3-10-1995

15th Annual Legal Issues for Financial Institutions Conference

Office of Continuing Legal Education at the University of Kentucky College of Law

Walter R. Byrne Jr
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Mark F. Sommer
Greenebaum Doll & McDonald

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15th Annual

LEGAL ISSUES FOR FINANCIAL INSTITUTIONS CONFERENCE

March 1995
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Louisville, Kentucky

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15th Annual Conference On
LEGAL ISSUES FOR FINANCIAL INSTITUTIONS
Friday and Saturday
March 10-11, 1995
University of Kentucky College of Law
Lexington, Kentucky

Program Planning Chair and Moderator
M. Brooks Senn
Vice President and General Counsel
Kentucky Bankers Association
Louisville, Kentucky

Friday, March 10, 1995

8:00 am  CHECK-IN / LATE REGISTRATION / CONTINENTAL BREAKFAST
8:45 am  WELCOME AND ANNOUNCEMENTS
9:00 am  OVERVIEW OF RECENT DEVELOPMENTS IN BANKING LAW:
A Historical Perspective
    M. Thurman Senn
    Morgan & Pottinger
    Louisville, Kentucky

10:00 am  THE INTERSTATE BANKING AND BRANCHING EFFICIENCY ACT:
Its Meaning to Kentucky Financial Institutions
• Kentucky's Movement Toward "Market State" Status
    Walter R. Byrne
    Stites & Harbison
    Lexington, Kentucky
• Developments in the "Bank Shares Tax" for Kentucky
    Mark F. Sommer
    Greenebaum Doll & McDonald
    Louisville, Kentucky
• Taxation Issues in Light of the Act
    M. Brooks Senn
    Kentucky Bankers Association
    Louisville, Kentucky

10:50 am  BREAK
11:05 am  THE BANKRUPTCY REFORM ACT OF 1994:
Amendments to the Bankruptcy Code and Necessary Changes in Banking Practices
    Lisa Koch Bryant
    Rubin Hays & Foley
    Louisville, Kentucky

11:55 am  LUNCH BREAK
1:20 pm  REGULATORY UPDATE - FAIR LENDING
    Leonard A. Watkins
    PNC Bank, Kentucky, Inc.
    Louisville, Kentucky

1:50 pm  REGULATORY UPDATE - FLOOD INSURANCE & RESPA
    Thomas W. Grundy
    Kentucky Bankers Association
    Louisville, Kentucky

2:40 pm  REGULATORY UPDATE - COMMUNITY REINVESTMENT ACT
    JoAnn B. Heppermann
    Liberty National Bank & Trust Company
    Louisville, Kentucky

3:00 pm  BREAK
LENDING TO LIMITED LIABILITY COMPANIES
- Understanding LLCs
- Creditor Concerns in Lending
  James C. Seiffert
  Stites & Harbison
  Louisville, Kentucky
- Loan Documentation
- Perfection of Security Interests
  William H. Haden, Jr.
  Stites & Harbison
  Louisville, Kentucky

LENDER AND ENVIRONMENTAL LIABILITY UPDATE
- Lender Liability: Negligence, Fraud & Bad Faith
  John T. McGarvey
  Morgan & Pottinger
  Louisville, Kentucky
- Environmental Liability Issues in Lending Transactions
  Marcus P. McGraw
  Greenebaum Doll & McDonald
  Lexington, Kentucky

4:45 pm
RECESS

Saturday, March 11, 1995

8:15 am
REGISTRATION DESK OPENS / CONTINENTAL BREAKFAST

9:00 am
LOAN AGREEMENTS: Selection and Drafting of Documents
- Loan Documentation
- Loan Agreements vs. Note & Mortgage
- Loan Agreements Covenants
  T. Richard Riney
  Hirn Doheny Reed & Harper
  Louisville, Kentucky

10:10 am
BREAK

10:20 am
RECENT DEVELOPMENTS IN ARBITRATION - Including Allied-Bruce Terminix Companies v. Dobson (U.S. Supreme Court, January 18, 1995)
  M. Thurman Senn
  Morgan & Pottinger
  Louisville, Kentucky

11:05 am
SELECTED SHORT TOPICS OF CRITICAL IMPORTANCE
- Usury Update
  M. Brooks Senn
  Kentucky Bankers Association
  Louisville, Kentucky
- IRS Returns Regarding Debt Forgiveness
  W. Bradford Boone
  Stites & Harbison
  Lexington, Kentucky
- UCC Update
  John T. McGarvey
  Morgan & Pottinger
  Louisville, Kentucky
- 1994 Home Ownership and Equity Protection Legislation-Reverse Redlining
  Amendments to Truth in Lending
  James F. Rose
  Brown, Todd & Heyburn, PLLC
  Lexington, Kentucky
- Subjects Prompting Frequent Inquiries to the Kentucky Department of Financial Institutions
  J. Rick Jones
  Kentucky Department of Financial Institutions
  Frankfort, Kentucky

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ADJOURN
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OVERVIEW OF RECENT DEVELOPMENTS IN BANKING LAW

- A Historical Perspective -

M. Thurman Senn
Morgan & Pottinger, P.S.C.
Louisville, Kentucky

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SECTION A
This outline is designed to provide general information on the subject matters covered. It is not intended to provide either a complete survey of all possible developments or a comprehensive explanation or analysis of those developments mentioned. Readers should consult the original source materials referenced. Furthermore, this outline is not intended nor should it be used as a substitute for specific legal advice or opinion. Finally, this outline is published with the understanding that the publisher is not engaged in rendering legal service.

Note: The author is currently, or in the future may be, engaged in representing clients in lawsuits and other proceedings which directly involve some or all of the materials set forth in this outline. No statements contained herein or any statements made by the author during his presentation should be construed as the position of those clients for purposes of those proceedings. Nor should such statements be construed as precluding the author from advocating any position on behalf of those or other clients.
OVERVIEW OF RECENT DEVELOPMENTS
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- A Historical Perspective -

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SECTION A
I. Bank Insurance Agent Powers In Kentucky - A Historical Summary.

1819 McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819)
- Supreme Court declares unconstitutional, under the Supremacy Clause, a Maryland statute imposing a tax on the branches of the Second Bank of the United States.
- Congress has the authority to charter the Bank under "its great powers to lay and collect taxes; to borrow money; to regulate commerce; to declare and conduct a war; and to raise and support armies and navies." Id. at 408.

- Some limited deference to state law is explicitly provided for. For example, §30 of the Act expressly provided that the interest rate national banks generally could charge was "at the rate allowed by the laws of the state or territory where the bank is located, and no more".

1869 Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1869)
- Virginia could penalize Virginia resident for selling insurance for a New York insurance company without a Virginia agent's license.
- Virginia's licensing laws did not violate the dormant Commerce Clause because "issuing a policy of insurance is not a transaction of commerce". Id. at 183.

- state cannot impose upon a national bank a usury penalty which is more stringent than that imposed by federal law.
- Congress' authority to establish and regulate national banks is the same basis as set forth in McCulloch v. Maryland. Id. at 33-34.

- "Any trust company organized under this articles may . . . act as agent . . . for the transaction of any business. . . ."

1899

- Unanimous Supreme Court reverses a decision of Kentucky's highest court and precludes Kentucky from taxing the bank contrary to Congress' plan.

1916

Congress grants insurance agency powers to small town national banks.
- National bank "located and doing business in any place the population of which does not exceed five thousand inhabitants . . . may, under such rules and regulations as may be prescribed by the Comptroller of Currency, act as the agent for any fire, life or other insurance company . . . ."
- Insurance company must be "authorized by the authorities of the State in which said bank is located to do business in said State".
- Sole legislative history: letter from then Comptroller of the Current, John Skelton Williams, to Senator Robert L. Owens, then Chairman of the Senate Banking and Currency Committee. See 64 Cong. Rec. 11,001 (1916).

1925

- Court affirms issuance of mandatory injunction requiring insurance commissioner to grant a license to the President of the Fidelity & Columbia Trust Company so that he could act as a insurance agent writing policies on the property held in trust by the trust company and paying his commissions to the trust company.
- Trust companies may act as insurance agents under K.S. 208.

1925

Court affirms issuance of mandatory injunction requiring insurance commissioner to grant an insurance agent's license to a combined bank and trust company.

1926


1944

United States v. South-Eastern Underwriting Ass'n, 322 U.S. 533 (1944)

- Insurance company doing business across state lines was engaged in interstate commerce and therefore subject to the federal antitrust laws.

1945

McCarran-Ferguson Act enacted.


- §1: "Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states."

- §2:

  (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

  (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended,
shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

1952 United States Code states that §92 is "omitted" from the Code based upon the codifier's opinion that some punctuation in a 1918 statute caused the provision to be accidentally repealed.

1956 Congress passes the Bank Holding Company Act (12 U.S.C. §1841 et seq.).

1956 Kentucky enacts KRS 287.030(3) effectively prohibiting bank holding companies. [1956 Ky. Acts ch. 80, §1].

- "No person shall, directly or indirectly, hold or own more than one half of the capital stock of a bank or combined bank and trust company, exclusive of stock held as collateral; but there is no limitation on the amount of capital stock that may be held by the United States or by a corporation in which the United States owns or holds the majority of the stock."

- Does not say anything about insurance activities of banks.


- the McCarran-Ferguson Act does not give states the power to tax insurance covering property located outside the taxing state because several Supreme Court decisions rendered prior to the enactment of McCarran-Ferguson Act held that such taxes could not be imposed.

9/21/70 OAG 70-643 (John B. Breckinridge).

- KRS 287.030(3) [Now KRS 287.030(4)] "is applicable to national banks doing business in Kentucky."

- The "state law is in the public interest as a means of preventing the concentration of financial power in one person or company."

1971 Federal Reserve Board promulgated 12 C.F.R. §225.4(a)(9) of Regulation Y listing certain insurance activities
which were considered "so closely related to banking or managing or controlling banks as to be a proper incident thereto" and therefore may be engaged in by BHC's and their non-bank subsidiaries.


1972


1972

Kentucky enacts precursor to 287.030(4) which was then (in 1972) codified at 287.030(3). See 1972 Ky. Acts Ch. 174, §1.

"No person shall, directly or indirectly, hold or own more than one half of the capital stock of a bank or combined bank and trust company, exclusive of stock held as collateral, except that a person may own or acquire more than one half of the capital stock of not more than on bank or combined bank and trust company, but no person who hereafter owns or acquires more than one-half of the capital stock of one bank or combined bank and trust company shall: (a) own or acquire directly or indirectly any capital stock in any other bank or combined bank and trust company domiciled in Kentucky, or (b) act as insurance agent or broker with respect to any insurance except credit life insurance, credit health insurance, insurance of the interest of a real property mortgagee in mortgaged property, other than title insurance; but there is no limitation on the amount of capital stock that may be held by the United States or by a corporation in which the United States owns or holds the majority of the stock. As used herein, "person" includes a natural person, partnership, corporation, association, business trust, voting trust, or similar organization."

1980


- Upholding OCC regulation preventing insiders from benefiting personally by the regular receipt of
credit life insurance income sold to bank customers.

- "Nothing in the McCarran-Ferguson Act was intended to affect the power of the Comptroller under authority of Congress to regulate 'unsafe and unsound' banking practices of national banks."

5/7/81 OAG 81-173 (Steven L. Beshear).
- KRS 287.030(4) prevents a bank holding company from acquiring 100% of the outstanding common stock of an insurance agency in Kentucky.

- the Supreme Court "rejected" the "argument that the McCarran-Ferguson Act altered constitutional standards other than those derived from the Commerce Clause." Id. at 655 n.6.

- Applying normal Equal Protection Clause analysis to California's retaliatory tax on out-of-state insurance companies doing business in California when the insurer's state of incorporation imposes higher taxes on California insurers doing business in that state.

8/18/86 Comptroller approves proposal by United States National Bank of Oregon to sell insurance from its branch in Banks, Oregon, population 489, "to customers of U.S. Bank and others".
- "A national bank or its branch which is located in a place of 5,000 or under population may sell insurance to existing and potential customers located anywhere. In other words, while the bank or bank branch must be located in a small town, it can sell insurance to person and business located outside that town."

- Department of Financial Institution's bill.
- "Any bank or trust company organized under the laws of this state may: . . . (2) act as agent for the transaction of any business . . . ."
- Section 1 of the bill amended "Bank" for purposes of KRS Ch. 287.

7/13/84 Kentucky authorizes multi-bank holding companies. [1984 Ky. Acts Ch. 130].
- Amends KRS 287.030(4) to reflect that fact that Kentucky now has multi-bank holding companies.
- "No person who after this Act takes effect [July 13, 1984] owns or acquires more than one-half of the capital stock of a bank shall act as insurance agent or broker with respect to any insurance except credit life insurance, credit health insurance, insurance of the interest of a real property mortgagee in mortgaged property, other than title insurance."

2/28/86 Letter from Department of Insurance (Stephen B. Cox, Assistant General Counsel) to David F. Presser (Morganfield National Bank) concluding that KRS 287.030(4) operates to prevent a national bank from exercising 12 U.S.C. §92 powers.

- Pennsylvania statute prohibiting a savings bank (as well as banks and other financial institutions) from being an affiliate of an insurance company was not a statute regulating the "business of insurance" within the meaning of McCarran-Ferguson §2(b).

- Bank Holding Company Act does not grant authority to FRB to regulate the powers of a bank even if owned by a BHC.

- Arkansas Department of Insurance may not preclude national bank from offering debt cancellation contracts under its "incidental powers" under 12 U.S.C. §24(Seventh).
Congress "did not intend the 'business of insurance' to encompass lawful activities of national banks" so McCarran-Ferguson §2(b) does not save Arkansas state law from preemption. Id. at 779-780.


- Louisiana Commissioner of Insurance rules that wholly owned subsidiary of a national bank (which in turn is the subsidiary of a bank holding company) may only sell credit-related insurance to its customers in towns with a population of 5,000 or less.

- Because of the Bank Holding Company Act and the McCarran-Ferguson Act, Louisiana's laws restricting bank insurance operations to acting as agent for only credit-related insurance take precedence over §92 unlimited grant of authority.

- Since the subsidiary in this case is a national bank, its only authority to be an agent is §92 and this imposes a geographic restriction on customer scope.

1/24/91 Kentucky Bankers Association, Owensboro National Bank, First National Bank of Louisa and Citizens National Bank of Paintsville file suit against Department of Insurance seeking license to act as noncredit-related insurance agent.


- Bank Holding Company Act does not grant authority to FRB to regulate the subsidiaries of a bank subsidiary of a BHC.


- 12 U.S.C. §92 was accidentally repealed in 1918.

6/15/92 American Land Title Ass'n v. Clarke, 968 F.2d 150 (2nd Cir. 1992), cert. denied, 113 S.Ct. 2959 (6/14/93).
- 12 U.S.C. §92 constitutes an implied prohibition on national banks acting as title insurance agents in towns of greater than 5,000.
- rejects argument that acting as title insurance agent is within a national bank's incidental powers under 12 U.S.C. §24(Seventh).

7/14/92
Commissioner of the Kentucky Department of Financial Institutions given discretionary authority to grant "parity" with national banks to state banks. [1992 Ky. Acts Ch. 226, §1].
- "This section shall not apply to activities prohibited under Subtitle 9 of KRS Chapter 304."

8/4/92
- District Court states that it "has no difficulty concluding that §92 preempts Ky.Rev.Stat. 287.030(4)", and the National Banks "may not be prevented from applying for insurance licenses."

6/7/93
- 12 U.S.C. §92 was not accidentally repealed in 1918.

6/11/93
- Court split 5-4 over whether or not an Ohio law prioritizing claims in a state liquidation of an insolvent insurance company was a statute is "enacted . . . for the purpose of regulating the business of insurance" within the first prong of McCarran-Ferguson's §2(b)

- "We hold that the Ohio priority statute, to the extent that it regulates policyholders, is a law enacted for the purpose of regulating the business of insurance. To the extent that it is designed to further the interests of other creditors, however, it is not a law enacted for the purpose of regulating the business of insurance." [Fabe, 113 S.Ct. at 2212].

- Applying this holding, the Court upheld the Ohio statutory priority scheme to the extent that it
placed claims of the U.S. Government behind administrative expenses and claims of policyholders. On the other hand, McCarran-Ferguson did not preserve the Ohio statute from preemption to the extent it placed the U.S. Government's claims behind claims of general creditors. Id. at 2204. The basis of this distinction was that first paying administrative expenses and policyholder claims directly "redound to the benefit of policyholders" by providing funds to pay policyholders while paying the general creditor claims ahead of the U.S. Government does not. Id. at 2212.

