
Law and Banking

Seventh Edition

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Catherine M. Brown



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Layout and composition of the Law and Banking textbook was done by Wendi Calvert (wendeyec@hotmail.com), Punxsutawney, PA.

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Printed in the United States of America

Catalog Number: 3006962

ISBN: 0-89982-656-3

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Preface

Law and Banking is intended to give those who are new to banking a broad understanding of the laws and regulations that pertain to banking today. *Law and Banking* introduces fundamental legal and regulatory principles and explains how they apply to bank products, services, and customer relationships.

OBJECTIVES OF THIS BOOK

- Explain the legal and legislative sources of U.S. banking law and the judiciary's and regulatory agencies' roles in interpreting the law (chapter 1).
- Describe the major torts and crimes that affect the banking industry (chapter 2).
- Identify the customer relationships of individuals, sole proprietorships, and partnerships, and a bank's legal obligations and responsibilities when transacting business with these customers (chapter 3).
- Identify the legal entities of corporations, government agencies, limited liability companies, estates, and trusts, and a bank's legal obligations and responsibilities when transacting business with these entities (chapter 4).
- Explain how contractual relationships are formed and enforced and the different elements of contracts (chapter 5).
- Describe how property may be acquired, transferred, and owned, and how creditors obtain property interests (chapter 6).
- Describe the requirements of negotiable instruments as defined by Uniform Commercial Code Article 3 and other laws (chapter 7).
- Describe the parties and their rights in the transfer of negotiable instruments and the legal responsibilities of banks in collections and returns as governed by the UCC and federal regulation (chapter 8).
- Explain the legal obligations of banks to act responsibly as businesses and in their dealings with customers (chapter 9).
- Identify the laws and regulations that protect bank deposits and govern the relationship between a bank and its depositors (chapter 10).
- Describe the legal protections provided to borrowers and the rights and responsibilities of banks when they offer consumer credit and make loans (chapter 11).
- Identify the laws and regulations that protect borrowers and lenders in real estate transactions and that serve the community interest (chapter 12).
- Explain how the asset liquidation and reorganization provisions of bankruptcy law protect the interests of both debtors and creditors (chapter 13).

- Describe the legal obligations, including the requirements of the Dodd-Frank Act, that banks must fulfill when they serve in a fiduciary capacity and provide insurance and securities products and services (chapter 14).
- Discuss how the global trade and investment activities of U.S. banks are affected by both domestic and international law, including the Foreign Corrupt Practices Act (chapter 15).
- Explain laws and regulations that govern bank marketing and advertising practices (chapter 16).
- Identify the bank safety and soundness laws that help protect bank assets, guard against deposit insurance system losses, govern capital requirements, and reduce risk in the banking system (chapter 17).
- Explain some requirements placed on banks to report financial and customer information to government authorities and the responsibilities placed on banks to ensure safeguards when receiving, using, and disclosing customer information (chapter 18).

CHANGES TO THIS EDITION

In addressing these topics, this text updates the material covered in the sixth edition of *Law and Banking*. The changes in this seventh edition include

- The effects of the subprime mortgage crisis, the broader financial crisis, and the concerns over the “too big to fail” issue that led to passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the merger of the Office of Thrift Supervision and the Office of the Comptroller of the Currency, the passage of the Emergency Economic Stabilization Act, and the creation of programs intended to assist homeowners keep their homes (chapter 1).
- An expanded discussion of fraud, insider trading, elder financial fraud, pharming, phishing, shoulder surfing and skimming, and such Internet fraud crimes as hacking into payment systems (chapter 2).
- A revised discussion of account documentation and titling and the power of attorney (chapter 3).
- Additional information about the rights and powers of shareholders, the responsibilities and liabilities of boards of directors, the rights of creditors filing claims against estates, and types of trusts, including revocable and irrevocable trusts (chapter 4).
- Additional information about foreclosure and state law (chapter 6)
- An explanation of the amendments to regulations governing funds availability, including check processing and collection (chapter 8).
- An update of the information on the Community Reinvestment Act and Fair Lending to include the additional responsibilities imposed on financial institutions by the Dodd-Frank Act (chapter 9).
- New details regarding deposit insurance, resulting from the repeal of Regulation Q and the passage of the Emergency Economic Stabilization Act, new disclosure requirements mandated by emendations to Regulation E, and

the elimination of nonlocal checks and new standards for availability of funds (chapter 10).

