs of the community for fiduciary services and the probable volume of such fiduciary business available to the association;
(3) the general character and ability of the management of the association;
(4) the nature of the supervision to be given to the fiduciary activities, including the qualifications, experience and character of the proposed officer or officers of the trust department . . . .
43 Id. at 82,166 (1980) (to be codified at 12 C.F.R. § 550.9(a)).
FHLBB regulations specifically require detailed recordkeeping, segregation of funds, a yearly independent audit and written policies and procedures which specifically prohibit the use of insider information. The sale or transfer of trust assets to the association or its directors, officers or employees is also prohibited unless specifically authorized by law.

Primary responsibility for the proper exercise of the fiduciary powers is vested in the board of directors. The board or its designee must approve each account, review trust assets at least once every fifteen months and review all actions of officers, employees and committees utilized by the association in the exercise of its powers. No officer or employee may obtain compensation for acting as co-fiduciary with the association, or accept a gift or bequest of trust assets (other than from a relative) without board approval.

C. Expanded Investment Powers

Federal associations are given national bank-type real estate lending powers, including elimination of the first lien requirement for loans on residential real estate, elimination of any dollar limitations on the ability to make loans on residential property and elimination of geographic restrictions on the making or buying of loans.

Also included is broader investment authority including: (1) a new “twenty percent of assets” investment authority for corporate debt securities, commercial paper, and consumer loans; (2) an expanded service corporation investment authority of from one percent to three percent; and (3) a mutual fund investment authority (provided that the fund invests only in assets that the federal association could invest in itself without limitation as to percentage of assets). This would include such investments as treasury and government agency securities, bankers’ acceptances, commercial bank certificates of deposit, and residential property and home improvement loans.

1. Real Estate

In regulations that became effective November 17, 1980, the Board

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44 Id. at 82,165 (12 C.F.R. § 550.6).
45 Id. (12 C.F.R. § 550.7).
46 Id. at 82,166 (12 C.F.R. § 550.11).
47 Id. at 82,165 (12 C.F.R. § 550.5(c)).
48 Id. at 82,166 (12 C.F.R. § 550.10(b)).
49 Id. at 82,165 (12 C.F.R. § 550.5(a)(1)).
50 Id. at 82,167 (12 C.F.R. § 550.12(b)).
52 Id. 94 Stat. 153 (12 U.S.C. § 1464(c)(2)).
53 Id. 94 Stat. 154 (12 U.S.C. § 1464(c)(4)(B)).
54 Id. 94 Stat. 153 (12 U.S.C. § 1464(c)(1)(Q)).
fully implemented this new real estate lending authority. Under the new regulations, federal associations may now buy and sell mortgages "primarily secured" (eliminating the first-lien requirement) by residential real estate without regard to any geographic limitations, percentage of asset limitations, local eligible servicers' requirements, or scheduled item limitations. In short, if they are able to make the loan, they are able to buy the loan under the same terms and conditions. The only exceptions are the without recourse requirement and appraisal requirement. However, the Board, in its preamble to these changes did state that it will "continue to evaluate associations' efforts under the Community Reinvestment Act in satisfying the continuing and affirmative obligation to help meet the credit needs of their local communities, including low- and moderate-income neighborhoods." This would not preclude associations, however, from investing outside their area for economic reasons, such as an unrealistic usury rate which prevents them from getting market rates on their loans, or as a means of diversifying loan portfolios. While state-chartered associations continue to be bound by their own state law, the Federal Savings and Loan Insurance Corporation (FSLIC) restrictions on the nationwide buying and selling of real estate loans and participation interests therein have been removed, except for the two exceptions noted above.

The new regulations now make the ninety percent loan the "standard" loan for federal associations, rather than the old eighty percent loan. Thus the certification of intent to occupy requirement and the tax and insurance escrow requirement now must come into play only where the loan exceeds ninety percent. Private mortgage insurance is still required on over ninety percent loans and need not be retained once the principal amount of the loan is reduced to ninety percent. There are no percentage of asset limitations with respect to any residential loan, including apartment loans and home improve-

