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CONSUMER PROTECTION AND AMERICAN BANKS

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In a recent definitive history of the construction of the Panama Canal,[1] the author searches for the reasons why the French failed, while the Americans succeeded. Certainly the French were blessed with expertise. Engineers from l'École des Chemins et Ponts devised a master plan of ingenious simplicity. In essence, it required the removal of all of the earth between two bodies of water to a given depth, the result being a sea-level canal. After all, the same master plan had worked at Suez. The problem at the Isthmus of Panama, however, was a range of mountains between the Atlantic and Pacific Oceans which the then state of the engineering art was powerless to remove. When the French effort was abandoned, the Americans concocted a different master plan — one learned in the course of building railroads in the western United States. Its basic premise: build something; if it falls down, building something else. Applying this principle, the Panama Canal was completed by construction of a series of locks permitting the ships to climb over the mountains, pulled by little railroad engines.

While it might be tempting to compare the approach of the French engineers to the civil law, and the American approach to their peculiar legal system, let us limit the analogy to the American banking system — which has fallen down and been rebuilt several times. No scholar's master plan could have designed our present banking mishmash. The American banking system is a product of its peculiar history, goegraphy, economics, politics and perhaps most of all, its compromises. Broadly speaking, it consists of a system of collection and payment overseen generally by the Federal Reserve Board through a series of "banker's banks" which not only regulates currency but actually attempts to control the money supply. Three regulatory agencies (sometimes with overlapping powers) control chartering, federal banking operation and expansion through tight regulation and frequent examination. Since the Great Depression, there have been relatively few significant bank failures. However, the recent failure of three billion-dollar banks coupled with the banking indiscretions of a Presidential confidant seem to have caused a shift of the relationship between the American

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[1] JOHNSTON, *Path Between the Seas*.

banks and their regulators from a somewhat paternalistic relationship to that of adversaries.

To some extent, the anti-competitive aspects of banking are curbed by branching restrictions of the various states, which apply even to banks chartered by the federal government. Some states allow branching throughout, others on a county-wide basis, while still others permit no branching at all. In only isolated instances is branching permitted beyond state lines. The larger and more agressive banks have partially offset these limitations through international branching, a nation-wide system of "loan production" offices and by the introduction of the bank credit card.

The political implications of banking are everywhere apparent. Banks are, at once, emblems of financial solidarity and symbols of the excesses of capitalism. Bankers are portrayed by some as prime abusers of economic power. Consumer advocates attempt to weld blocks of voters, unsympathetic to the banking establishment, who may become real factors in the re-election of Congressmen. These pressures have resulted in a myriad of federal consumer protection legislation enacted during the past ten years. The first was the Truth-in-Lending legislation[2] designed to permit "comparative shopping" for credit. The Act does not purport to regulate usury, but merely requires the disclosure of the costs of credit on a uniform basis by introducing a new uniform measure of the cost of credit, the "Annual Percentage Rate". In addition, Truth-in-Lending requires somewhat detailed disclosure of security interests retained by the seller or lender. This is particularly true with regard to junior mortgages and on the borrower's residence. (It is said that the origin of these provisions came in reaction to the proliferation of "suede shoe siding salesmen" in the Washington D. C. area.)

Later on Congress passed the *Fair Credit Reporting Act*[3] designed to insure accuracy and completeness in the collection and reporting of consumer credit information. It sets strict standards on the circulation of credit information and gives the consumer an opportunity to examine and correct his credit records. The *Real Estate Settlement Procedures Act*[4] requires the disclosure of closing costs in advance of purchasing a residence. The *Fair Credit Billing Act*[5] addresses the problem of credit cards, and particularly, irregularities in the billing process. In a sense, it infuses a right of redhibition into the three-party credit card transaction.