- Information regarding the Credit CARD Act of 2009 and other changes to consumer lending resulting from the Dodd-Frank Act (chapter 11).
- Additional information on the subprime crisis and information on the broader financial crisis that led to the Dodd-Frank Act in 2010 (chapter 12).
- Describes the changes the Dodd-Frank Act made to bank securities activities and the effects of the Financial Services Regulatory Relief Act on banks offering brokerage services (chapter 14)
- Introduces a short explanation of the Foreign Corrupt Practices Act and explains how the Dodd-Frank Act affects foreign exchange transactions (chapter 15).
- Provides new information on do-not-call lists, on the Credit Card Accountability Responsibility and Disclosure Act's rules on the marketing of credit cards, and on the OCC's rules on marketing gift cards. Presents information about the Dodd-Frank Act and the Consumer Financial Protection Bureau and their authority to make rules against abusive acts and practices (chapter 16).
- Information on how the Dodd-Frank Act restricts capital and affiliate transactions and affects real estate appraisals, and how the Financial Stability Oversight Council monitors the risk of systemically important institutions (chapter 17).
- Information regarding impending changes to the Home Mortgage Disclosure Act reporting requirements resulting from the Dodd-Frank Act (chapter 18).

The previous editions introduced the following graphic design features that continue in this text: the text is typeset in a one-column format with featured sidebars that highlight relevant information, and graphics and prominent color visually enhance the reading and learning experience. Instructional design features that were kept include

- Learning objectives at the beginning of the chapter that convey what should be learned from the material presented.
- An introduction that sets the stage for topics covered in the chapter.
- Historical facts, “Did you know?” features, sidebars, charts, and exhibits that supplement chapter content.
- Definitions in sidebars for key terms bolded in the text.
- Legal case studies with questions that test understanding of legal concepts and principles.
- Situations that present the application of legal principles.
- A summary of the chapter's main points.
- Self-check and review questions for testing comprehension of chapter content.
- A list of additional resources, including publications and Web sites that contain material related to chapter content.

- Separate sections at the back of the book with answers to chapter self-check and review and legal case study questions.
- A glossary of terms used in the text.
- An index that can be used to locate content.

PART ONE: PRINCIPLES

Chapter 1 describes the regulations, statutes, and codes that provide the legal framework within which the business of banking is conducted. These laws and regulations define banking, the types of activities conducted, the obligations that must be met, and the sanctions applied when rules are not obeyed. Violations of law, which are known as torts and crimes, that most affect bankers and the banking industry are the subject of Chapter 2.

Chapters 3 and 4 look at the different types of customers who do business with banks and the legal considerations that apply. The legal entities of individuals, sole proprietorships, and partnerships are covered in Chapter 3. Chapter 4 addresses the legal entities of corporations, government agencies, estates, and trusts.

Most banking transactions involve a contract, which is the subject of Chapter 5. The legal rights and duties of the parties under a contract are covered, as are requirements under common law and statutory law for having a legally enforceable contract. In Chapter 6, the discussion turns to property, which is a contractual element of consideration in many banking transactions. This chapter explains how property can be acquired, transferred, and owned under the law; how laws govern the rights of owners to possess and use property; and the rights of creditors to place liens on property to ensure repayment.

Chapters 7 and 8 address the laws that govern the payment process. The principle topic of Chapter 7 is Uniform Commercial Code Article 3, which governs the rights and duties of parties to negotiable instruments such as checks. When a check is presented for payment, several laws apply, including UCC Article 4 and Regulation CC. Chapter 8 discusses the affect of the UCC and federal law as it applies to the responsibilities of the parties involved in check collections and returns, including banks as they perform their various payment functions.

In Chapter 9, the focus turns to the subject of corporate responsibility. Banks have unique lending and deposit-taking powers, and the federal government has enacted laws and regulations that oblige banks to be responsible to serve the people and businesses located in their communities. For their part, bank employees must adhere to high standards of integrity and ethical behavior and protect the privacy of the bank–customer relationship.