In contrast, the 4 dissenting Justices would have found that the Ohio statute "does not qualify as regulating the business of insurance under Pireno's tripartite test for the same reason that it fails to do so under National Securities: it regulates an activity which is too removed from the contractual relationship between the policyholder and the insurance company." Id. at 2216. In the dissent's eyes, the entire Ohio statutory scheme was preempted since post-insolvency priority rules "do not increase the reliability or the solvency of the insurer" because they operate "too late in the day". Id. at 2214.

"parties agree[d] that . . . the federal priority statute does not 'specifically relat[e] to the business of insurance.'" Fabe, 113 S.Ct. at 2208.

Troublesome dicta:

"The McCarran-Ferguson Act did not simply overrule South-Eastern Underwriters and restore the status quo. To the contrary, it transformed the legal landscape by overturning the normal rules of pre-emption. Ordinarily, a federal law supersedes any inconsistent state law. The first clause of §2(b) reverses this by imposing what is, in effect, a clear-statement rule, a rule that state laws enacted 'for the business of insurance' do not yield to conflicting federal statutes unless a federal statute specifically requires otherwise."
- Upholding, a permissible construction of 12 U.S.C. §92, the Comptroller's interpretation that §92 "imposes no geographic limit on the insurance market so that, as long as it is located in a small town, a bank is free to solicit and serve insurance customers everywhere."

- Issue - whether the fiduciary duties imposed by the Employee Retirement Income Security Act of 1974 ("ERISA") (29 U.S.C. §1001 et seq.) supersede conflicting standards of conduct established for insurance companies by state insurance law. The insurance company argued that McCarran-Ferguson §2(b) preserved the state law.
- The Supreme Court rejected this argument because "ERISA, both in general and in the guaranteed benefit policy provision in particular, obviously and specifically relates to the business of insurance." John Hancock, 114 S.Ct. at 525.
- No cite to Fabe.


-- the laws of the state in which the branch is located regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches will apply to the branch to the same extent as they apply to the branch of an in-state bank with two exceptions.
-- Exception #1: "when federal law preempts the application of such State laws to a national bank"

-- Exception #2: when the Comptroller determines "that the application of such State laws would have a discriminatory effect on the branch in comparison with the effect the application of such State laws would have with respect to branches of a bank chartered by the host State."

-- Wild Card Statement: "No provision of this subsection may be construed as affecting the legal standards for preemption of the application of State law to national banks".


-- the laws of the state in which the branch is located regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches will apply to the branch to the same extent as they apply to the branch of an in-state bank.

-- Further, an interstate branch of a state-chartered bank may not engage in any activity that is not permissible for a bank chartered by the state in which the branch is located.

§114: all "appropriate Federal banking agencies" (as defined in FDIA §3) must give public notice and allow public comment before issuing "any opinion letter or interpretive rule . . . that concludes that Federal law preempts the application to a national bank of any State law regarding community reinvestment, consumer protection, fair lending or the establishment of intrastate branches."

Does not apply to opinion letters or interpretive rules which raises issues "that are essentially identical to those previously resolved by the courts or on which the agency has previously issued an opinion letter or interpretive rule".
- Court affirms decision by Indiana Commissioner of Insurance to issue an insurance license to a national bank but limiting the scope of the license to activities only "within the geographic boundaries of a town with a population of 5,000 or less in which it is located and doing business."

- The "'clear intent' of Congress in passing Section 92 was to permit banks located in small communities to sell insurance within those small communities only."

Owensboro National Bank v. Stephens, Nos. 92-6330/6331 (6th Cir.) (2-1 decision).
- Majority (Guy; McKeague) rules that 12 U.S.C. §92 preempts KRS 287.030(4) and McCarran-Ferguson Act §2(b) does not save statute from preemption because KRS 287.030(4) does not "regulate" the "business of insurance".

- Dissent (Batchelder) would find that KRS 287.030(4) is saved because it satisfies both prongs of McCarran-Ferguson §2(b).

-- Did not cite John Hancock, however.

- national banks' incidental powers under 12 U.S.C. §24(7) include that authority to brokerage fixed and variable annuities.

- "We expressly hold that the 'business of banking' is not limited to the enumerated powers in §24 (Seventh) and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated. The exercise of the Comptroller's discretion, however, must be kept within reasonable bounds. Ventures distant from dealing in financial investment instruments - for example, operating a general travel agency - may exceed those bounds." [Id. at 814].

- Court's defers to Comptroller's construction of "incidental powers"
12 U.S.C. §92 does not act as a limitation because "annuities are properly classified as investments, not 'insurance'". [Id. at 815. Does not reach the question of "whether §92, by negative implication, precludes national banks located in places more populous than 5,000 from selling insurance."

1/25/95 Department of Insurance and insurance trade associations file petition for rehearing and suggestion of rehearing en banc with Sixth Circuit in Owensboro National Bank.
- heart of argument: Sixth Circuit panel did not follow Supreme Court's instructions in Fabe.

1/30/95 Barnett Bank of Marion County, N.A. v. Gallagher, 1995 WL 12117 (11th Cir. 1/30/95).
- 11th Circuit panel (3-0) holds that McCarran-Ferguson §2(b) preserves Florida law prohibiting financial institutions from acting as non-credit insurance agents or being affiliates with such agents against preemption claim based upon 12 U.S.C. §92.

- Petition for rehearing and rehearing en banc expected to be filed by national bank.

2/14/95 6th Circuit directs national banks and OCC to file a 10-page brief responding to petition for rehearing in Owensboro National Bank.

3/3/95 First Advantage Insurance, Inc. v. Green, State of Louisiana, Court of Appeal, No. 94/CA/0813 (3-0).
- Affirms ruling by Louisiana Commissioner of Insurance that wholly owned subsidiary of a national bank (which in turn is the subsidiary of a bank holding company) may only sell credit-related insurance to its customers in towns with a population of 5,000 or less.

- Applies Fabe "clear statement" rule for when §92 "specifically relates" to business of insurance.

- "[W]e believe the opinion in Barnett Bank by the Eleventh Circuit Court of Appeal and the dissenting opinion in Owensboro by the Sixth Circuit Court of Appeal are the better reasoned
and are more persuasive than the majority opinion in Owensboro."

II. Bank Percentage Leases - A Historical Summary.

1970

Kentucky substantially rewrites its insurance laws and creates an "Insurance Code". 1970 Ky. Acts Ch. 301. KRS 304.9-420 enacted by §42:

"No agent or solicitor shall directly or indirectly share his commission or other compensation received or to be received under his license with any person not also licensed as agent or solicitor under this subtitle as to the kinds of insurance involved in the transaction. This provision shall not affect personal use of such commissions or compensation, payment of the regular salaries due employes of the agent or distribution in the regular course of business of compensation and profits among members or stockholders of licensee firms or corporations."

1982

KRS 304.9-425 enacted:

"No . . . insurance agent . . . shall pay directly or indirectly, any commission, brokerage, or other valuable consideration to any person for services as an insurance agent . . . within this state unless such person held at the time such services were performed a valid license for that line of insurance as required by the laws of this state for such services; nor shall any person, other than a person duly licensed by this state . . ., accept any such commission, brokerage, or other valuable consideration. . . ."

1982

Concern exists that KRS 304.9-420 is accidentally repealed by 1982 Ky. Act. Ch. 171, §5 and §8.

12/2/83

OCC Interpretive Letter No. 274:

- national banks may sell space to insurance agents "based in part on volume of sales".
"By leasing a portion of its premises to an insurance agent on a percentage lease, a national bank is not engaging in the insurance business or acting as an insurance agent . . . ."

"[S]tate insurance laws, such as laws barring the payment to or the splitting of commissions with unlicensed parties, cannot bar a national bank and an insurance agent from entering into a percentage lease."


National bank lessors "should include a clause expressly negating a partnership or joint venture. For safe and sound banking purposes, this clause should also preclude any bank liability for the tenant's debts and liabilities."


Kentucky enacts KRS 304.9-421 to replace KRS 304.920. 1984 Ky. Acts Ch. 322, §9:

"No agent, solicitor, consultant, adjuster, or surplus lines broker shall directly or indirectly share his commission or other compensation received or to be received on account of a transaction under his license with any person not also licensed as agent, solicitor, consultant, adjuster, or surplus lines broker under this subtitle as to the kinds of insurance involved in the transaction. This provision shall not affect personal use of such commissions or compensation, payment of the regular salaries due employees of the agent, consultant, adjuster, or surplus lines broker, or distribution in the regular course of business of compensation and profits among members or stockholders of licensee firms or corporations."
FDIC-88-43.

FDIC does not have objections to bank permitting unrelated third party to offer "securities, life insurance, financial planning services, and employee benefits packages to the bank's customers" from leased bank space in which "bank will receive 30% of all the commissions generated... in lieu of rent".

FDIC's concerns are "safe and sound banking practice" and would "require that the bank be adequately compensated."

Letter from Kentucky Department of Insurance (Stephen B. Cox) to New York Senator Martin Solomon approving bank percentage leases to insurance agents.

Letter from Kentucky Department of Insurance (Stephen B. Cox) to Mr. Kenneth Kehrer approving bank percentage leases to insurance agents.

KenBanc Life & Annuity Agency, Inc. submits request to Kentucky Attorney General for opinion "as to the validity under Kentucky law of the [proposed] leases and activities of KenBanc Life in marketing fixed annuities."

Kentucky Attorney General refers matter to the General Counsels of the Department of Financial Institutions and Department of Insurance with the request that they "respond to [KenBanc's] questions."

Department of Financial Institutions (Edward B. Hatchett, Jr.) responds to KenBanc Life and "finding no provision in KRS Chapter 287 that would prohibit the leasing of bank premises by the subsidiary as you have proposed in your letter to General Cowan."


OCC opinion (Interpretive Letter No. 562) reaffirming earlier approval of percentage leases.

Department of Insurance issues life agent license to KenBanc Life.
Request made to Governor pursuant to KRS 12.100 to finally determine that KenBanc Life's annuity program marketed from office space leased in bank offices is completely legal.

J. Patrick Abell exercises his authority under KRS 12.100 and issues Memorandum to Commissioner of Insurance Don Stephens determining that percentage leases between insurance agents and landlords do not violate the "insurance code's prohibition against commission sharing."

Suetta Dickinson, Acting General Counsel of the Insurance Department, ignores Patrick Abell's decision and issues memorandum to Commissioner Stephens disputing J. Patrick Abell's resolution of the matter.

Letter from Bill G. Houston, Regional Director of the FDIC, advising that FDIC's Legal Division follows OCC's position that KenBanc Life's lease and dual employee is permissible for banks.

OCC, FDIC, FRB, and OTS issue Interagency Statement On Retail Sales of Nondeposit Investment Products.
- Statement applies "when retail recommendations or sales of nondeposit investment products are made by . . . employees of a third party, which may or may not be affiliated with the institution occurring on the premises of the institutions (including telephone sales or recommendations by employees or from the institution's premises and sales or recommendations initiated by mail from its premises);"

- Statement does not apply to the "subsidiaries of insured state nonmember banks, which are subject to separate provisions, contained in 12 CFR 337.4, relating to securities activities."

- Overview: to "ensure that customers for these products are clearly and fully informed of the nature and risks associated with these products."

Old Colony Insurance Agency (West), Inc. ("OCI West") leases space from the Peoples First National Bank & Trust Company of Paducah.
10/17/94 Independent Insurance Agents of Kentucky, Inc. ("IIAK") requests Kentucky Department of Insurance to investigate legality of OCI West lease.

10/18/94 IIAK announces establishment of a "Task Force for the Continued Separation of Banks and Insurance."

12/6/94 IIAK and Paducah insurance agent file suit against OCI West and Department of Insurance over percentage lease. Independent Insurance Agents of Kentucky, Inc. v. Stephens, Franklin Circuit Court, No. 94-CI-01821.

2/8/95 Franklin Circuit Court dismisses Department of Insurance from the IIAK lawsuit for failure to exhaust administrative remedies.

2/16/95 Department of Insurance notices formal hearing on OCI West lease.
RIEGLE - NEAL
INTERSTATE BANKING AND BRANCHING
EFFICIENCY ACT OF 1994

Walter R. Byrne, Jr.
Stites & Harbison
Lexington, Kentucky

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SECTION B
RIEGLE - NEAL
INTERSTATE BANKING AND BRANCHING EFFICIENCY ACT
OF 1994

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RIEGLE-NEAL INTERSTATE BANKING
AND
BRANCHING EFFICIENCY ACT OF 1994
by
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I. OVERVIEW: The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Act"), enacted September 29, 1994, permits domestic and international banking organizations to engage in interstate bank acquisitions and interstate branching by merger and consolidation.

II. INTERSTATE BANKING: One year after enactment (September 29, 1995), adequately capitalized (according to federal regulatory capital standards), adequately managed bank holding companies may, with applicable federal agency approval, acquire subsidiary banks within any state.

A. No Opt-Out: States may not "opt-out" of the interstate banking provision. The Federal Reserve Board may approve an application for interstate acquisition regardless of whether such transactions are permitted under the law of the state in which the bank to be acquired is located.

B. Entry Limitations: States may protect new charters by prohibiting the acquisition of banks which are less than five years old. The Act preempts any age requirement greater than five years. A "shell bank" that has been chartered solely for the purpose of facilitating a bank holding company's
acquisition of an existing bank and does not open for business prior to acquiring control of or acquiring the assets of, the existing bank will be deemed to be in existence for the same period of time as the existing bank.

C. State Deposit Caps: Nothing in the Act affects state authority to impose "nondiscriminatory" deposit caps (i.e. caps which apply to both out-of-state and in-state banks and bank holding companies). Existing state laws which meet this nondiscriminatory test will remain in effect; other states may choose to enact such provisions.

D. Concentration Limits:

1. Nationwide: An application cannot be approved if the bank holding company applicant controls, or would control, upon consummation of the acquisition, more than ten percent (10%) of the total amount of deposits of all insured depository institutions in the United States.

2. Statewide: In addition, the Act imposes state deposit concentration limits. Specifically, a bank may not receive federal approval for interstate expansion if it and its affiliates would control more than thirty percent (30%) of deposits in any one state.

3. States may by statute, regulation or order, raise or lower the limit on a non-discriminatory basis and state law prevails.
4. Concentration limits are on-going for future acquisitions and not merely applicable to initial entry into the state.

5. The concentration limits are not intended to affect the applicability of federal or non-discriminatory state antitrust laws and similar state laws.

E. Community Reinvestment Act Compliance. In its review of an application of a bank holding company to acquire a subsidiary bank, the Federal Reserve Board is required to "take into account" the applicant’s record of compliance with state and federal community reinvestment laws.

F. Agency Authority:

1. Banks: A bank holding company’s bank subsidiary may act as agent for sister banks or thrifts in offering specified limited banking services (specifically, receive deposits, renew time deposits, close and service loans, and receive payments on loans and other obligations), both within and across state lines. In addition, such agency relationships must be on terms that are consistent with safe and sound banking practices and all applicable banking regulations. A bank acting as agent for a depository institutions shall not be considered to be a branch of the affiliate.

2. Savings Institutions: An insured savings association that was an affiliate of a bank as of July 1, 1994, may act as agent for the
bank in states in which the principal could operate a branch and in which they had operations as of July 1, 1994.

3. Prohibited Activities: A bank subsidiary may not conduct any of these activities as an agent if the institution is prohibited from conducting an activity as a principal under applicable federal or state law. A bank subsidiary may not conduct any of these activities if the institution itself is prohibited from conducting the activity under federal or state laws.

G. State Taxation Authority. The authority of the state, or political subdivision thereof, to adopt, apply or administer any tax or method of taxation to any domestic or foreign banking organization or any affiliate thereof is unaffected to the extent that the tax or tax method is otherwise permissible by or under the Constitution or other federal laws. The Conference Report states the intent of the conferees is to reaffirm that states may segregate separately incorporated entities within a bank or bank holding company for state taxation purposes.

III. INTERSTATE BRANCHING: On June 1, 1997, insured banks located in different states may merge and operate their existing bank operations to form interstate branching networks.
A. **State Entry Rules:** Bank mergers would have to comply with non-discriminatory state laws imposing age restrictions up to five (5) years on acquisitions.