56 Investment in mobile home paper secured by property outside the normal lending territory is still subject to the requirements that the seller retain twenty-five percent, that the seller be an insured institution, and that an association may not sell mobile home paper if its scheduled items are in excess of five percent of its total portfolio in such paper. However, the requirement that the seller service the loans and the geographic area prohibitions have been removed. 45 Fed. Reg. 76,102 (1980) (to be codified at 12 C.F.R. § 545.7-6). Of course, to the extent that the underlying loans are subject to the percentage of asset requirements, then the ability to invest nationwide in those loans would come within the same percentage of asset restrictions, for example, the twenty percent commercial loan restriction, the twenty percent consumer loan restriction and the twenty percent mobile home restriction.
57 45 Fed. Reg. 76,099 (1980) (to be codified at 12 C.F.R. § 545.6(b)).
58 Id. at 76,098.
59 Id. at 76,099 (12 C.F.R. § 545.6(c)).
60 Id. (12 C.F.R. § 545.6-2). The amount in excess of eighty percent must still be covered.
61 A federal association making variable rate loans may not have more than fifty percent of its portfolio in such loans. Furthermore, a home improvement loan could be categorized as a consumer loan and, thus, be subject to the twenty percent of asset limitation. Mobile home loans are also subject to a twenty percent of asset limitation. Id. at 76,102 (12
ment loans, and the previous statutory dollar restrictions on home loans is removed. However, the "loan to one borrower" limitations for all insured associations still apply. The new regulations raise the limitations for new insured institutions from $100,000 to $200,000 and provide for annual adjustment to reflect an increase in the consumer price index. The Board also took the occasion to increase the maximum loan term from thirty to forty years on home loans and to thirty years on multifamily or apartment loans. Commercial real estate loans may now be made up to ninety percent of the value of the security property for a thirty year term. However, these commercial loans may only be made up to twenty percent of the association's assets and, unlike residential loans, must be secured by a first lien.

The FHLBB also took the opportunity to liberalize the existing "leeway authority" for federal associations. This authority was granted by the Consumer Home Mortgage Assistance Act of 1974 but had never been fully implemented. The Board's new regulations now allow an association to make construction loans where the association is relying only on the "borrower's general credit standing and forecast of income, with or without other security" up to a maximum of five percent of its assets, or an amount equal to its surplus, undivided profits and reserves, whichever is greater. A similar five percent of assets category is allowed for nonconforming secured loans, that is, loans secured by residential real estate or real estate used or to be used for commercial farming. This would authorize, for example, investments in alternative mortgage instruments which are not presently authorized under the regulations for federal associations.

2. Consumer Lending and Other Unsecured Investments

With regulations becoming effective the same date as the real estate provisions (November 17, 1980), the Board implemented the new authority to invest in consumer loans, commercial paper and corporate debt securities up to twenty percent of assets. Particularly noteworthy was the Board's

C.F.R. § 545.7-6(b)). Unsecured and nonconforming secured loans are each subject to a five percent of asset limitation. Id. at 76,101 (12 C.F.R. § 545.6-5).

Id. at 76,098 (rescinding 12 C.F.R. § 525.13).

For established associations the limit is ten percent of the insured association's withdrawable accounts or an amount equal to the association's net worth, whichever is less. Id. at 1852 (12 C.F.R. § 563.9-3).

Id. at 76,103 (12 C.F.R. § 563.9-3(b)).

Id. at 76,099 (12 C.F.R. § 545.6-2(a)).

Id. at 76,100 (12 C.F.R. § 545.6-2(b)). The Board also liberalized the regulations for partially amortized loans by increasing the loan-to-value ratio from sixty percent to seventy-five percent and the maximum term from three to five years. Id.

Id. at 76,101 (12 C.F.R. § 545.6-6).


45 Fed. Reg. 76,101 (1980) (to be codified at 12 C.F.R. § 545.6-5(a)).

Id. (12 C.F.R. § 545.6-5(b)).

definition of "consumer loan" to not include credit extended in connection with credit cards and overdraft protection for NOW accounts. Thus, such extensions of credit, even though to consumers, are not subject to the twenty percent of assets limitation.

Originally, the Board proposed to exclude from the definition of consumer credit any credit which was secured by real estate. After considering comments, the Board changed its criteria and adopted a definition modeled after the Comptroller of the Currency's regulations pertaining to national banks. Now loans in which the association "relies substantially upon other factors, such as the general credit standing of the borrower, guaranties, or security other than the real estate or mobile home as the primary security for the loan" are to be made as consumer loans, provided they are made to a natural person. In some cases an association would want to classify the loan as one where it "relies substantially upon the real estate as the primary security for the loan," i.e., a real estate loan, to avoid the twenty percent of asset limitation for consumer loans. In other cases, however, an association might wish to classify the loan as a consumer loan in order to avoid the substantial documentation required for real estate loans (e.g., appraisals, title searches, title insurance, and closings). Such a classification would also give the association more flexibility in payment requirements, allowing such things as balloon payment loans. In many cases, classification of a loan as a consumer loan or real estate loan will be a matter of management discretion provided appropriate documentation is made. An association's ability to use this consumer lending authority to make automobile loans was considerably hampered when the Board declined to authorize dealer inventory financing under the consumer lending authority.