The women's movement has produced the *Equal Credit Opportunity Act*[6] which originally prohibited discrimination in credit transactions only on the basis of sex or marital status. A recent amendment expanded the bases of discrimination to include age, race, nationality, the receipt of public welfare assistance, or a history of asserting one's consumer rights. The central feature of this legislation is

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[2] 15 U.S.C. 1601, Regulation Z (12 CFR 226).
[3] 15 U.S.C. 1681.
[4] 12 U.S.C. 2601, Regulation X (24 CFR 3500).
[5] 15 U.S.C. 1666, Regulation Z (12 CFR 226).
[6] 15 U.S.C. 1691, Regulation B (12 CFR 202).

the requirement that the creditor treat the prospective borrower or credit purchaser as an individual, rather than as a class. Recently, Congress has favored us with the *Fair Housing Act*[7] prohibiting "redlining", i.e. discrimination on the basis of geography or neighborhood, and has followed that with the *Community Reinvestment Act* of 1977.[8] The latter requires financial institutions to declare and define the "community" which they serve, and to specify the financial products offered to the members of that community. Compliance is a pre-condition to expansion by branching, merger or acquisition. Critics of this legislation argue that it constitutes the emergence of the most dreaded dragon in the financial community, namely the political allocation of credit. There are strong arguments on both sides.

As one traces the history of federal consumer protection legislation over the past ten years, a new legislative technique emerges. Most of the consumer protection legislation does little more than state a policy and some very general guidelines. The appropriate regulatory agencies are given broad powers to define and implement what Congress means. Almost inevitably they issue long and complex regulations, the authors of which frequently are persons with little or no experience with financial institutions. At times the results can be maddening. For example, the first regulations issued pursuant to the *Equal Credit Opportunity Act* were literally impossible to understand. They were wisely withdrawn, repaired and reissued. Then, after the Act was amended to expand the basis of discrimination, regulations were issued again, this time in a largely workable form.

Administrative enforcement, however repugnant to some, is absolutely essential in order to make our unique system work. This is particularly so with regard to banks. Through the power of examination the various federal banking agencies have ready access to the evidence of compliance or non-compliance. Once the examiner reports a violation, there is no real administrative machinery for appeal. Theoretically, failure to comply with an examiner's findings could cause publication of the alleged offense, the issuance of appropriate cease and desist orders, removal of responsible bank officers or even the withdrawal of the charter in extreme cases. Practically speaking, most banks capitulate to the examiner. But there is more. All of these consumer protection statutes provide for *private* enforcement through the individual or class action. Thus the accused institution finds itself subject to the possibility of dual enforcement actions for a single alleged offense. Moreover, inconsistent administrative interpretations, and inconsistent judicial opinions frequently leave grave doubt as to what the laws or the regulations really mean. Thus, the financial institution finds itself obligated to protect its safety and soundness while trying to decide whether to incur the cost of defending compliance actions provoked by examiners as advance agents of its customers allegedly maligned. An example of this dilemma can be drawn from recent guidelines proposed by the various federal bank regulatory agencies for the

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7 42 U.S.C. 3605.

8 12 U.S.C. 2901, Regulation BB (12 CFR 228).

enforcement of the *Equal Credit Opportunity Act*. A bank which is found to have discouraged applications on a prohibited basis must, in lieu of the identifying of the particular victims and seeking them out, solicit applications from the general class of persons it has discriminated against. A bank which has misquoted the Annual Percentage Rate must refund the amounts of understated interest. Banks which have rejected credit on a discriminatory basis must review all applications refused and resolicit all of those individuals, reallocating the bank capital and resources to them although subsequent later, more stringent criteria of creditworthiness have demonstrated that they were not good credit risks in the first place.

To describe our system is perhaps to suggest that you try something else. However, from what I know of your current and proposed consumer protection legislation, perhaps you should devote more attention towards *remedies* — because they ultimately are necessary. If consumer protection is to work, I think it will require some sort of rather elaborate administrative machinery with intricate regulation and mass enforcement. To return to my original analogy, I don't think you can remove all of the dirt between the business man and the consumer through regulation of the the contract. Whatever you erect (if it works) will appear awkward and unconventional. For your sake I hope it doesn't tumble down. But if it does, I wish you every success in its reconstruction.