B. **Opt-out:** States have the right to decide whether to participate in interstate bank mergers. Before June 1, 1997, states have the right to pass non-discriminatory legislation effectively opting-out of this provision. These states would not be permitted to have interstate branches. Such laws would not apply retroactively to merger transactions that are approved before the effective date of the state law.

C. **Early Opt-In:** Interstate branching may be permitted earlier if both states involved in an interstate bank merger transaction expressly permit it by statute. States opting-in early may impose certain temporary conditions on such mergers so long as these conditions do not discriminate against out-of-state banks, are not pre-empted by federal law and are limited in duration so that they expire no later than May 31, 1997.

D. **State Opt-In to De Novo Branching:** An out-of-state bank may establish and operate a "de novo" branch, i.e. a new branch established without first acquiring an existing institution, **only if the state has passed a specific piece of legislation expressly allowing de novo branching.**

E. **State Opt-In to Branch Acquisitions:** An out-of-state bank may likewise acquire a branch of an insured bank without the acquisition of the entire bank (i.e. the bank's charter), **only if the law of the state in which the**
branch is located permits out-of-state banks to acquire a branch without acquiring the bank. The branch will be treated for purposes of the Act as an insured bank, the home state of which is the state in which the branch is located.

F. State Inaction: If a particular state does not enact legislation "opting out" of or permitting interstate branching, state-chartered banks within its borders will not be allowed to branch out-of-state, unless permitted under Kentucky Revised Statutes Section 287.020(3), which is referred to as the "parity" section.

G. Conditions and Restrictions.

1. Minimum Age/Concentration limits. The minimum age requirements and deposit concentration limits applicable to interstate banking are applicable to interstate branching.

2. State Filing Requirements. A bank filing an interstate merger transaction application with a federal banking agency is also required to submit a copy of the application to the host state’s bank supervisor and comply with any host state filing requirements to the extent that the requirement (i) does not have the effect of discriminating against out-of-state banking organizations or their subsidiaries and (ii) is similar in effect to any requirement imposed by the host state on a non-banking corporation incorporated in another state that engages in business in the host state. If the bank
materially fails to comply with these requirements, the responsible 
federal banking agency is not permitted to approve the transaction.

H. **Safety and Soundness.** Regulators must primarily consider the safety and 
soundness and capital position of the acquiring bank.

I. **Community Reinvestment Act Compliance.** The Community 
Reinvestment Act rating of the bank and its affiliated institutions must 
also be considered by regulators.

J. **Applicability of Certain State Laws.**

1. **State Taxation Authority.** The Act does not affect the authority of 
any state or political subdivision to administer any tax or method 
of taxation to any domestic or foreign banking organization or any 
affiliate thereof is unaffected to the extent that the tax or tax 
method is otherwise permissible by or under the Constitution or 
other federal laws. A proportionate amount of the value of the 
out-of-state bank's shares may be subject to any bank shares tax 
levied or imposed by a branch's host state or any political 
subdivision thereof.

2. **State Notice and Reporting Requirements.** A host state is author- 
ized to impose any notification or reporting requirement on 
branches of out-of-state banks so long as the requirement does not 
discriminate against out-of-state banking organizations and is not 
pre-empted by federal law.
IV. FOREIGN BANKS: Foreign Banks are able to take advantage of the Act to the same extent as U.S. Banks so long as they do so through U.S. subsidiaries. The Act allows branches only by acquisition. States wishing to allow foreign banks to branch de novo into their borders may pass a law specifically allowing this. If a foreign bank branch acquires an institution which was previously subject to the Community Reinvestment Act, it must continue to comply with the Community Reinvestment Act, even if it divests the retail operations, is not eligible for deposit insurance and only runs wholesale operations in that institution.

V. STATE LAW: The Act allows state law to apply to reporting requirements, community reinvestment, consumer protection, fair lending and intrastate branching as long as these laws are applied on a non-discriminatory basis and unless specifically preempted by federal law.

VI. BRANCH CLOSINGS: The act requires Regulators to consult with community groups that have undertaken a non-frivolous protest before permitting an interstate institution to close a branch in a low or moderate income area.

VII. DEPOSIT PRODUCTION OFFICES: The federal banking agencies are required to prescribe uniform regulations effective June 1, 1997 prohibiting out-of-state banks from using any authority to engage in interstate branching primarily for the purpose of deposit production. The regulations must include
guidelines to ensure that interstate branches operated by an out-of-state bank in a host state are reasonably helping to meet the credit needs of the communities in which the branches serve. If the federal agency determines that an out-of-state bank is not helping to meet those needs, it may order the closing of a particular interstate branch of such bank in the host state.

VIII. COORDINATION OF EXAMINATION AUTHORITY: A state bank supervisor of a host state may examine a branch of an out-of-state state bank resulting from an interstate banking transaction for compliance with host state law, and to ensure that the branch is being operated in a safe and sound manner. If a state bank supervisor of a host state determines that there is a violation of host state law, the supervisor may take such enforcement action as would be permitted as if the branch were a host state bank. State bank supervisors from two or more states may enter into cooperative agreements to facilitate state regulatory supervision of state banks, including cooperative agreements relating to the coordination of examinations and joint participations in examinations.

IX. STATUTE OF LIMITATIONS: The statute of limitations is extended for particular claims made against individuals involved with failed banks and thrifts, specifically "fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to the institution."
X. POWERS OF THE ACT: The Act provides greater benefit to national banks than to state-chartered banks. National banks are allowed to export their national bank powers throughout the country whereas state-chartered banks will have to look to the laws of each state entered for powers. In addition, if a bank entered a state before the date of enactment of the Act under conditions or commitments set by the state, the bank must continue to comply with these conditions or commitments.

XI. OTHER APPLICABLE PROVISIONS:

A. United States Financial Services Systems Study. The Secretary of the Treasury is required to conduct a study of matters relating to the strengths and weaknesses of the United States financial services system in meeting the needs of users.

B. Federal Reserve Bank Board Study. The Federal Reserve Board is required to conduct a study of certain retail banking services provided by depository institutions and the fees, if any, imposed by institutions for providing those services.
Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994


§ 1000

SEC. 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

TITLE I—INTERSTATE BANKING AND BRANCHING

§ 1001

SEC. 101. INTERSTATE BANKING.

(a) IN GENERAL.—Section 3(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(d)) is amended to read as follows:

"(d) INTERSTATE BANKING.—

"(1) APPROVALS AUTHORIZED.—

"(A) ACQUISITION OF BANKS.—The Board may approve an application under this section by a bank holding company that is adequately capitalized and adequately managed to acquire control of, or acquire all or substantially all of the assets of, a bank located in a State other than the home State of such bank holding company, without regard to whether such transaction is prohibited under the law of any State.

"(B) PRESERVATION OF STATE AGE LAWS.—

"(i) IN GENERAL.—Notwithstanding subparagraph (A), the Board may not approve an application pursuant to such subparagraph that would have the effect of permitting an out-of-State bank holding company to acquire a bank in a host State that has not been in existence for the minimum period of time, if any, specified in the statutory law of the host State.

"(ii) SPECIAL RULE FOR STATE AGE LAWS SPECIFYING A PERIOD OF MORE THAN 5 YEARS.—Notwithstanding clause (i), the Board may approve, pursuant to subparagraph (A), the acquisition of a bank that has been in existence for at least 5 years without regard to any longer minimum period of time specified in a statutory law of the host State."
Interstate Banking and Branching Act

“(C) SHELL BANKS.—For purposes of this subsection, a bank that has been chartered solely for the purpose of, and does not open for business prior to, acquiring control of, or acquiring all or substantially all of the assets of, an existing bank shall be deemed to have been in existence for the same period of time as the bank to be acquired.

“(D) EFFECT ON STATE CONTINGENCY LAWS.—No provision of this subsection shall be construed as affecting the applicability of a State law that makes an acquisition of a bank contingent upon a requirement to hold a portion of such bank's assets available for call by a State-sponsored housing entity established pursuant to State law, if—

“(i) the State law does not have the effect of discriminating against out-of-State banks, out-of-State bank holding companies, or subsidiaries of such banks or bank holding companies;

“(ii) that State law was in effect as of the date of enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994;

“(iii) the Federal Deposit Insurance Corporation has not determined that compliance with such State law would result in an unacceptable risk to the appropriate deposit insurance fund; and

“(iv) the appropriate Federal banking agency for such bank has not found that compliance with such State law would place the bank in an unsafe or unsound condition.

“(2) CONCENTRATION LIMITS.—

“(A) NATIONWIDE CONCENTRATION LIMITS.—The Board may not approve an application pursuant to paragraph (1)(A) if the applicant (including all insured depository institutions which are affiliates of the applicant) controls, or upon consummation of the acquisition for which such application is filed would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States.

“(B) STATEWIDE CONCENTRATION LIMITS OTHER THAN WITH RESPECT TO INITIAL ENTRIES.—The Board may not approve an application pursuant to paragraph (1)(A) if—

“(i) immediately before the consummation of the acquisition for which such application is filed, the applicant (including any insured depository institution affiliate of the applicant) controls any insured depository institution or any branch of an insured depository institution in the home State of any bank to be acquired or in any host State in which any such bank maintains a branch; and
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"(ii) the applicant (including all insured depository institutions which are affiliates of the applicant), upon consummation of the acquisition, would control 30 percent or more of the total amount of deposits of insured depository institutions in any such State.

"(C) Effectiveness of State Deposit Caps.—No provision of this subsection shall be construed as affecting the authority of any State to limit, by statute, regulation, or order, the percentage of the total amount of deposits of insured depository institutions in the State which may be held or controlled by any bank or bank holding company (including all insured depository institutions which are affiliates of the bank or bank holding company) to the extent the application of such limitation does not discriminate against out-of-State banks, out-of-State bank holding companies, or subsidiaries of such banks or holding companies.

"(D) Exceptions to Subparagraph (B).—The Board may approve an application pursuant to paragraph (1)(A) without regard to the applicability of subparagraph (B) with respect to any State if—

"(i) there is a limitation described in subparagraph (C) in a State statute, regulation, or order which has the effect of permitting a bank or bank holding company (including all insured depository institutions which are affiliates of the bank or bank holding company) to control a greater percentage of total deposits of all insured depository institutions in the State than the percentage permitted under subparagraph (B); or

"(ii) the acquisition is approved by the appropriate State bank supervisor of such State and the standard on which such approval is based does not have the effect of discriminating against out-of-State banks, out-of-State bank holding companies, or subsidiaries of such banks or holding companies.

"(E) Deposit Defined.—For purposes of this paragraph, the term 'deposit' has the same meaning as in section 3(l) of the Federal Deposit Insurance Act.

"(3) Community Reinvestment Compliance.—In determining whether to approve an application under paragraph (1)(A), the Board shall—

"(A) comply with the responsibilities of the Board regarding such application under section 804 of the Community Reinvestment Act of 1977; and

"(B) take into account the applicant's record of compliance with applicable State community reinvestment laws.

"(4) Applicability of Antitrust Laws.—No provision of this subsection shall be construed as affecting—

"(A) the applicability of the antitrust laws; or
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“(B) the applicability, if any, of any State law which is similar to the antitrust laws.

“(5) EXCEPTION FOR BANKS IN DEFAULT OR IN DANGER OF DEFAULT.—The Board may approve an application pursuant to paragraph (1)(A) which involves—

“(A) an acquisition of 1 or more banks in default or in danger of default; or

“(B) an acquisition with respect to which assistance is provided under section 13(c) of the Federal Deposit Insurance Act; without regard to subparagraph (B) or (D) of paragraph (1) or paragraph (2) or (3).”.

(b) STATE TAXATION AUTHORITY NOT AFFECTED.—Section 7 of the Bank Holding Company Act of 1956 (12 U.S.C. 1846) is amended—

(1) by striking “No provision” and inserting “(a) IN GENERAL.—No provision”; and

(2) by adding at the end the following new subsection:

“(B) STATE TAXATION AUTHORITY NOT AFFECTED.—No provision of this Act shall be construed as affecting the authority of any State or political subdivision of any State to adopt, apply, or administer any tax or method of taxation to any bank, bank holding company, or foreign bank, or any affiliate of any bank, bank holding company, or foreign bank, to the extent that such tax or tax method is otherwise permissible by or under the Constitution of the United States or other Federal law.”.

(c) DEFINITIONS.—Section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) is amended by adding at the end the following new subsections:

“(n) INCORPORATED DEFINITIONS.—For purposes of this Act, the terms ‘insured depository institution’, ‘appropriate Federal banking agency’, ‘default’, ‘in danger of default’, and ‘State bank supervisor’ have the same meanings as in section 3 of the Federal Deposit Insurance Act.

“(o) OTHER DEFINITIONS.—For purposes of this Act, the following definitions shall apply:

“(1) ADEQUATELY CAPITALIZED.—The term ‘adequately capitalized’ means a level of capitalization which meets or exceeds all applicable Federal regulatory capital standards.

“(2) ANTITRUST LAWS.—Except as provided in section 11, the term ‘antitrust laws’—

“(A) has the same meaning as in subsection (a) of the first section of the Clayton Act; and

“(B) includes section 5 of the Federal Trade Commission Act to the extent that such section 5 relates to unfair methods of competition.
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(3) BRANCH.—The term 'branch' means a domestic branch (as defined in section 3 of the Federal Deposit Insurance Act).

(4) HOME STATE.—The term 'home State' means—

(A) with respect to a national bank, the State in which the main office of the bank is located;

(B) with respect to a State bank, the State by which the bank is chartered; and

(C) with respect to a bank holding company, the State in which the total deposits of all banking subsidiaries of such company are the largest on the later of—

(i) July 1, 1966; or

(ii) the date on which the company becomes a bank holding company under this Act.

(5) HOST STATE.—The term 'host State' means—

(A) with respect to a bank, a State, other than the home State of the bank, in which the bank maintains, or seeks to establish and maintain, a branch; and

(B) with respect to a bank holding company, a State, other than the home State of the company, in which the company controls, or seeks to control, a bank subsidiary.

(6) OUT-OF-STATE BANK.—The term 'out-of-State bank' means, with respect to any State, a bank whose home State is another State.

(7) OUT-OF-STATE BANK HOLDING COMPANY.—The term 'out-of-State bank holding company' means, with respect to any State, a bank holding company whose home State is another State.

(d) SUBSIDIARY DEPOSITORY INSTITUTIONS AS AGENTS.—Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) is amended by adding at the end the following new subsection:

(r) SUBSIDIARY DEPOSITORY INSTITUTIONS AS AGENTS FOR CERTAIN AFFILIATES.—

(1) IN GENERAL.—Any bank subsidiary of a bank holding company may receive deposits, renew time deposits, close loans, service loans, and receive payments on loans and other obligations as an agent for a depository institution affiliate.

(2) BANK ACTING AS AGENT IS NOT A BRANCH.—Notwithstanding any other provision of law, a bank acting as an agent in accordance with paragraph (1) for a depository institution affiliate shall not be considered to be a branch of the affiliate.

(3) PROHIBITIONS ON ACTIVITIES.—A depository institution may not—
"(A) conduct any activity as an agent under paragraph (1) or (6) which such institution is prohibited from conducting as a principal under any applicable Federal or State law; or

"(B) as a principal, have an agent conduct any activity under paragraph (1) or (6) which the institution is prohibited from conducting under any applicable Federal or State law.

"(4) EXISTING AUTHORITY NOT AFFECTED.—No provision of this subsection shall be construed as affecting—

"(A) the authority of any depository institution to act as an agent on behalf of any other depository institution under any other provision of law; or

"(B) whether a depository institution which conducts any activity as an agent on behalf of any other depository institution under any other provision of law shall be considered to be a branch of such other institution.

"(5) AGENCY RELATIONSHIP REQUIRED TO BE CONSISTENT WITH SAFE AND SOUND BANKING PRACTICES.—An agency relationship between depository institutions under paragraph (1) or (6) shall be on terms that are consistent with safe and sound banking practices and all applicable regulations of any appropriate Federal banking agency.

"(6) AFFILIATED INSURED SAVINGS ASSOCIATIONS.—An insured savings association which was an affiliate of a bank on July 1, 1994, may conduct activities as an agent on behalf of such bank in the same manner as an insured bank affiliate of such bank may act as agent for such bank under this subsection to the extent such activities are conducted only in—

"(A) any State in which—

"(i) the bank is not prohibited from operating a branch under any provision of Federal or State law; and

"(ii) the savings association maintained an office or branch and conducted business as of July 1, 1994; or

"(B) any State in which—

"(i) the bank is not expressly prohibited from operating a branch under a State law described in section 44(a)(2); and

"(ii) the savings association maintained a main office and conducted business as of July 1, 1994.”.