The Board limited investments in corporate debt securities to those which have an average maturity of six years and which are graded in one of the four highest grades by a nationally recognized national rating service. Commercial paper must be rated in one of the two highest grades by such a service and may not be issued by a foreign

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72 Id. at 76,109 (12 C.F.R. § 541.25).
73 Id. at 52,177.
74 Id. at 76,105.
75 Id. at 76,110 (12 C.F.R. § 561.38). There is a limitation on consumer loans to one borrower. The limit is "the lesser of 1/4 of one percent of a federal association's assets or five percent of its net worth." A $3000 minimum is allowed, that figure to be adjusted annually to reflect increases in the Consumer Price Index. Id. at 76,109 (12 C.F.R. § 545.7-10(c)).
76 Id. (12 C.F.R. § 545.7-10(a)).
77 Id. at 76,105. The Board also required that the association's board of directors approve any dealer with which the association is going to engage in indirect lending. Id. at 76,109 (12 C.F.R. § 545.7-10(a)).
78 Id. at 76,109-10 (12 C.F.R. §§ 545.9-4(b)(1), .9-4(b)(5)).
Also included in the twenty percent investment authority are investments in open-end investment companies (mutual funds) which invest in commercial paper and corporate debt. Such companies could be used by an association as an indirect method of investing in corporate debt securities with an average term of more than six years and as a device to avoid the one percent of assets restrictions on investments in one issuer's securities.

3. Authority to Issue Mutual Capital Certificates

As an alternative to converting to stock charter, federal mutual associations are now empowered to issue mutual capital certificates. Under final regulations effective December 29, 1980, these certificates will count as part of the association's statutory reserves and net worth account. Dividends may be paid which are either fixed or variable, cumulative or participatory, and the certificates may be redeemable as long as the association is still able to meet its net worth and statutory reserve requirement. Before Federals may issue such certificates, a charter amendment must be approved by a majority of the outstanding eligible voters. State charters must also obtain approval of the majority of voters. The procedure for obtaining approval is similar to that for obtaining approval for a conversion. Prior FSLIC approval is also required.

The minimum denomination for certificates is $100,000 except: (1) where issued in connection with a private placement to institutional investors; (2) where not offered or sold at any office of the institution and (a) not sold to more than thirty-five people or offered by advertisement to more than thirty-five disinterested persons or (b) SEC-type disclosures were made.

IV. TRUTH-IN-LENDING SIMPLIFICATION ACT

Title VI of the Act alters both the timing and the form of Truth-in-Lending disclosures and changes the liability for non-compliance. Most of these provisions are not effective until April 1, 1982. Still creditors

79 Id. at 76,109 (12 C.F.R. §§ 545.9-4(1), .9-4(b)(2)).
80 Id. (12 C.F.R. § 545.9-4(a)).
81 Not more than one percent of the association's net assets may be invested in the commercial paper and corporate debt securities of one issuer or any person affiliated with the issuer. Id. (12 C.F.R. § 545.9-4(b)(3)). See Supplemental Information, 45 Fed. Reg. 76,108, sanctioning this "loophole."
84 Id. at 82,159 (12 C.F.R. § 563.7-4(1)(2)(iv)).
85 Id. at 82,157-58 (12 C.F.R. §§ 544.2-1, 563.7-4(d)).
86 Id. at 82,158 (12 C.F.R. § 563.7-4(a)).
87 Id. (12 C.F.R. § 563.7-4(e)).
88 Pub. L. No. 96-221, title VI, § 625(a), 94 Stat. 185 (1980) ("take effect . . . two years after the date of enactment . . . .")
have the option to comply with the changes in accordance with any regulations or forms prescribed by the Board prior to that date. Of the changes effective April 1, 1982, perhaps the most significant is a new requirement for loans subject to the Real Estate Settlement Act of 1974. For such loans the good faith estimates of TIL disclosures must be provided to the consumer within three days after the loan application or on the date credit is extended, whichever is earlier.

The type of disclosure required has also been changed substantially. There follows a list of the disclosure items which will now appear on all TIL forms. Items which will be "new" insofar as purchase money mortgage loans are concerned are indicated with an asterisk.