PART TWO: APPLICATIONS

Chapter 10 begins the analysis of how the law applies to specific areas of bank operations. In Chapter 10, the various laws and implementing regulations that govern deposits are explored. This includes reserve requirements (Regulation D), the Electronic Fund Transfer Act (Regulation E), the Expedited Funds Availability Act (Regulation CC), and the Truth in Savings Act (Regulation DD). It also describes the changes in the deposit market due to the repeal of Regulation Q.

Chapter 11 centers on consumer loan products. Consumer protection laws like the Truth in Lending Act and the Equal Credit Opportunity Act govern every stage of the lending process, from application to credit decision making and notification. Perhaps no product is more subject to laws and regulations than credit secured by real property. The application of laws to real estate lending is the subject of Chapter 12.

One of the possible consequences of a lending relationship is bankruptcy. Bankruptcy law protects the interests of both creditors and debtors. Chapter 13 looks at the provisions of bankruptcy law that allow debtors to seek protection from their creditors. Provisions also allow creditors to seek the orderly liquidation or reorganization of the debtor's property and recover something of value for the funds they loan. In covering this topic, the requirements of bankruptcy law are discussed, including the Bankruptcy Abuse Prevention and Consumer Protection Act.

In Chapter 14, the laws governing trust, insurance, and securities activities are discussed. Although banks have long been involved in trust activities, and the laws governing these activities are well established, the Gramm-Leach-Bliley Act has altered the legal and regulatory framework to allow banks to offer insurance and securities products. In 2010, the Dodd-Frank Act made some changes to a bank's trust and securities activities. Other legal requirements that specifically apply to trust, securities, and insurance activities are covered also, including UCC Article 8 and the Lost and Stolen Securities Program.

International bank law and regulation is the subject of Chapter 15. Any bank with international activities is subject to U.S. banking laws and to comparable laws and regulations in the foreign country or countries in which it operates. This creates complex and unique legal and compliance challenges for an internationally active bank.

Chapter 16 reviews laws and regulations that affect bank marketing activities. Banks are subject to a number of laws and regulations issued by banking agencies and other federal agencies such as the Federal Communications Commission. The laws and regulations have evolved to keep pace with different marketing channels such as e-mail and the Internet.

Chapter 17 examines the laws that help ensure bank safety and soundness. Federal and state governments impose safety and soundness laws because of the central role banking plays in the economy. These laws are wide-ranging and affect

everything from the bank's physical premises to the use of its loanable funds, its capital requirements, transactions with insiders and affiliates, and the value of collateral. This textbook concludes with an examination of laws that govern the collection and reporting of financial and customer information, which is the subject of Chapter 18.

Acknowledgments

Developing a textbook and related course materials requires the knowledge of different professionals. The American Bankers Association extends grateful thanks to Kathlyn L. Farrell and Catherine M. Brown, subject matter experts and authors, and to the following banking and legal professionals for their suggestions and contributions to *Law and Banking*, seventh edition.

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Ms. Farrell has more than 30 years' experience in the banking industry, including in-house counsel for medium and large banks. Her experience encompasses federal and state regulatory compliance, secured lending transactions, and the management of loans in litigation and bankruptcy. She has conducted compliance seminars, including Internet-based compliance training for Office of Thrift Supervision examiners. She is the co-author of *Law and Banking*, 6th edition, the author of *Law and Banking: Principles* 4th edition, the author of the *Reference Guide to Regulatory Compliance*, now in its 22nd edition, the co-author of the first edition of the *Compliance Audit Manual*, and the author of many articles in the *ABA Bank Compliance Magazine*, all published by the American Bankers Association. Ms. Farrell has served as a faculty advisor for the National Compliance School. She also has worked in the legal division of General Electric Capital Corporation.

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With over 13 years of legal and regulatory compliance experience, Ms. Brown held several compliance related positions for Charter One Bank, N.A./Citizens Financial Group, most notably as Senior Vice President and Chief Corporate Compliance and Ethics Officer. A frequent speaker and author on compliance related topics, she has served on the faculty of the American Bankers Association's Intermediate Compliance School.

Ms. Brown received her J.D. from the University of Dayton School of Law and an M.B.A. from Case Western Reserve University. She is active in the American Bar Association.