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect at the end of the 1-year period beginning on the date of the enactment of this Act.
SEC. 102. INTERSTATE BANK Mergers.

(a) In General.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by adding at the end the following new section:

"SEC. 44. INTERSTATE BANK Mergers.

"(a) Approval of Interstate Merger Transactions Authorized.—

"(1) In General.—Beginning on June 1, 1997, the responsible agency may approve a merger transaction under section 18(c) between insured banks with different home States, without regard to whether such transaction is prohibited under the law of any State.

"(2) State Election to Prohibit Interstate Merger Transactions.—

"(A) In General.—Notwithstanding paragraph (1), a merger transaction may not be approved pursuant to paragraph (1) if the transaction involves a bank the home State of which has enacted a law after the date of enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 and before June 1, 1997, that—

"(i) applies equally to all out-of-State banks; and

"(ii) expressly prohibits merger transactions involving out-of-State banks.

"(B) No Effect on Prior Approvals of Merger Transactions.—A law enacted by a State pursuant to subparagraph (A) shall have no effect on merger transactions that were approved before the effective date of such law.

"(3) State Election to Permit Early Interstate Merger Transactions.—

"(A) In General.—A merger transaction may be approved pursuant to paragraph (1) before June 1, 1997, if the home State of each bank involved in the transaction has in effect, as of the date of the approval of such transaction, a law that—

"(i) applies equally to all out-of-State banks; and

"(ii) expressly permits interstate merger transactions with all out-of-State banks.

"(B) Certain Conditions Allowed.—A host State may impose conditions on a branch within such State of a bank resulting from an interstate merger transaction if—

"(i) the conditions do not have the effect of discriminating against out-of-State banks, out-of-State bank holding companies, or any subsidiary of such bank or company (other than on the basis of a nationwide reciprocal treatment requirement);
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“(ii) the imposition of the conditions is not preempted by Federal law; and
“(iii) the conditions do not apply or require performance after May 31, 1997.

“(4) INTERSTATE MERGER TRANSACTIONS INVOLVING ACQUISITIONS OF BRANCHES.—

“(A) IN GENERAL.—An interstate merger transaction may involve the acquisition of a branch of an insured bank without the acquisition of the bank only if the law of the State in which the branch is located permits out-of-State banks to acquire a branch of a bank in such State without acquiring the bank.

“(B) TREATMENT OF BRANCH FOR PURPOSES OF THIS SECTION.—In the case of an interstate merger transaction which involves the acquisition of a branch of an insured bank without the acquisition of the bank, the branch shall be treated, for purposes of this section, as an insured bank the home State of which is the State in which the branch is located.

“(5) PRESERVATION OF STATE AGE LAWS.—

“(A) IN GENERAL.—The responsible agency may not approve an application pursuant to paragraph (1) that would have the effect of permitting an out-of-State bank or out-of-State bank holding company to acquire a bank in a host State that has not been in existence for the minimum period of time, if any, specified in the statutory law of the host State.

“(B) SPECIAL RULE FOR STATE AGE LAWS SPECIFYING A PERIOD OF MORE THAN 5 YEARS.—Notwithstanding subparagraph (A), the responsible agency may approve a merger transaction pursuant to paragraph (1) involving the acquisition of a bank that has been in existence at least 5 years without regard to any longer minimum period of time specified in a statutory law of the host State.

“(6) SHELL BANKS.—For purposes of this subsection, a bank that has been chartered solely for the purpose of, and does not open for business prior to, acquiring control of, or acquiring all or substantially all of the assets of, an existing bank or branch shall be deemed to have been in existence for the same period of time as the bank or branch to be acquired.

“(B) PROVISIONS RELATING TO APPLICATION AND APPROVAL PROCESS.—

“(1) COMPLIANCE WITH STATE FILING REQUIREMENTS.—

“(A) IN GENERAL.—Any bank which files an application for an interstate merger transaction shall—

“(i) comply with the filing requirements of any host State of the bank which will result from such transaction to the extent that the requirement—
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"(I) does not have the effect of discriminating against out-of-State banks or out-of-State bank holding companies or subsidiaries of such banks or bank holding companies; and

"(II) is similar in effect to any requirement imposed by the host State on a nonbanking corporation incorporated in another State that engages in business in the host State; and

"(ii) submit a copy of the application to the State bank supervisor of the host State.

"(B) PENALTY FOR FAILURE TO COMPLY.—The responsible agency may not approve an application for an interstate merger transaction if the applicant materially fails to comply with subparagraph (A).

"(2) CONCENTRATION LIMITS.—

"(A) NATIONWIDE CONCENTRATION LIMITS.—The responsible agency may not approve an application for an interstate merger transaction if the resulting bank (including all insured depository institutions which are affiliates of the resulting bank), upon consummation of the transaction, would control more than 10 percent of the total amount of deposits of insured depository institutions in the United States.

"(B) STATEWIDE CONCENTRATION LIMITS OTHER THAN WITH RESPECT TO INITIAL ENTRIES.—The responsible agency may not approve an application for an interstate merger transaction if—

"(i) any bank involved in the transaction (including all insured depository institutions which are affiliates of any such bank) has a branch in any State in which any other bank involved in the transaction has a branch; and

"(ii) the resulting bank (including all insured depository institutions which would be affiliates of the resulting bank), upon consummation of the transaction, would control 30 percent or more of the total amount of deposits of insured depository institutions in any such State.

"(C) EFFECTIVENESS OF STATE DEPOSIT CAPS.—No provision of this subsection shall be construed as affecting the authority of any State to limit, by statute, regulation, or order, the percentage of the total amount of deposits of insured depository institutions in the State which may be held or controlled by any bank or bank holding company (including all insured depository institutions which are affiliates of the bank or bank holding company) to the extent the application of such limitation does not discriminate against out-of-State banks, out-of-State bank holding companies, or subsidiaries of such banks or holding companies.

"(D) EXCEPTIONS TO SUBPARAGRAPH (b).—The responsible agency may approve an application for an interstate merger transac-
tion pursuant to subsection (a) without regard to the applicability of subparagraph (B) with respect to any State if—

“(i) there is a limitation described in subparagraph (C) in a State statute, regulation, or order which has the effect of permitting a bank or bank holding company (including all insured depository institutions which are affiliates of the bank or bank holding company) to control a greater percentage of total deposits of all insured depository institutions in the State than the percentage permitted under subparagraph (B); or

“(ii) the transaction is approved by the appropriate State bank supervisor of such State and the standard on which such approval is based does not have the effect of discriminating against out-of-State banks, out-of-State bank holding companies, or subsidiaries of such banks or holding companies.

“(E) EXCEPTION FOR CERTAIN BANKS.—This paragraph shall not apply with respect to any interstate merger transaction involving only affiliated banks.

“(3) COMMUNITY REINVESTMENT COMPLIANCE.—In determining whether to approve an application for an interstate merger transaction in which the resulting bank would have a branch or bank affiliate immediately following the transaction in any State in which the bank submitting the application (as the acquiring bank) had no branch or bank affiliate immediately before the transaction, the responsible agency shall—

“(A) comply with the responsibilities of the agency regarding such application under section 804 of the Community Reinvestment Act of 1977;

“(B) take into account the most recent written evaluation under section 804 of the Community Reinvestment Act of 1977 of any bank which would be an affiliate of the resulting bank; and

“(C) take into account the record of compliance of any applicant bank with applicable State community reinvestment laws.

“(4) ADEQUACY OF CAPITAL AND MANAGEMENT SKILLS.—The responsible agency may approve an application for an interstate merger transaction pursuant to subsection (a) only if—

“(A) each bank involved in the transaction is adequately capitalized as of the date the application is filed; and

“(B) the responsible agency determines that the resulting bank will continue to be adequately capitalized and adequately managed upon the consummation of the transaction.

“(5) SURRENDER OF CHARTER AFTER MERGER TRANSACTION.—The charters of all banks involved in an interstate merger transaction, other than the charter of the resulting bank, shall be surrendered, upon request, to the Federal banking agency or State bank supervisor which issued the charter.
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“(c) Applicability of Certain Laws to Interstate Banking Operations.—

“(1) State Taxation Authority Not Affected.—

“(a) In General.—No provision of this section shall be construed as affecting the authority of any State or political subdivision of any State to adopt, apply, or administer any tax or method of taxation to any bank, bank holding company, or foreign bank, or any affiliate of any bank, bank holding company, or foreign bank, to the extent such tax or tax method is otherwise permissible by or under the Constitution of the United States or other Federal law.

“(b) Imposition of Shares Tax by Host States.—In the case of a branch of an out-of-State bank which results from an interstate merger transaction, a proportionate amount of the value of the shares of the out-of-State bank may be subject to any bank shares tax levied or imposed by the host State, or any political subdivision of such host State that imposes such tax based upon a method adopted by the host State, which may include allocation and apportionment.

“(2) Applicability of Antitrust Laws.—No provision of this section shall be construed as affecting—

“(a) the applicability of the antitrust laws; or

“(b) the applicability, if any, of any State law which is similar to the antitrust laws.

“(3) Reservation of Certain Rights to States.—No provision of this section shall be construed as limiting in any way the right of a State to—

“(a) determine the authority of State banks chartered by that State to establish and maintain branches; or

“(b) supervise, regulate, and examine State banks chartered by that State.

“(4) State-Imposed Notice Requirements.—A host State may impose any notification or reporting requirement on a branch of an out-of-State bank if the requirement—

“(a) does not discriminate against out-of-State banks or bank holding companies; and

“(b) is not preempted by any Federal law regarding the same subject.

“(d) Operations of the Resulting Bank.—

“(1) Continued Operations.—A resulting bank may, subject to the approval of the appropriate Federal banking agency, retain and operate, as a main office or a branch, any office that any bank involved in an interstate merger transaction was operating as a main office or a branch immediately before the merger transaction.
"(2) ADDITIONAL BRANCHES.—Following the consummation of any interstate merger transaction, the resulting bank may establish, acquire, or operate additional branches at any location where any bank involved in the transaction could have established, acquired, or operated a branch under applicable Federal or State law if such bank had not been a party to the merger transaction.

"(3) CERTAIN CONDITIONS AND COMMITMENTS CONTINUED.—If, as a condition for the acquisition of a bank by an out-of-State bank holding company before the date of the enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994—

"(A) the home State of the acquired bank imposed conditions on such acquisition by such out-of-State bank holding company; or

"(B) the bank holding company made commitments to such State in connection with the acquisition, the State may enforce such conditions and commitments with respect to such bank holding company or any affiliated successor company which controls a bank or branch in such State as a result of an interstate merger transaction to the same extent as the State could enforce such conditions or commitments against the bank holding company before the consummation of the merger transaction.

"(e) EXCEPTION FOR BANKS IN DEFAULT OR IN DANGER OF DEFAULT.—If an application under subsection (a)(1) for approval of a merger transaction which involves 1 or more banks in default or in danger of default or with respect to which the Corporation provides assistance under section 13(c), the responsible agency may approve such application without regard to subsection (b), or paragraph (2), (4), or (5) of subsection (a).

"(f) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

"(1) ADEQUATELY CAPITALIZED.—The term 'adequately capitalized' has the same meaning as in section 38.

"(2) ANTITRUST LAWS.—The term 'antitrust laws'—

"(A) has the same meaning as in subsection (a) of the first section of the Clayton Act; and

"(B) includes section 5 of the Federal Trade Commission Act to the extent such section 5 relates to unfair methods of competition.

"(3) BRANCH.—The term 'branch' means any domestic branch.

"(4) HOME STATE.—The term 'home State'—

"(A) means—

"(i) with respect to a national bank, the State in which the main office of the bank is located; and

"(ii) with respect to a State bank, the State by which the bank is chartered; and
"(B) with respect to a bank holding company, has the same meaning as in section 2(o)(4) of the Bank Holding Company Act of 1956.

"(5) HOST STATE.—The term ‘host State’ means, with respect to a bank, a State, other than the home State of the bank, in which the bank maintains, or seeks to establish and maintain, a branch.

"(6) INTERSTATE MERGER TRANSACTION.—The term ‘interstate merger transaction’ means any merger transaction approved pursuant to subsection (a)(1).

"(7) MERGER TRANSACTION.—The term ‘merger transaction’ has the meaning determined under section 18(c)(3).

"(8) OUT-OF-STATE BANK.—The term ‘out-of-State bank’ means, with respect to any State, a bank whose home State is another State.

"(9) OUT-OF-STATE BANK HOLDING COMPANY.—The term ‘out-of-State bank holding company’ means, with respect to any State, a bank holding company whose home State is another State.

"(10) RESPONSIBLE AGENCY.—The term ‘responsible agency’ means the agency determined in accordance with section 18(c)(2) with respect to a merger transaction.

"(11) RESULTING BANK.—The term ‘resulting bank’ means a bank that has resulted from an interstate merger transaction under this section.”.

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) REVISED STATUTES.—Section 5155 of the Revised Statutes (12 U.S.C. 36) is amended—

(A) by redesignating subsections (d) through (h) as subsections (h) through (l), respectively; and

(B) by inserting after subsection (c) the following new subsections:

"(d) BRANCHES RESULTING FROM INTERSTATE MERGER TRANSACTIONS.—A national bank resulting from an interstate merger transaction (as defined in section 44(f)(6) of the Federal Deposit Insurance Act) may maintain and operate a branch in a State other than the home State (as defined in subsection (g)(3)(B)) of such bank in accordance with section 44 of the Federal Deposit Insurance Act.

"(e) EXCLUSIVE AUTHORITY FOR ADDITIONAL BRANCHES.—

“(1) IN GENERAL.—Effective June 1, 1997, a national bank may not acquire, establish, or operate a branch in any State other than the bank’s home State (as defined in subsection (g)(3)(B)) or a State in which the bank already has a branch unless the acquisition, establishment, or operation of such branch in such State by such national bank is authorized under this section or section 13(f), 13(k), or 44 of the Federal Deposit Insurance Act.
"(2) RETENTION OF BRANCHES.—In the case of a national bank which relocates the main office of such bank from 1 State to another State after May 31, 1997, the bank may retain and operate branches within the State which was the bank's home State (as defined in subsection (g)(3)(B)) before the relocation of such office only to the extent the bank would be authorized, under this section or any other provision of law referred to in paragraph (1), to acquire, establish, or commence to operate a branch in such State if—

"(A) the bank had no branches in such State; or

"(B) the branch resulted from—

"(i) an interstate merger transaction approved pursuant to section 44 of the Federal Deposit Insurance Act; or

"(ii) a transaction after May 31, 1997, pursuant to which the bank received assistance from the Federal Deposit Insurance Corporation under section 13(c) of such Act.

"(f) LAW APPLICABLE TO INTERSTATE BRANCHING OPERATIONS.—

"(1) LAW APPLICABLE TO NATIONAL BANK BRANCHES.—

"(A) IN GENERAL.—The laws of the host State regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of-State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State, except—

"(i) when Federal law preempts the application of such State laws to a national bank; or

"(ii) when the Comptroller of the Currency determines that the application of such State laws would have a discriminatory effect on the branch in comparison with the effect the application of such State laws would have with respect to branches of a bank chartered by the host State.

"(B) ENFORCEMENT OF APPLICABLE STATE LAWS.—The provisions of any State law to which a branch of a national bank is subject under this paragraph shall be enforced, with respect to such branch, by the Comptroller of the Currency.

"(2) TREATMENT OF BRANCH AS BANK.—All laws of a host State, other than the laws regarding community reinvestment, consumer protection, fair lending, establishment of intrastate branches, and the application or administration of any tax or method of taxation, shall apply to a branch (in such State) of an out-of-State national bank to the same extent as such laws would apply if the branch were a national bank the main office of which is in such State.

"(3) RULE OF CONSTRUCTION.—No provision of this subsection may be construed as affecting the legal standards for preemption of the application of State law to national banks."
(2) ACT OF MAY 1, 1886.—Section 2 of the Act entitled “An Act to enable national banking associations to increase their capital stock and to change their names and locations.” and approved May 1, 1886 (12 U.S.C. 30) is amended by adding at the end the following new subsection:

“(c) COORDINATION WITH REVISED STATUTES.—In the case of a national bank which relocates the main office of such bank from 1 State to another State after May 31, 1997, the bank may retain and operate branches within the State from which the bank relocated such office only to the extent authorized in section 5155(e)(2) of the Revised Statutes.”.