1. Identity of the creditor
2. The amount financed
* 3. The total of the finance charge
4. The annual percentage rate
* 5. Total of payments
6. Payment schedule information
7. Total sale price
* 8. Federal Reserve's descriptive explanation of the above terms
9. Security interest
10. Late payment information
11. Rebate information
12. "A statement that the consumer should refer to the appropriate contract document for any information such document provides about nonpayment, default, the right to accelerate the maturity of the debt, and prepayment rebates and penalties."
13. "In any residential mortgage transaction, a statement indicating whether a subsequent purchaser or assignee of the consumer may assume the debt obligation on its original terms and conditions."

More importantly, the statute directs the Federal Reserve Board to issue model disclosure forms which may be relied on by creditors to avoid civil liability. This is particularly helpful in light of court decisions hold-

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89 The Federal Reserve Board first proposed implementing regulations on May 5, 1980. 45 Fed. Reg. 29,702 (1980). On December 5, 1980, after receiving a number of critical comments, the Board issued a completely revised set of proposals. Id. at 80,648. The period for comments ended January 18, 1981.


92 Id. § 614(a), 94 Stat. 178-79 (amending 15 U.S.C. § 1638(a)).

93 Id. at 1605(b) (to be codified at 15 U.S.C. § 1605(b)).
ing that clauses patterned after the Federal Reserve Board's illustrative forms were in violation of the disclosure requirements and that the creditors using them were liable for the violation.94

Even though the TIL disclosure form may change, the basic method of computing the annual percentage rate is not likely to be markedly different as the result of the “simplification” statute. The basic APR formula has not been changed and is not expected to change much. Associations may, however, have to purchase new tables or other tools in order to conform their procedures to some of the changes in the disclosure statement itself. The Act also amends the accuracy provisions to allow disclosure of an annual percentage rate which is either rounded to the nearest one quarter of one-percent or which has a tolerance of not more than one eighth of one-percent even if there is no rounding.95 This will provide associations which do not use the rounding method with greater flexibility.96

The liability provisions were also changed:

In closed-end credit, a statutory penalty of $100 to $1,000 [now attaches] only to recission requirements and disclosures of the amount financed, finance charge, annual percentage rate, total of payments, number, amount, and due dates of payments, and the security interest statement. Thus, the creditor will not be subject to a statutory penalty for more technical requirements. . . .

The defense for bonafide errors in section 130(c) . . . [is] amended to provide that a bonafide error may include calculation and clerical errors as well as computer errors and faulty programming. The committee intends this amendment to provide protection where the errors are clerical or mechanical in nature. The committee does not intend this defense to apply to erroneous legal judgments as to the act's requirements.97

The statute also clarifies the liability of assignees who are liable for violations which are “apparent on the face of the disclosure statement.” This is defined to include “(1) a disclosure which can be determined to be incomplete or inaccurate from the face of the disclosure statement or other documents assigned, or (2) a disclosure which does not use the terms required to be used by this title.”98

96 Such tolerances were already permitted by Federal Reserve Board Regulations issued December 31, 1979. 12 C.F.R. § 226.5(a) (1980).
Another change in the statute makes it clear that when lenders orally quote rates, they may state only the annual percentage rate. However, they may also state the simple interest rate where a substantial component of the overall finance charge is comprised of simple interest (as is true of mortgage loans).  

The Act, in what may be a major change, "requires the Federal Reserve Board to initiate a pilot project to determine the feasibility and value of 'shopper's guides to credit.' These publications would be issued in metropolitan areas periodically, preferably monthly, and would list the annual percentage rates charged by creditors in that area for common types of loans."  

New rules are also established for administrative enforcement of the Act through the device of requiring creditors to make restitution to their customers where there has been an understated APR in TIL disclosures. These rules are effective March 31, 1980. The restitution device first appeared in this context January 9, 1979 in a set of policy guidelines jointly adopted by the agencies responsible for the administrative enforcement of the Truth-in-Lending Act (members of the Federal Financial Institutions Examination Council). Under those guidelines, corrective action was required for violations on all outstanding loans consumated since October 28, 1974 where there was a disclosed annual percentage rate which was more than one eighth of one-percent less than the correct annual percentage rate calculated without rounding. 

Questions were raised concerning the validity of these new guidelines since they were issued without comment or notice and did not incorporate the legal defenses and tolerances established by the statute. In more than a few instances, creditors found that they would be forced to make a restitution of such size as would put them out of business. This was particularly burdensome in light of the fact that those same creditors had been examined by the promulgating agencies for some five years before and had never been criticized for their TIL disclosures. Nevertheless, the 1979 guidelines told them that what they had been doing was wrong and that they must make retroactive restitution. 