(3) FEDERAL DEPOSIT INSURANCE ACT.—

(A) EXCLUSIVE AUTHORITY FOR ADDITIONAL BRANCHES OF STATE NONMEMBER BANKS.—Section 18(d) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) is amended by adding at the end the following new paragraph:

“(3) EXCLUSIVE AUTHORITY FOR ADDITIONAL BRANCHES.—

“(A) IN GENERAL.—Effective June 1, 1997, a State nonmember bank may not acquire, establish, or operate a branch in any State other than the bank’s home State (as defined in section 44(f)(4)) or a State in which the bank already has a branch unless the acquisition, establishment, or operation of a branch in such State by a State nonmember bank is authorized under this subsection or section 13(f), 13(k), or 44.

“(B) RETENTION OF BRANCHES.—In the case of a State nonmember bank which relocates the main office of such bank from 1 State to another State after May 31, 1997, the bank may retain and operate branches within the State which was the bank’s home State (as defined in section 44(f)(4)) before the relocation of such office only to the extent the bank would be authorized, under this section or any other provision of law referred to in subparagraph (A), to acquire, establish, or commence to operate a branch in such State if—

“(i) the bank had no branches in such State; or

“(ii) the branch resulted from—

“(I) an interstate merger transaction approved pursuant to section 44; or

“(II) a transaction after May 31, 1997, pursuant to which the bank received assistance from the Corporation under section 13(c).”.

(B) ACTIVITIES OF BRANCHES OF STATE BANKS RESULTING FROM INTERSTATE MERGER TRANSACTIONS.—Section 24 of the Federal Deposit Insurance Act (12 U.S.C. 1831a) is amended by adding at the end the following new subsection:

“(j) ACTIVITIES OF BRANCHES OF OUT-OF-STATE BANKS.—
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“(1) IN GENERAL.—The laws of a host State, including laws regarding community reinvestment, consumer protection, fair lending, and establishment of intrastate branches, shall apply to any branch in the host State of an out-of-State State bank to the same extent as such State laws apply to a branch of a bank chartered by that State.

“(2) ACTIVITIES OF BRANCHES.—An insured State bank that establishes a branch in a host State may not conduct any activity at such branch that is not permissible for a bank chartered by the host State.

“(3) DEFINITIONS.—The terms ‘host State’, ‘interstate merger transaction’, and ‘out-of-State bank’ have the same meanings as in section 44(f).”.

(4) Act of November 7, 1918.—The Act entitled “An Act to provide for the consolidation of the national banking associations.” and approved November 7, 1918 (12 U.S.C. 215 et seq.) is amended—

(A) by redesignating section 2 as section 3;
(B) by redesignating section 3 as section 5;
(C) in the 1st section, by striking “That (a) any national banking association” and inserting the following:

“SECTION 1. SHORT TITLE.

“This Act may be cited as the ‘National Bank Consolidation and Merger Act’.

“SEC. 2. CONSOLIDATION OF BANKS WITHIN THE SAME STATE.

“(a) IN GENERAL.—Any national bank”; and

(D) by inserting after section 3 (as so redesignated under subparagraph (A) of this paragraph) the following new section:

“SEC. 4. INTERSTATE CONSOLIDATIONS AND Mergers.

“(a) IN GENERAL.—A national bank may engage in a consolidation or merger under this Act with an out-of-State bank if the consolidation or merger is approved pursuant to section 44 of the Federal Deposit Insurance Act.

“(b) SCOPE OF APPLICATION.—Subsection (a) shall not apply with respect to any consolidation or merger before June 1, 1997, unless the home State of each bank involved in the transaction has in effect a law described in section 44(a)(3) of the Federal Deposit Insurance Act.

“(c) DEFINITIONS.—The terms ‘home State’ and ‘out-of-State bank’ have the same meaning as in section 44(f) of the Federal Deposit Insurance Act.”.

(5) Home Owners’ Loan Act.—Section 3 of the Home Owners’ Loan Act (12 U.S.C. 1462a) is amended—

(A) by redesignating subsections (f) through (i) as subsections (g) through (j), respectively; and
(B) by inserting after subsection (e), the following new subsection:

"(f) STATE HOMESTEAD PROVISIONS.—No provision of this Act or any other provision of law administered by the Director shall be construed as superseding any homestead provision of any State constitution, including any implementing State statute, in effect on the date of enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, or any subsequent amendment to such a State constitutional or statutory provision in effect on such date, that exempts the homestead of any person from foreclosure, or forced sale, for the payment of all debts, other than a purchase money obligation relating to the homestead, taxes due on the homestead, or an obligation arising from work and material used in constructing improvements on the homestead."

¶ 1003

SEC. 103. STATE "OPT-IN" ELECTION TO PERMIT INTERSTATE BRANCHING THROUGH DE NOVO BRANCHES.

(a) NATIONAL BANKS.—Section 5155 of the Revised Statutes (12 U.S.C. 36) is amended by inserting after subsection (f) (as added by section 102(b)) the following new subsection:

"(g) STATE 'OPT-IN' ELECTION TO PERMIT INTERSTATE BRANCHING THROUGH DE NOVO BRANCHES.—

"(1) IN GENERAL.—Subject to paragraph (2), the Comptroller of the Currency may approve an application by a national bank to establish and operate a de novo branch in a State (other than the bank's home State) in which the bank does not maintain a branch if—

"(A) there is in effect in the host State a law that—

"(i) applies equally to all banks; and

"(ii) expressly permits all out-of-State banks to establish de novo branches in such State; and

"(B) the conditions established in, or made applicable to this paragraph by, paragraph (2) are met.

"(2) CONDITIONS ON ESTABLISHMENT AND OPERATION OF INTERSTATE BRANCH.—

"(A) ESTABLISHMENT.—An application by a national bank to establish and operate a de novo branch in a host State shall be subject to the same requirements and conditions to which an application for an interstate merger transaction is subject under paragraphs (1), (3), and (4) of section 44(b) of the Federal Deposit Insurance Act.

"(B) OPERATION.—Subsections (c) and (d)(2) of section 44 of the Federal Deposit Insurance Act shall apply with respect to each
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branch of a national bank which is established and operated pursuant to an application approved under this subsection in the same manner and to the same extent such provisions of such section 44 apply to a branch of a national bank which resulted from an interstate merger transaction approved pursuant to such section 44.

“(3) DEFINITIONS.—The following definitions shall apply for purposes of this section:

“(A) DE NOVO BRANCH.—The term ‘de novo branch’ means a branch of a national bank which—

“(i) is originally established by the national bank as a branch; and

“(ii) does not become a branch of such bank as a result of—

“(I) the acquisition by the bank of an insured depository institution or a branch of an insured depository institution; or

“(II) the conversion, merger, or consolidation of any such institution or branch.

“(B) HOME STATE.—The term ‘home State’ means the State in which the main office of a national bank is located.

“(C) HOST STATE.—The term ‘host State’ means, with respect to a bank, a State, other than the home State of the bank, in which the bank maintains, or seeks to establish and maintain, a branch.”.

(b) STATE BANKS.—Section 18(d) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) is amended by inserting after paragraph (3) (as added by section 102(b)(3) of this title) the following new paragraph:

“(4) STATE ‘OPT-IN’ ELECTION TO PERMIT INTERSTATE BRANCHING THROUGH DE NOVO BRANCHES.—

“(A) IN GENERAL.—Subject to subparagraph (B), the Corporation may approve an application by an insured State nonmember bank to establish and operate a de novo branch in a State (other than the bank’s home State) in which the bank does not maintain a branch if—

“(i) there is in effect in the host State a law that—

“(I) applies equally to all banks; and

“(II) expressly permits all out-of-State banks to establish de novo branches in such State; and

“(ii) the conditions established in, or made applicable to this paragraph by, subparagraph (B) are met.

“(B) CONDITIONS ON ESTABLISHMENT AND OPERATION OF INTERSTATE BRANCH.—

“(i) ESTABLISHMENT.—An application by an insured State nonmember bank to establish and operate a de novo branch in a
host State shall be subject to the same requirements and conditions to which an application for a merger transaction is subject under paragraphs (1), (3), and (4) of section 44(b).

"(ii) Operation.—Subsections (c) and (d)(2) of section 44 shall apply with respect to each branch of an insured State nonmember bank which is established and operated pursuant to an application approved under this paragraph in the same manner and to the same extent such provisions of such section apply to a branch of a State bank which resulted from a merger transaction under such section 44.

"(C) De novo branch defined.—For purposes of this paragraph, the term ‘de novo branch’ means a branch of a State bank which—

"(i) is originally established by the State bank as a branch; and

"(ii) does not become a branch of such bank as a result of—

"(I) the acquisition by the bank of an insured depository institution or a branch of an insured depository institution; or

"(II) the conversion, merger, or consolidation of any such institution or branch.

"(D) Home State defined.—The term ‘home State’ means the State by which a State bank is chartered.

"(E) Host State defined.—The term ‘host State’ means, with respect to a bank, a State, other than the home State of the bank, in which the bank maintains, or seeks to establish and maintain, a branch.”.

¶1004

SEC. 104. BRANCHING BY FOREIGN BANKS.

(a) In general.—Section 5(a) of the International Banking Act of 1978 (12 U.S.C. 3103(a)) is amended to read as follows:

"(a) Interstate Branching and Agency Operations.—

"(1) Federal branch or agency.—Subject to the provisions of this Act and with the prior written approval by the Board and the Comptroller of the Currency of an application, a foreign bank may establish and operate a Federal branch or agency in any State outside the home State of such foreign bank to the extent that the establishment and operation of such branch would be permitted under section 5155(g) of the Revised Statutes or section 44 of the Federal Deposit Insurance Act if the foreign bank were a national bank whose home State is the same State as the home State of the foreign bank.
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“(2) STATE BRANCH OR AGENCY.—Subject to the provisions of this Act and with the prior written approval by the Board and the appropriate State bank supervisor of an application, a foreign bank may establish and operate a State branch or agency in any State outside the home State of such foreign bank to the extent that such establishment and operation would be permitted under section 18(d)(4) or 44 of the Federal Deposit Insurance Act if the foreign bank were a State bank whose home State is the same State as the home State of the foreign bank.

“(3) CRITERIA FOR DETERMINATION.—In approving an application under paragraph (1) or (2), the Board and (in the case of an application under paragraph (1)) the Comptroller of the Currency—

“(A) shall apply the standards applicable to the establishment of a foreign bank office in the United States under section 7(d);

“(B) may not approve an application unless the Board and (in the case of an application under paragraph (1)) the Comptroller of the Currency—

“(i) determine that the foreign bank's financial resources, including the capital level of the bank, are equivalent to those required for a domestic bank to be approved for branching under section 5155 of the Revised Statutes and section 44 of the Federal Deposit Insurance Act; and

“(ii) consult with the Secretary of the Treasury regarding capital equivalency; and

“(C) shall apply the same requirements and conditions to which an application for an interstate merger transaction is subject under paragraphs (1), (3), and (4) of section 44(b) of the Federal Deposit Insurance Act.

“(4) OPERATION.—Subsections (c) and (d)(2) of section 44 of the Federal Deposit Insurance Act shall apply with respect to each branch and agency of a foreign bank which is established and operated pursuant to an application approved under this subsection in the same manner and to the same extent such provisions of such section apply to a domestic branch of a national or State bank (as such terms are defined in section 3 of such Act) which resulted from a merger transaction under such section 44.

“(5) EXCLUSIVE AUTHORITY FOR ADDITIONAL BRANCHES.—Except as provided in this section, a foreign bank may not, directly or indirectly, acquire, establish, or operate a branch or agency in any State other than the home State of such bank.

“(6) REQUIREMENT FOR A SEPARATE SUBSIDIARY.—If the Board or the Comptroller of the Currency, taking into account differing regulatory or accounting standards, finds that adherence by a foreign bank to capital requirements equivalent to those imposed under section 5155 of the Revised Statutes and section 44 of the Federal Deposit Insurance Act could be verified only if the banking activities of such bank in the United

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States are carried out in a domestic banking subsidiary within the United States, the Board and (in the case of an application under paragraph (1)) the Comptroller of the Currency may approve an application under paragraph (1) or (2) subject to a requirement that the foreign bank or company controlling the foreign bank establish a domestic banking subsidiary in the United States.

"(7) ADDITIONAL AUTHORITY FOR INTERSTATE BRANCHES AND AGENCIES OF FOREIGN BANKS.—Notwithstanding paragraphs (1) and (2), a foreign bank may, with the approval of the Board and the Comptroller of the Currency, establish and operate a Federal branch or Federal agency or, with the approval of the Board and the appropriate State bank supervisor, a State branch or State agency in any State outside the foreign bank's home State if—

"(A) the establishment and operation of a branch or agency is expressly permitted by the State in which the branch or agency is to be established; and

"(B) in the case of a Federal or State branch, the branch receives only such deposits as would be permissible for a corporation organized under section 25A of the Federal Reserve Act.

"(9) HOME STATE OF DOMESTIC BANK DEFINED.—For purposes of this subsection, the term 'home State' means—

"(A) with respect to a national bank, the State in which the main office of the bank is located; and

"(B) with respect to a State bank, the State by which the bank is chartered."

(b) CONTINUED AUTHORITY FOR LIMITED BRANCHES, AGENCIES, OR COMMERCIAL LENDING COMPANIES.—Section 5(b) of the International Banking Act of 1978 (12 U.S.C. 3103(b)) is amended by adding at the end the following new sentence: "Notwithstanding subsection (a), a foreign bank may continue to operate, after the enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, any Federal branch, State branch, Federal agency, State agency, or commercial lending company subsidiary which such bank was operating on the day before the date of the enactment of such Act to the extent the branch, agency, or subsidiary continues, after the enactment of such Act, to engage in operations which were lawful under the laws in effect on the day before such date."

(c) CLARIFICATION OF BRANCHING RULES IN THE CASE OF A FOREIGN BANK WITH A DOMESTIC BANK SUBSIDIARY.—Section 5 of the International Banking Act of 1978 (12 U.S.C. 3103) is amended by adding at the end the following new subsection:

"(d) CLARIFICATION OF BRANCHING RULES IN THE CASE OF A FOREIGN BANK WITH A DOMESTIC BANK SUBSIDIARY.—In the case of a foreign bank that has a domestic bank subsidiary within the United States—
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“(1) the fact that such bank controls a domestic bank shall not affect the authority of the foreign bank to establish Federal and State branches or agencies to the extent permitted under subsection (a); and

“(2) the fact that the domestic bank is controlled by a foreign bank which has Federal or State branches or agencies in States other than the home State of such domestic bank shall not affect the authority of the domestic bank to establish branches outside the home State of the domestic bank to the extent permitted under section 5155(g) of the Revised Statutes or section 18(d)(4) or 44 of the Federal Deposit Insurance Act, as the case may be.”.

(d) HOME STATE DETERMINATIONS.—Section 5(c) of the International Banking Act of 1978 (12 U.S.C. 3103(c)) is amended to read as follows:

“(c) DETERMINATION OF HOME STATE OF FOREIGN BANK.—For the purposes of this section—

“(1) in the case of a foreign bank that has any branch, agency, subsidiary commercial lending company, or subsidiary bank in more than 1 State, the home State of the foreign bank is the 1 State of such States which is selected to be the home State by the foreign bank or, in default of any such selection, by the Board; and

“(2) in the case of a foreign bank that does not have a branch, agency, subsidiary commercial lending company, or subsidiary bank in more than 1 State, the home State of the foreign bank is the State in which the foreign bank has a branch, agency, subsidiary commercial lending company, or subsidiary bank.”.

¶ 1005

SEC. 105. COORDINATION OF EXAMINATION AUTHORITY.

Section 10 of the Federal Deposit Insurance Act (12 U.S.C. 1820) is amended by inserting after subsection (g) the following new subsection:

“(h) COORDINATION OF EXAMINATION AUTHORITY.—

“(1) IN GENERAL.—The appropriate State bank supervisor of a host State may examine a branch operated in such State by an out-of-State insured State bank that resulted from an interstate merger transaction approved under section 44 or a branch established in such State pursuant to section 5155(g) of the Revised Statutes or section 18(d)(4)—

“(A) for the purpose of determining compliance with host State laws, including those that govern banking, community reinvestment, fair lending, consumer protection, and permissible activities; and

“(B) to ensure that the activities of the branch are not conducted in an unsafe or unsound manner.

“(2) ENFORCEMENT.—If the State bank supervisor of a host State determines that there is a violation of the law of the host State concerning the activities being conducted by a branch described in paragraph (1) or
that the branch is being operated in an unsafe and unsound manner, the
State bank supervisor of the host State or, to the extent authorized by the
law of the host State, a State law enforcement officer may undertake such
enforcement actions and proceedings as would be permitted under the law
of the host State as if the branch were a bank chartered by that host
State.

“(3) COOPERATIVE AGREEMENT.—The State bank supervisors from 2
or more States may enter into cooperative agreements to facilitate State
regulatory supervision of State banks, including cooperative agreements
relating to the coordination of examinations and joint participation in
examinations.

“(4) FEDERAL REGULATORY AUTHORITY.—No provision of this subsec­
tion shall be construed as limiting in any way the authority of an
appropriate Federal banking agency to examine or to take any enforce­
ment actions or proceedings against any bank or branch of a bank for
which the agency is the appropriate Federal banking agency.”.

 SEC. 106. BRANCH CLOSURES.

Section 42 of the Federal Deposit Insurance Act (12 U.S.C. 1831r-1) is
amended by adding at the end the following new subsection:

“(d) BRANCH CLOSURES IN INTERSTATE BANKING OR BRANCHING OPERA-
TIONS.—

“(1) NOTICE REQUIREMENTS.—In the case of an interstate bank
which proposes to close any branch in a low- or moderate-income area, the
notice required under subsection (b)(2) shall contain the mailing address
of the appropriate Federal banking agency and a statement that com­
ments on the proposed closing of such branch may be mailed to such
agency.

“(2) ACTION REQUIRED BY APPROPRIATE FEDERAL BANKING AGENCY.—
If, in the case of a branch referred to in paragraph (1)—

“(A) a person from the area in which such branch is located—

“(i) submits a written request relating to the closing of
such branch to the appropriate Federal banking agency; and

“(ii) includes a statement of specific reasons for the re­
quest, including a discussion of the adverse effect of such closing
on the availability of banking services in the area affected by
the closing of the branch; and

“(B) the agency concludes that the request is not frivolous, the
agency shall consult with community leaders in the affected area
and convene a meeting of representatives of the agency and other
interested depository institution regulatory agencies with commu­
nity leaders in the affected area and such other individuals, organi­
zations, and depository institutions (as defined in section 19(b)(1)(A)
of the Federal Reserve Act) as the agency may determine, in the
discretion of the agency, to be appropriate, to explore the feasibility
of obtaining adequate alternative facilities and services for the
affected area, including the establishment of a new branch by
another depository institution, the chartering of a new depository
institution, or the establishment of a community development credit
union, following the closing of the branch.

“(3) No effect on closing.—No action by the appropriate Federal
banking agency under paragraph (2) shall affect the authority of an
interstate bank to close a branch (including the timing of such closing) if
the requirements of subsections (a) and (b) have been met by such bank
with respect to the branch being closed.

“(4) Definitions.—For purposes of this subsection, the following
definitions shall apply:

“(A) Interstate bank defined.—The term ‘interstate bank’
means a bank which maintains branches in more than 1 State.

“(B) Low- or moderate-income area.—The term ‘low- or mod­
erate-income area’ means a census tract for which the median family
income is—

“(i) less than 80 percent of the median family income for
the metropolitan statistical area (as designated by the Director
of the Office of Management and Budget) in which the census
tract is located; or

“(ii) in the case of a census tract which is not located in a
metropolitan statistical area, less than 80 percent of the median
family income for the State in which the census tract is located,
as determined without taking into account family income in
metropolitan statistical areas in such State.”.

§ 1007

SEC. 107. EQUALIZING COMPETITIVE OPPORTUNITIES FOR
UNITED STATES AND FOREIGN BANKS.

(a) Regulatory Objectives.—Section 6 of the International Banking Act
of 1978 (12 U.S.C. 3104) is amended—

(1) by redesignating subsections (a) through (c) as subsections (b)
through (d), respectively; and

(2) by inserting after “SEC. 6” the following new subsection:

“(a) Objective.—In implementing this section, the Comptroller and the
Federal Deposit Insurance Corporation shall each, by affording equal competi­
tive opportunities to foreign and United States banking organizations in their
United States operations, ensure that foreign banking organizations do not
receive an unfair competitive advantage over United States banking organiza­

(b) REVIEW OF REGULATIONS.—

(1) IN GENERAL.—Each Federal banking agency, after consultation with the other Federal banking agencies to assure uniformity, shall revise the regulations adopted by such agency under section 6 of the International Banking Act of 1978 to ensure that the regulations are consistent with the objective set forth in section 6(a) of the International Banking Act of 1978.

(2) SPECIFIC FACTORS.—In carrying out paragraph (1), each Federal banking agency shall consider whether to permit an uninsured branch of a foreign bank to accept initial deposits of less than $100,000 only from—

(A) individuals who are not citizens or residents of the United States at the time of the initial deposit;

(B) individuals who—

(i) are not citizens of the United States;

(ii) are residents of the United States; and

(iii) are employed by a foreign bank, foreign business, foreign government, or recognized international organization;

(C) persons to whom the branch or foreign bank has extended credit or provided other nondeposit banking services;

(D) foreign businesses and large United States businesses;

(E) foreign governmental units and recognized international organizations; and

(F) persons who are depositing funds in connection with the issuance of a financial instrument by the branch for the transmission of funds.

(3) REDUCTION IN REGULATORY DE MINIMIS EXEMPTION.—In carrying out paragraph (1), each Federal banking agency shall limit any exemption which is—

(A) available under any regulation prescribed pursuant to section 6(d) of the International Banking Act of 1978 providing for the acceptance of initial deposits of less than $100,000 by an uninsured branch of a foreign bank; and

(B) based on a percentage of the average deposits at such branch; to not more than 1 percent of the average deposits at such branch.

(4) ADDITIONAL RELEVANT CONSIDERATIONS.—In carrying out paragraph (1), each Federal banking agency shall also consider the importance of maintaining and improving the availability of credit to all sectors of the United States economy, including the international trade finance sector of the United State economy.

(5) DEADLINE FOR PRESCRIBING REVISED REGULATIONS.—Each Federal banking agency—
(A) shall publish final regulations under paragraph (1) in the Federal Register not later than 12 months after the date of enactment of this Act; and

(B) may establish reasonable transition rules to facilitate any termination of any deposit-taking activities that were permissible under regulations that were in effect before the date of enactment of this Act.

(6) DEFINITIONS.—For purposes of this subsection—

(A) the term "Federal banking agency" means—

(i) the Comptroller of the Currency with respect to Federal branches of foreign banks; and

(ii) the Federal Deposit Insurance Corporation with respect to State branches of foreign banks; and

(B) the term "uninsured branch" means a branch of a foreign bank that is not an insured branch, as defined in section 3(s)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)(3)).

(c) AMENDMENT AFFIRMING THAT CONSUMER PROTECTION LAWS APPLY TO FOREIGN BANKS.—Section 9(b) of the International Banking Act of 1978 (12 U.S.C. 3106a) is amended—

(1) in paragraph (1)—

(A) by redesignating subparagraphs (A) and (B) as subparagraphs (B) and (C), respectively; and

(B) by inserting after "which—" the following new subparagraph:

"(A) impose requirements that protect the rights of consumers in financial transactions, to the extent that the branch, agency, or commercial lending company engages in activities that are subject to such laws;"); and

(2) in paragraph (2)—

(A) by redesignating subparagraphs (A) and (B) as subparagraphs (B) and (C), respectively; and

(B) by inserting after "which—" the following new subparagraph:

"(A) impose requirements that protect the rights of consumers in financial transactions, to the extent that the branch, agency, or commercial lending company engages in activities that are subject to such laws;".

(d) INSURED BANKS IN TERRITORIES NOT TREATED AS FOREIGN BANKS FOR PURPOSES OF RETAIL DEPOSIT-TAKING RULE.—Section 6(d) of the International Banking Act of 1978 (12 U.S.C. 3104(c)) (as so redesignated by subsection (a)(1) of this section) is amended by adding at the end the following new paragraph:
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“(3) INSURED BANKS IN U.S. TERRITORIES.—For purposes of this subsection, the term ‘foreign bank’ does not include any bank organized under the laws of any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands the deposits of which are insured by the Federal Deposit Insurance Corporation pursuant to the Federal Deposit Insurance Act.”.

(e) AMENDMENT RELATING TO SHELL BRANCHES.—

(1) IN GENERAL.—Section 7 of the International Banking Act of 1978 (12 U.S.C. 3105) is amended by adding at the end the following new subsection:

“(k) MANAGEMENT OF SHELL BRANCHES.—

“(1) TRANSACTIONS PROHIBITED.—A branch or agency of a foreign bank shall not manage, through an office of the foreign bank which is located outside the United States and is managed or controlled by such branch or agency, any type of activity that a bank organized under the laws of the United States, any State, or the District of Columbia is not permitted to manage at any branch or subsidiary of such bank which is located outside the United States.

“(2) REGULATIONS.—Any regulations promulgated to carry out this section—

“(A) shall be promulgated in accordance with section 13; and

“(B) shall be uniform, to the extent practicable.”.

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall become effective at the end of the 180-day period beginning on the date of enactment of this Act.

(f) MEETING COMMUNITY CREDIT NEEDS.—Section 5(a) of the International Banking Act of 1978 (12 U.S.C. 3103(a)) (as amended by section 104 of this Act) is amended by inserting after paragraph (7) the following new paragraph:

“(8) CONTINUING REQUIREMENT FOR MEETING COMMUNITY CREDIT NEEDS AFTER INITIAL INTERSTATE ENTRY BY ACQUISITION.—

“(A) IN GENERAL.—If a foreign bank acquires a bank or a branch of a bank, in a State in which the foreign bank does not maintain a branch, and such acquired bank is, or is part of, a regulated financial institution (as defined in section 803 of the Community Reinvestment Act of 1977), the Community Reinvestment Act of 1977 shall continue to apply to each branch of the foreign bank which results from the acquisition as if such branch were a regulated financial institution.

“(B) EXCEPTION FOR BRANCH THAT RECEIVES ONLY DEPOSITS PERMISSIBLE FOR AN EDGE ACT CORPORATION.—Paragraph (1) shall not apply to any branch that receives only such deposits as are permissible for a corporation organized under section 25A of the Federal Reserve Act to receive.”.
SEC. 108. FEDERAL RESERVE BOARD STUDY ON BANK FEES.

(a) IN GENERAL.—Section 1002 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (12 U.S.C. 1811 note) is amended to read as follows:

"SEC. 1002. SURVEY OF BANK FEES AND SERVICES.

"(a) ANNUAL SURVEY REQUIRED.—The Board of Governors of the Federal Reserve System shall obtain a sample, which is representative by geographic location and size of the institution, of—

"(1) certain retail banking services provided by insured depository institutions; and

"(2) the fees, if any, which are imposed by such institutions for providing any such service, including fees imposed for not sufficient funds, deposit items returned, and automated teller machine transactions.

"(b) ANNUAL REPORT TO CONGRESS REQUIRED.—

"(1) PREPARATION.—The Board of Governors of the Federal Reserve System shall prepare a report of the results of each survey conducted pursuant to subsection (a).

"(2) CONTENTS OF THE REPORT.—Each report prepared pursuant to paragraph (1) shall include—

"(A) a description of any discernible trend, in the Nation as a whole and in each region, in the cost and availability of retail banking services which delineates differences on the basis of size of the institution and engagement in multistate activity; and

"(B) a description of the correlation, if any, among the following factors:

"(i) An increase or decrease in the amount of any deposit insurance premium assessed by the Federal Deposit Insurance Corporation against insured depository institutions.

"(ii) An increase or decrease in the amount of the fees imposed by such institutions for providing retail banking services.

"(iii) A decrease in the availability of such services.

"(3) SUBMISSION TO CONGRESS.—The Board of Governors of the Federal Reserve System shall submit an annual report to the Congress not later than September 1, 1995, and not later than June 1 of each subsequent year.”.

(b) SUNSET.—The requirements of subsection (a) shall not apply after the end of the 7-year period beginning on the date of enactment of this Act.
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SEC. 109. PROHIBITION AGAINST DEPOSIT PRODUCTION OFFICES.

(a) REGULATIONS.—The appropriate Federal banking agencies shall prescribe uniform regulations effective June 1, 1997, which prohibit any out-of-State bank from using any authority to engage in interstate branching pursuant to this title, or any amendment made by this title to any other provision of law, primarily for the purpose of deposit production.

(b) GUIDELINES FOR MEETING CREDIT NEEDS.—Regulations issued under subsection (a) shall include guidelines to ensure that interstate branches operated by an out-of-State bank in a host State are reasonably helping to meet the credit needs of the communities which the branches serve.

(c) LIMITATION ON OUT-OF-STATE LOANS.—

(1) LIMITATION.—Regulations issued under subsection (a) shall require that, beginning no earlier than 1 year after establishment or acquisition of an interstate branch or branches in a host State by an out-of-State bank, if the appropriate Federal banking agency for the out-of-State bank determines that the bank's level of lending in the host State relative to the deposits from the host State (as reasonably determinable from available information including the agency's sampling of the bank's loan files during an examination or such data as is otherwise available) is less than half the average of total loans in the host State relative to total deposits from the host State (as determinable from relevant sources) for all banks the home State of which is such State—

(A) the appropriate Federal banking agency for the out-of-State bank shall review the loan portfolio of the bank and determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank in the host State; and

(B) if the agency determines that the out-of-State bank is not reasonably helping to meet those needs—

(i) the agency may order that an interstate branch or branches of such bank in the host State be closed unless the bank provides reasonable assurances to the satisfaction of the appropriate Federal banking agency that the bank has an acceptable plan that will reasonably help to meet the credit needs of the communities served by the bank in the host State, and

(ii) the out-of-State bank may not open a new interstate branch in the host State unless the bank provides reasonable assurances to the satisfaction of the appropriate Federal banking agency that the bank will reasonably help to meet the credit needs of the community that the new branch will serve.

(2) CONSIDERATIONS.—In making a determination under paragraph (1)(A), the appropriate Federal banking agency shall consider—
(A) whether the interstate branch or branches of the out-of-State bank were formerly part of a failed or failing depository institution;

(B) whether the interstate branch was acquired under circumstances where there was a low loan-to-deposit ratio because of the nature of the acquired institution's business or loan portfolio;

(C) whether the interstate branch or branches of the out-of-State bank have a higher concentration of commercial or credit card lending, trust services, or other specialized activities;

(D) the ratings received by the out-of-State bank under the Community Reinvestment Act of 1977;

(E) economic conditions, including the level of loan demand, within the communities served by the interstate branch or branches of the out-of-State bank; and

(F) the safe and sound operation and condition of the out-of-State bank.

(3) BRANCH CLOSING PROCEDURE.—

(A) NOTICE REQUIRED.—Before exercising any authority under paragraph (1)(B)(i), the appropriate Federal banking agency shall issue to the bank a notice of the agency's intention to close an interstate branch or branches and shall schedule a hearing.

(B) HEARING.—Section 8(h) of the Federal Deposit Insurance Act shall apply to any proceeding brought under this paragraph.

(d) APPLICATION.—This section shall apply with respect to any interstate branch established or acquired in a host State pursuant to this title or any amendment made by this title to any other provision of law.

(e) DEFINITIONS.—For the purposes of this section, the following definitions shall apply:

(1) APPROPRIATE FEDERAL BANKING AGENCY, BANK, STATE, AND STATE BANK.—The terms "appropriate Federal banking agency", "bank", "State", and "State bank" have the same meanings as in section 3 of the Federal Deposit Insurance Act.

(2) HOME STATE.—The term "home State" means—

(A) in the case of a national bank, the State in which the main office of the bank is located; and

(B) in the case of a State bank, the State by which the bank is chartered.

(3) HOST STATE.—The term "host State" means a State in which a bank establishes a branch other than the home State of the bank.

(4) INTERSTATE BRANCH.—The term "interstate branch" means a branch established pursuant to this title or any amendment made by this title to any other provision of law.
(5) OUT-OF-STATE BANK.—The term "out-of-State bank" means, with respect to any State, a bank the home State of which is another State and, for purposes of this section, includes a foreign bank, the home State of which is another State.

§ 1010
SEC. 110. COMMUNITY REINVESTMENT ACT EVALUATION OF BANKS WITH INTERSTATE BRANCHES.