Not surprisingly, the guidelines were challenged in a suit brought by the American Bankers Association, with the United States League joining as an amicus. In a decision handed down on February 28, 1980,

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the court refused to grant the request to declare the guidelines illegal and to enjoin any enforcement actions based on such guidelines. As a practical matter, however, the court, in dismissing the case, rendered the guidelines virtually useless. It held that:

More substantively, if a bank should refuse to implement a guidelines principle—failing to search its records, by failing to make reimbursements, or otherwise—no action can or will be taken against it as a result of the guidelines, and it will suffer no injury that it would not suffer in their absence. The defendant agencies may then institute cease and desist proceedings (15 U.S.C. Sec. 1607), but they may do so in any event. Thus, the guidelines are nothing more than general advisory statements of agency policy as to how their powers under the law and the regulations might be enforced if a violation should come to their attention. Since the guidelines do not concretely affect plaintiff and its members in any way, the case is not ripe for review by this court.

In October of 1979, the Council, recognizing the problems and criticisms, proposed amendments to the guidelines. Now the Truth-in-Lending Simplification Act specifically authorizes and requires such restitution and also provides more concrete rules as to when and how such restitution shall be enforced. First, the Act provides creditors with more lenient tolerances. Generally, restitution is required for regular home mortgage transactions when the APR was stated to be more than one quarter of one-percent lower than the actual rate. No specific tolerances are provided for irregular mortgage transactions.

For those loans consumated after March 31, 1982, and amortized over a schedule of more than ten years, the tolerance becomes the same as contained in section 107(c), that is, one eighth of one-percent or the percent obtained by rounding to the nearest one quarter. For loans with an amortization schedule of ten years or less which are consumated after March 31, 1982, the one quarter of one-percent tolerance remains.

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104 Id.
109 Id.

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restitution may be required at all if the amount of the adjustment is less than one dollar.\textsuperscript{110}

Most importantly, no restitution may be ordered if "it would have a significantly adverse impact upon the safety and soundness of the creditor."\textsuperscript{111} Cease and desist orders are required before any such restitution may be ordered.\textsuperscript{112} Except for those loans consumated between January 1, 1977 and March 31, 1980, there are strict cut-off limits as to when agencies can order restitution.\textsuperscript{113} For those creditors subject to regular examination by agencies, (e.g., savings associations subject to FHLBB examination), no restitution may be ordered except in connection with violations arising from practices identified in the current examination and in connection with transactions which were consumated after the immediately preceding examination unless a violation identified in an earlier examination was not corrected, or unless the error resulted from a willful violation intended to mislead the borrower.\textsuperscript{114}

V. MISCELLANEOUS PROVISIONS

Among the other new provisions of the statute affecting savings associations are an increase in insurance of accounts coverage from $40,000 to $100,000,\textsuperscript{115} the imposition of a moratorium on foreign acquisitions of United States depository institutions, including savings associations, until July 1, 1980,\textsuperscript{116} and the authorization for capital stock savings and loan associations with a state charter to convert directly to a federal charter provided the association has existed in stock form for at least four years prior to March 31, 1980.\textsuperscript{117} There are other important provisions affecting mutual savings banks, credit unions and national banks and a myriad of other minor changes which may affect savings association activities.

Lawyers may find comfort in Title VIII of the Act, the Financial Regulation Simplification Act of 1980, which provides:

The Congress hereby finds that many regulations issued by the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Federal Home Loan Bank Board, and the National Credit Union Administration Board . . . often impose costly, duplicative, and unnecessary burdens on both financial institutions and consumers. Regulations should be simple and clearly written. Regulations

\textsuperscript{110} Id. 94 Stat. 172 (15 U.S.C. § 1607(e)(3)(B)).
\textsuperscript{111} Id. (15 U.S.C. § 1607(e)(3)(A)).
\textsuperscript{112} Id. 94 Stat. 173 (15 U.S.C. § 1607(e)(4)(A)).
\textsuperscript{113} Id. (15 U.S.C. § 1607(e)(7)).
\textsuperscript{114} Id. 94 Stat. 172 (15 U.S.C. § 1607(e)(3)).
\textsuperscript{117} Pub. L. No. 96-221, title IV, § 404, 94 Stat. 158 (1980).
should achieve legislative goals effectively and efficiently. Regulations should not impose unnecessary costs and paperwork burdens on the economy, on financial institutions, or on consumers.\textsuperscript{118}

Perhaps Congress should have pursued this objective by simply repealing the prior seven titles.

\textsuperscript{118} Pub. L. No. 96-221, title VIII, \textsection 802, 94 Stat. 191 (1980).