(a) In General.—Section 807 of the Community Reinvestment Act of 1977 (12 U.S.C. 2906) is amended by adding at the end the following new subsections:

"(d) INSTITUTIONS WITH INTERSTATE BRANCHES.—

“(1) STATE-BY-STATE EVALUATION.—In the case of a regulated financial institution that maintains domestic branches in 2 or more States, the appropriate Federal financial supervisory agency shall prepare—

“(A) a written evaluation of the entire institution's record of performance under this title, as required by subsections (a), (b), and (c); and

“(B) for each State in which the institution maintains 1 or more domestic branches, a separate written evaluation of the institution's record of performance within such State under this title, as required by subsections (a), (b), and (c).

“(2) MULTISTATE METROPOLITAN AREAS.—In the case of a regulated financial institution that maintains domestic branches in 2 or more States within a multistate metropolitan area, the appropriate Federal financial supervisory agency shall prepare a separate written evaluation of the institution's record of performance within such metropolitan area under this title, as required by subsections (a), (b), and (c). If the agency prepares a written evaluation pursuant to this paragraph, the scope of the written evaluation required under paragraph (1)(B) shall be adjusted accordingly.

“(3) CONTENT OF STATE LEVEL EVALUATION.—A written evaluation prepared pursuant to paragraph (1)(B) shall—

“(A) present the information required by subparagraphs (A) and (B) of subsection (b)(1) separately for each metropolitan area in which the institution maintains 1 or more domestic branch offices and separately for the remainder of the nonmetropolitan area of the State if the institution maintains 1 or more domestic branch offices in such nonmetropolitan area; and

“(B) describe how the Federal financial supervisory agency has performed the examination of the institution, including a list of the individual branches examined.

“(e) DEFINITIONS.—For purposes of this section the following definitions shall apply:
"(1) DOMESTIC BRANCH.—The term 'domestic branch' means any branch office or other facility of a regulated financial institution that accepts deposits, located in any State.

"(2) METROPOLITAN AREA.—The term 'metropolitan area' means any primary metropolitan statistical area, metropolitan statistical area, or consolidated metropolitan statistical area, as defined by the Director of the Office of Management and Budget, with a population of 250,000 or more, and any other area designated as such by the appropriate Federal financial supervisory agency.

"(3) STATE.—The term 'State' has the same meaning as in section 3 of the Federal Deposit Insurance Act.”

(b) SEPARATE PRESENTATION.—Section 807(b)(1) of the Community Reinvestment Act of 1977 (12 U.S.C. 2906(b)(1)) is amended—

(1) by redesignating subparagraphs (A) through (C) as clauses (i) through (iii), respectively;

(2) by striking “The public” and inserting the following:

“(A) CONTENTS OF WRITTEN EVALUATION.—The public”; and

(3) by adding at the end the following new subparagraph:

“(B) METROPOLITAN AREA DISTINCTIONS.—The information required by clauses (i) and (ii) of subparagraph (A) shall be presented separately for each metropolitan area in which a regulated depository institution maintains one or more domestic branch offices.”.

§ 1011

SEC. 111. RESTATEMENT OF EXISTING LAW.

No provision of this title and no amendment made by this title to any other provision of law shall be construed as affecting in any way—

(1) the authority of any State or political subdivision of any State to adopt, apply, or administer any tax or method of taxation to any bank, bank holding company, or foreign bank, or any affiliate of any such bank, bank holding company, or foreign bank, to the extent that such tax or tax method is otherwise permissible by or under the Constitution of the United States or other Federal law;

(2) the right of any State, or any political subdivision of any State, to impose or maintain a nondiscriminatory franchise tax or other nonproperty tax instead of a franchise tax in accordance with section 3124 of title 31, United States Code; or

(3) the applicability of section 5197 of the Revised Statutes or section 27 of the Federal Deposit Insurance Act.
SEC. 112. GAO REPORT ON DATA COLLECTION UNDER INTERSTATE BRANCHING.

(a) IN GENERAL.—The Comptroller General of the United States shall submit to the Congress, not later than 9 months after the date of enactment of this Act, a report that—

(1) examines statutory and regulatory requirements for insured depository institutions to collect and report deposit and lending data; and

(2) determines what modifications to such requirements are needed, so that the implementation of the interstate branching provisions contained in this title will result in no material loss of information important to regulatory or congressional oversight of insured depository institutions.

(b) CONSULTATION.—The Comptroller General, in preparing the report required by this section, shall consult with individuals representing the appropriate Federal banking agencies, insured depository institutions, consumers, community groups, and other interested parties.

(c) DEFINITIONS.—For purposes of this section, the terms "appropriate Federal banking agency" and "insured depository institution" have the same meanings as in section 3 of the Federal Deposit Insurance Act.

SEC. 113. MAXIMUM INTEREST RATE ON CERTAIN FmHA LOANS.

(a) IN GENERAL.—Section 307(a) of the Consolidated Farm and Rural Development Act (7 U.S.C. 1927(a)) is amended—

(1) in paragraph (3)(A), by striking "Except" and inserting "Notwithstanding the provisions of the constitution or laws of any State limiting the rate or amount of interest that may be charged, taken, received, or reserved, except"; and

(2) in paragraph (5)—

(A) by striking

"(5) The" and inserting

"(5)(A) Except as provided in subparagraph (B), the"; and

(B) by adding at the end the following new subparagraph:

"(B) In the case of a loan made under section 310B as a guaranteed loan, subparagraph (A) shall apply notwithstanding the provisions of the constitution or laws of any State limiting the rate or amount of interest that may be charged, taken, received, or reserved.".

(b) EFFECTIVE DATES.—
Interstate Banking and Branching Act

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amendments made by subsection (a) shall apply to a loan made, insured, or guaranteed under the Consolidated Farm and Rural Development Act (7 U.S.C. 1921 et seq.) in a State on or after the date of enactment of this Act.

(2) STATE OPTION.—Except as provided in paragraph (3), the amendments made by subsection (a) shall not apply to a loan made, insured, or guaranteed under the Consolidated Farm and Rural Development Act in a State after the date (that occurs during the 3-year period beginning on the date of enactment of this Act) on which the State adopts a law or certifies that the voters of the State have voted in favor of a provision of the constitution or law of the State that states that the State does not want the amendments made by subsection (a) to apply with respect to loans made, insured, or guaranteed under such Act in the State.

(3) TRANSITIONAL PERIOD.—In any case in which a State takes an action described in paragraph (2), the amendments made by subsection (a) shall continue to apply to a loan made, insured, or guaranteed under the Consolidated Farm and Rural Development Act in the State after the date the action was taken pursuant to a commitment for the loan that was entered into during the period beginning on the date of enactment of this Act, and ending on the date on which the State takes the action.

§ 1014

SEC. 114. NOTICE REQUIREMENTS FOR BANKING AGENCY DECISIONS PREEMPTING STATE LAW.

Chapter 4 of title LXII of the Revised Statutes (12 U.S.C. 21 et seq.) is amended by adding at the end the following new section:

“SEC. 5244. INTERPRETATIONS CONCERNING PREEMPTION OF CERTAIN STATE LAWS.

“(a) NOTICE AND OPPORTUNITY FOR COMMENT REQUIRED.—Before issuing any opinion letter or interpretive rule, in response to a request or upon the agency’s own motion, that concludes that Federal law preempts the application to a national bank of any State law regarding community reinvestment, consumer protection, fair lending, or the establishment of intrastate branches, or before making a determination under section 5155(f)(1)(A)(ii) of the Revised Statutes, the appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act) shall—

“(1) publish in the Federal Register notice of the preemption or discrimination issue that the agency is considering (including a description of each State law at issue);

“(2) give interested parties not less than 30 days in which to submit written comments; and

“(3) in developing the final opinion letter or interpretive rule issued by the agency, or making any determination under section
5155(f)(1)(A)(ii) of the Revised Statutes, consider any comments received.

"(b) PUBLICATION REQUIRED.—The appropriate Federal banking agency shall publish in the Federal Register—

“(1) any final opinion letter or interpretive rule concluding that Federal law preempts the application of any State law regarding community reinvestment, consumer protection, fair lending, or establishment of intrastate branches to a national bank; and

“(2) any determination under section 5155(f)(1)(A)(ii) of the Revised Statutes.

“(c) EXCEPTIONS.—

“(1) NO NEW ISSUE OR SIGNIFICANT BASIS.—This section shall not apply with respect to any opinion letter or interpretive rule that—

“(A) raises issues of Federal preemption of State law that are essentially identical to those previously resolved by the courts or on which the agency has previously issued an opinion letter or interpretive rule; or

“(B) responds to a request that contains no significant legal basis on which to make a preemption determination.

“(2) JUDICIAL, LEGISLATIVE, OR INTRAGOVERNMENTAL MATERIALS.—This section shall not apply with respect to materials prepared for use in judicial proceedings or submission to Congress or a Member of Congress, or for intragovernmental use.

“(3) EMERGENCY.—The appropriate Federal banking agency may make exceptions to subsection (a) if—

“(A) the agency determines in writing that the exception is necessary to avoid a serious and imminent threat to the safety and soundness of any national bank; or

“(B) the opinion letter or interpretive rule is issued in connection with—

“(i) an acquisition of 1 or more banks in default or in danger of default (as such terms are defined in section 3 of the Federal Deposit Insurance Act); or

“(ii) an acquisition with respect to which the Federal Deposit Insurance Corporation provides assistance under section 13(c) of the Federal Deposit Insurance Act.”.

§ 1015

SEC. 115. MORATORIUM ON EXAMINATION FEES UNDER THE INTERNATIONAL BANKING ACT OF 1978.

(a) BRANCHES, AGENCIES, AND AFFILIATES.—Section 7(c)(1)(D) of the International Banking Act of 1978 shall not apply with respect to any
examination under section 7(c)(1)(A) of such Act which begins before or during the 3-year period beginning on July 25, 1994.

(b) **REPRESENTATIVE OFFICES.**—The provision of section 10(c) of the International Banking Act of 1978 relating to the cost of examinations under such section shall not apply with respect to any examination under such section which begins before or during the 3-year period beginning on July 25, 1994.
TITLE II—GENERAL PROVISIONS

SEC. 201. AMENDMENTS TO FEDERAL DEPOSIT INSURANCE ACT AND FEDERAL HOME LOAN BANK ACT.

(a) FEDERAL DEPOSIT INSURANCE ACT.—Section 11(d)(14) of the Federal Deposit Insurance Act (12 U.S.C. 1821(d)(14)) is amended by adding at the end the following new subparagraph:

"(C) REVIVAL OF EXPIRED STATE CAUSES OF ACTION.—

"(i) IN GENERAL.—In the case of any tort claim described in clause (ii) for which the statute of limitation applicable under State law with respect to such claim has expired not more than 5 years before the appointment of the Corporation as conservator or receiver, the Corporation may bring an action as conservator or receiver on such claim without regard to the expiration of the statute of limitation applicable under State law.

"(ii) CLAIMS DESCRIBED.—A tort claim referred to in clause (i) is a claim arising from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to the institution.".

(b) FEDERAL HOME LOAN BANK ACT.—Section 21A(b)(14) of the Federal Home Loan Bank Act (12 U.S.C. 1441a(b)(14)) is amended by adding at the end the following new subparagraph:

"(E) REVIVAL OF EXPIRED STATE CAUSES OF ACTION.—In the case of any tort claim described in subparagraph (A)(ii) for which the statute of limitation applicable under State law with respect to such claim has expired not more than 5 years before the appointment of the Corporation as conservator or receiver, the Corporation may bring an action as conservator or receiver on such claim without regard to the expiration of the statute of limitation applicable under State law.".

SEC. 202. SENSE OF THE SENATE CONCERNING MULTILATERAL EXPORT CONTROLS.

(a) FINDINGS.—The Senate finds that—

(1) the United States and its allies have agreed that as of March 31, 1994, the Coordinating Committee (hereafter referred to as "COCOM"), the multilateral body that controlled strategic exports to the former Soviet Union and other Communist States, ceased to exist;

(2) no successor has yet been established to replace the COCOM;
(3) threats to United States security are posed by rogue regimes that support terrorism as a matter of national policy;

(4) a critical element of the United States proposal for a successor to COCOM is that supplier nations agree on a list of militarily critical products and technologies that would be denied to a handful of rogue regimes;

(5) some allies of the United States oppose this principle and instead propose that such controls be left to "national discretion", effectively replacing multilateral export controls with a loose collection of unilateral export control policies which would be adverse for United States security and economic interests;

(6) multilateral controls are needed to thwart efforts of Iran, Iraq, North Korea, Libya, and other rogue regimes, to acquire arms and sensitive dual-use goods and technologies that could contribute to their efforts to build weapons of mass destruction; and

(7) the United States would be forced to make the difficult choice of choosing between unilateral export controls under the Export Administration Act of 1979, which would put American companies at a competitive disadvantage worldwide, or allowing exports that could seriously harm the national security interests of the United States.

(b) SENSE OF THE SENATE.—It is the sense of the Senate that—

(1) the President should work to achieve a clearly defined and enforceable agreement with allies of the United States which establishes a multilateral export control system for the proliferation of products and technologies to rogue regimes that would jeopardize the national security of the United States; and

(2) the President should persuade allies of the United States to promote mutual security interests by preventing rogue regimes from obtaining militarily critical products and technologies.

¶ 2003

SEC. 203. AMENDMENTS RELATING TO SILVER MEDALS FOR PERSIAN GULF VETERANS.

Title III of Public Law 102-281 (31 U.S.C. 5111 note) is amended—

(1) in section 303(b), by striking "entitlemente" and inserting "enactment"; and

(2) in section 307 by striking subsection (b) and inserting the following:

"(B) NO EXPENDITURES IN ADVANCE OF RECEIPT OF FUNDS.—The Secretary of the Treasury shall begin minting and issuing the medals described in section 302 whenever there are any funds
available to cover the cost of minting and issuing any such medals from amounts received by the Secretary under section 305 and donations by private persons, and shall continue minting and issuing such medals, subject to the availability of funds to cover the costs, until all of the medals authorized have been issued.

*Title II—General Provisions*

**SEC. 204. COMMEMORATION OF 1995 SPECIAL OLYMPIC WORLD GAMES.**

(a) **COIN SPECIFICATIONS.**—

(1) **ONE DOLLAR SILVER COINS.**—

(A) **ISSUANCE.**—The Secretary of the Treasury (hereafter in this section referred to as the “Secretary”) shall issue not more than 800,000 $1 coins, which shall weigh 26.73 grams, have a diameter of 1.500 inches, and shall contain 90 percent silver and 10 percent copper.

(B) **DESIGN.**—The design of the coins issued under this section shall be emblematic of the 1995 Special Olympics World Games. On each such coin there shall be a designation of the value of the coin, an inscription of the year “1995”, and inscriptions of the words “Liberty”, “In God We Trust”, “United States of America”, and “E Pluribus Unum”.

(2) **LEGAL TENDER.**—The coins issued under this section shall be legal tender as provided in section 5103 of title 31, United States Code.

(3) **NUMISMATIC ITEMS.**—For purposes of section 5132(a)(1) of title 31, United States Code, all coins minted under this section shall be considered to be numismatic items.

(b) **SOURCES OF BULLION.**—The Secretary shall obtain silver for the coins minted under this section only from stockpiles established under the Strategic and Critical Materials Stock Piling Act.

(c) **SELECTION OF DESIGN.**—The design for the coins authorized by this section shall be selected by the Secretary after consultation with the 1995 Special Olympics World Games Organizing Committee, Inc. and the Commission of Fine Arts. As required by section 5135 of title 31, United States Code, the design shall also be reviewed by the Citizens Commemorative Coin Advisory Committee.

(d) **ISSUANCE OF THE COINS.**—

(1) **QUALITY OF COINS.**—The coins authorized under this section may be issued in uncirculated and proof qualities.

(2) **MINT FACILITY.**—Not more than 1 facility of the United States Mint may be used to strike any particular quality of the coins minted under this section.
(3) Period for Issuance.—The Secretary shall issue coins minted under this section during the period beginning on January 15, 1995, and ending on December 31, 1995.

(e) Sale of the Coins.—

(1) Sale Price.—The coins issued under this section shall be sold by the Secretary at a price equal to the sum of the face value of the coins, the surcharge provided in paragraph (4) with respect to such coins, and the cost of designing and issuing such coins (including labor, materials, dies, use of machinery, overhead expenses, marketing, and shipping).

(2) Bulk Sales.—The Secretary shall make bulk sales at a reasonable discount.

(3) Prepaid Orders.—The Secretary shall accept prepaid orders for the coins authorized under this section prior to the issuance of such coins. Sales under this subsection shall be at a reasonable discount.

(4) Surcharge Required.—All sales shall include a surcharge of $10 per coin.

(5) International Sales.—The Secretary, in cooperation with the 1995 Special Olympics World Games Organizing Committee, shall develop an international marketing program to promote and sell coins outside of the United States.

(f) General Waiver of Procurement Regulations.—No provision of law governing procurement or public contracts shall be applicable to the procurement of goods or services necessary for carrying out the provisions of this section. Nothing in this subsection shall relieve any person entering into a contract under the authority of this section from complying with any law relating to equal employment opportunity.

(g) Distribution of Surcharges.—The total surcharges collected by the Secretary from the sale of the coins issued under this section shall be promptly paid by the Secretary to the 1995 Special Olympics World Games Organizing Committee, Inc. Such amounts shall be used to—

(1) provide a world class sporting event for athletes with mental retardation;

(2) demonstrate to a global audience the extraordinary talents, dedication, and courage of persons with mental retardation; and

(3) underwrite the cost of staging and promoting the 1995 Special Olympics World Games.

(h) Audits.—The Comptroller General of the United States shall have the right to examine such books, records, documents, and other data of the 1995 Special Olympics World Games Organizing Committee, Inc. as may be related to the expenditure of amounts paid under subsection (g).

(i) Financial Assurances.—
(1) NO NET COST TO THE GOVERNMENT.—The Secretary shall take all actions necessary to ensure that the issuance of the coins authorized by this section shall result in no net cost to the United States Government.

(2) ADEQUATE SECURITY FOR PAYMENT REQUIRED.—No coin shall be issued under this section unless the Secretary has received—

(A) full payment therefore;

(B) security satisfactory to the Secretary to indemnify the United States for full payment; or

(C) a guarantee of full payment satisfactory to the Secretary from a depository institution whose deposits are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration Board.

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SEC. 205. NATIONAL COMMUNITY SERVICE COMMEMORATIVE COINS.

(a) COIN SPECIFICATIONS.—

(1) $1 SILVER COINS.—The Secretary of the Treasury (hereafter in this section referred to as the "Secretary") shall mint and issue not more than 500,000 $1 coins to commemorate students who volunteer to perform community service, which shall—

(A) weigh 26.73 grams;

(B) have a diameter of 1.500 inches; and

(C) contain 90 percent silver and 10 percent copper.

(2) LEGAL TENDER.—The coins issued under this section shall be legal tender, as provided in section 5103 of title 31, United States Code.

(3) NUMISMATIC ITEMS.—For purposes of section 5134 of title 31, United States Code, all coins minted under this section shall be considered to be numismatic items.

(b) SOURCES OF BULLION.—The Secretary shall obtain silver for the coins minted under this section only from stockpiles established under the Strategic and Critical Minerals Stock Piling Act.

(c) DESIGN OF COINS.—

(1) DESIGN REQUIREMENTS.—

(A) IN GENERAL.—The design of the coins minted under this section shall be emblematic of community services provided by student volunteers.

(B) DESIGNATION AND INSCRIPTIONS.—On each coin minted under this section there shall be—

(i) a designation of the value of the coin;

(ii) an inscription of the year "1996"; and
(iii) inscriptions of the words “Liberty”, “In God We Trust”, “United States of America”, and “E Pluribus Unum”.

(2) SELECTION.—The design for the coins authorized by this section shall be—

(A) selected by the Secretary after consultation with the National Community Service Trust and the Commission of Fine Arts; and

(B) reviewed by the Citizens Commemorative Coin Advisory Committee.

(d) ISSUANCE OF COINS.—

(1) QUALITY OF COINS.—Coins minted under this section shall be issued in uncirculated and proof qualities.

(2) MINT FACILITY.—Only 1 facility of the United States Mint may be used to strike any particular quality of the coins minted under this section.

(3) PERIOD FOR ISSUANCE.—The Secretary shall issue coins minted under this section for a period of not less than 6 months and not more than 12 months, beginning no later than September 1, 1996.

(e) SALE OF COINS.—

(1) SALE PRICE.—The coins issued under this section shall be sold by the Secretary at a price equal to the sum of—

(A) the face value of the coins;

(B) the surcharge provided in paragraph (4) with respect to such coins; and

(C) the cost of designing and issuing the coins (including labor, materials, dies, use of machinery, overhead expenses, marketing, and shipping).

(2) BULK SALES.—The Secretary shall make bulk sales of the coins issued under this section available at a reasonable discount.

(3) PREPAID ORDERS.—

(A) IN GENERAL.—The Secretary shall accept prepaid orders for the coins minted under this section before the issuance of such coins.

(B) DISCOUNT.—Sale prices with respect to prepaid orders under subparagraph (A) shall be at a reasonable discount.

(4) SURCHARGES.—All sales shall include a surcharge of $10 per coin.

(f) GENERAL WAIVER OF PROCUREMENT REGULATIONS.—

(1) IN GENERAL.—Except as provided in paragraph (2), no provision of law governing procurement or public contracts shall be applicable to the procurement of goods and services necessary for carrying out the provisions of this section.
(2) EQUAL EMPLOYMENT OPPORTUNITY.—Paragraph (1) shall not relieve any person entering into a contract under the authority of this section from complying with any law relating to equal employment opportunity.

(g) DISTRIBUTION OF SURCHARGES.—

(1) IN GENERAL.—All surcharges received by the Secretary from the sale of coins issued under this section shall be promptly paid by the Secretary to the National Community Service Trust for the purpose of funding innovative community service programs at American universities, including the service, research, and teaching activities of faculty and students involved in such programs.

(2) AUDITS.—The Comptroller General of the United States shall have the right to examine such books, records, documents, and other data of the National Community Service Trust as may be related to the expenditures of amounts paid under paragraph (1).

(h) FINANCIAL ASSURANCES.—

(1) NO NET COST TO THE GOVERNMENT.—The Secretary shall take such actions as may be necessary to ensure that minting and issuing coins under this section will not result in any net cost to the United States Government.

(2) PAYMENT FOR COINS.—A coin shall not be issued under this section unless the Secretary has received—

(A) full payment for the coin;

(B) security satisfactory to the Secretary to indemnify the United States for full payment; or

(C) a guarantee of full payment satisfactory to the Secretary from a depository institution whose deposits are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration Board.

SEC. 206. ROBERT F. KENNEDY MEMORIAL COMMEMORATIVE COINS.

(a) COIN SPECIFICATIONS.—

(1) $1 SILVER COINS.—The Secretary of the Treasury (hereafter in this section referred to as the "Secretary") shall mint and issue not more than 500,000 $1 coins to commemorate the life and work of Robert F. Kennedy, which shall—

(A) weigh 26.73 grams;

(B) have a diameter of 1.500 inches; and

(C) contain 90 percent silver and 10 percent copper.
(2) LEGAL TENDER.—The coins issued under this section shall be legal tender, as provided in section 5103 of title 31, United States Code.

(3) NUMISMATIC ITEMS.—For purposes of section 5134 of title 31, United States Code, all coins minted under this section shall be considered to be numismatic items.

(b) SOURCES OF BULLION.—The Secretary shall obtain silver for the coins minted under this section only from stockpiles established under the Strategic and Critical Minerals Stock Piling Act.

(c) DESIGN OF COINS.—

(1) DESIGN REQUIREMENTS.—

(A) IN GENERAL.—The design of the coins minted under this section shall be emblematic of the life and work of Robert F. Kennedy.

(B) DESIGNATION AND INSCRIPTIONS.—On each coin minted under this section there shall be—

(i) a designation of the value of the coin;

(ii) an inscription of the year “1998”; and

(iii) inscriptions of the words “Liberty”, “In God We Trust”, “United States of America”, and “E Pluribus Unum”.

(2) SELECTION.—The design for the coins authorized by this section shall be—

(A) selected by the Secretary after consultation with the Robert F. Kennedy Memorial and the Commission of Fine Arts; and

(B) reviewed by the Citizens Commemorative Coin Advisory Committee.

(d) ISSUANCE OF COINS.—

(1) QUALITY OF COINS.—Coins minted under this section shall be issued in uncirculated and proof qualities.

(2) MINT FACILITY.—Only 1 facility of the United States Mint may be used to strike any particular quality of the coins minted under this section.

(3) PERIOD FOR ISSUANCE.—The Secretary shall issue coins minted under this section for a period of not less than 6 months and not more than 12 months, beginning no later than January 1, 1998.

(e) SALE OF COINS.—

(1) SALE PRICE.—The coins issued under this section shall be sold by the Secretary at a price equal to the sum of—

(A) the face value of the coins;

(B) the surcharge provided in paragraph (4) with respect to such coins; and
(C) the cost of designing and issuing the coins (including labor, materials, dies, use of machinery, overhead expenses, marketing, and shipping).

(2) **Bulk sales.**—The Secretary shall make bulk sales of the coins issued under this section available at a reasonable discount.

(3) **Prepaid orders.**—
   (A) **In general.**—The Secretary shall accept prepaid orders for the coins minted under this section before the issuance of such coins.
   (B) **Discount.**—Sale prices with respect to prepaid orders under subparagraph (A) shall be at a reasonable discount.

(4) **Surcharges.**—All sales shall include a surcharge of $10 per coin.

(f) **General waiver of procurement regulations.**—
   (1) **In general.**—Except as provided in paragraph (2), no provision of law governing procurement or public contracts shall be applicable to the procurement of goods and services necessary for carrying out the provisions of this section.
   (2) **Equal employment opportunity.**—Paragraph (1) shall not relieve any person entering into a contract under the authority of this section from complying with any law relating to equal employment opportunity.

(g) **Distribution of surcharges.**—
   (1) **In general.**—All surcharges received by the Secretary from the sale of coins issued under this section shall be promptly paid by the Secretary to the Robert F. Kennedy Memorial for the purpose of improving the endowment of the Robert F. Kennedy Memorial.
   (2) **Audits.**—The Comptroller General of the United States shall have the right to examine such books, records, documents, and other data of the Robert F. Kennedy Memorial as may be related to the expenditures of amounts paid under paragraph (1).

(h) **Financial assurances.**—
   (1) **No net cost to the government.**—The Secretary shall take such actions as may be necessary to ensure that minting and issuing coins under this section will not result in any net cost to the United States Government.
   (2) **Payment for coins.**—A coin shall not be issued under this section unless the Secretary has received—
   (A) full payment for the coin;
   (B) security satisfactory to the Secretary to indemnify the United States for full payment; or
   (C) a guarantee of full payment satisfactory to the Secretary from a depository institution whose deposits are insured by the
SEC. 207. UNITED STATES MILITARY ACADEMY BICENTENNIAL COMMEMORATIVE COINS.

(a) COIN SPECIFICATIONS.—

(1) ONE DOLLAR SILVER COINS.—

(A) ISSUANCE.—The Secretary shall issue not more than 500,000 $1 coins, which shall weigh 26.73 grams, have a diameter of 1.500 inches, and shall contain 90 percent silver and 10 percent copper.

(B) DESIGN.—The design of the $1 coins shall be emblematic of the United States Military Academy and its motto “Duty, Honor, Country”. On each such coin there shall be a designation of the value of the coin, an inscription of the year “2002”, and inscriptions of the words “Liberty”, “In God We Trust”, “United States of America”, and “E Pluribus Unum”.

(2) LEGAL TENDER.—The coins issued under this section shall be legal tender as provided in section 5103 of title 31, United States Code.

(b) SOURCES OF BULLION.—The Secretary shall obtain silver for the coins minted under this section only from stockpiles established under the Strategic and Critical Materials Stock Piling Act.

(c) SELECTION OF DESIGN.—The design of the coins minted under this section shall be selected by the Secretary after consultation with the Commission of Fine Arts and the Bicentennial Steering Group, Association of Graduates, United States Military Academy. As required by section 5135 of title 31, United States Code, the designs shall also be reviewed by the Citizens Commemorative Coin Advisory Committee.

(d) ISSUANCE OF THE COINS.—

(1) QUALITY AND MINT FACILITY.—The coins authorized under this section may be issued in uncirculated and proof qualities and shall be struck at the United States Bullion Depository at West Point.

(2) PERIOD FOR ISSUANCE.—The Secretary shall issue coins minted under this section during the period beginning on March 16, 2002, and ending on March 16, 2003.

(3) SUNSET PROVISION.—No coins shall be minted under this section after December 31, 2002.

(e) SALE OF THE COINS.—

(1) SALE PRICE.—The coins issued under this section shall be sold by the Secretary at a price equal to the sum of the face value of the coins, the surcharge provided in paragraph (4) with respect to such coins, and the cost of designing and issuing such coins (including labor, materials, dies, use of machinery, overhead expenses, marketing, and shipping).
(2) BULK SALES.—The Secretary shall make bulk sales available at a reasonable discount.

(3) PREPAID ORDERS.—The Secretary shall accept prepaid orders for the coins prior to the issuance of such coins. Sales under this paragraph shall be at a reasonable discount.

(4) SURCHARGE REQUIRED.—All sales shall include a surcharge of $10 per coin.

(f) GENERAL WAIVER OF PROCUREMENT REGULATIONS.—No provision of law governing procurement or public contracts shall be applicable to the procurement of goods and services necessary for carrying out the provisions of this section. Nothing in this subsection shall relieve any person entering into a contract under the authority of this section from complying with any law relating to equal employment opportunity.

(g) DISTRIBUTION OF SURCHARGES.—The total surcharges collected by the Secretary from the sale of the coins issued under this section shall be promptly paid by the Secretary to the Association of Graduates, United States Military Academy to assist the Association of Graduates' efforts to provide direct support to the academic, military, physical, moral, and ethical development programs of the Corps of Cadets, United States Military Academy.

(h) AUDITS.—The Comptroller General of the United States shall have the right to examine such books, records, documents, and other data of the Association of Graduates, United States Military Academy as may be related to the expenditure of amounts paid under subsection (g).

(i) NUMISMATIC PUBLIC ENTERPRISE FUND.—The coins issued under this section are subject to the provisions of section 5134 of title 31, United States Code, relating to the Numismatic Public Enterprise Fund.

(j) FINANCIAL ASSURANCES.—

(1) NO NET COST TO THE GOVERNMENT.—The Secretary shall take all actions necessary to ensure that the issuance of the coins authorized by this section shall result in no net cost to the United States Government.

(2) ADEQUATE SECURITY FOR PAYMENT REQUIRED.—No coin shall be issued under this section unless the Secretary has received—

(A) full payment therefore;

(B) security satisfactory to the Secretary to indemnify the United States for full payment; or

(C) a guarantee of full payment satisfactory to the Secretary from a depository institution whose deposits are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration Board.
SEC. 208. UNITED STATES BOTANIC GARDEN COMMEMORATIVE COINS.

(a) COIN SPECIFICATIONS.—

(1) ONE-DOLLAR SILVER COINS.—

   (A) ISSUANCE.—The Secretary of the Treasury (hereafter in this section referred to as the “Secretary”) shall mint and issue not more than 500,000 $1 coins, which shall weigh 26.73 grams, have a diameter of 1.500 inches, and contain 90 percent silver and 10 percent copper.

   (B) DESIGN.—The design of the coins issued under this section shall be a rose, the national floral emblem, and a frontal view of the French facade of the United States Botanic Garden. On each coin there shall be a designation of the value of the coin, an inscription of the years “1820-1995”, and inscriptions of the words “Liberty”, “In God We Trust”, “United States of America”, and “E Pluribus Unum”.

(2) LEGAL TENDER.—The coins issued under this section shall be legal tender, as provided in section 5103 of title 31, United States Code.

(3) NUMISMATIC ITEMS.—For purposes of section 5134 of title 31, United States Code, all coins minted under this section shall be considered to be numismatic items.

(b) SOURCE OF BULLION.—The Secretary shall obtain silver for the coins minted under this section only from stockpiles established under the Strategic and Critical Materials Stock Piling Act.

(c) SELECTION OF DESIGN.—The design for the coins minted under this section shall be—

   (1) selected by the Secretary after consultation with the National Fund for the United States Botanic Garden and the Commission of Fine Arts; and

   (2) reviewed by the Citizens Commemorative Coin Advisory Committee.

(d) ISSUANCE OF COINS.—

   (1) QUALITY OF COINS.—Coins minted under this section may be issued in uncirculated and proof qualities.

   (2) MINT FACILITY.—Not more than 1 facility of the United States Mint may be used to strike any particular quality of the coins minted under this section.

   (3) PERIOD OF ISSUANCE.—The Secretary may issue coins minted under this section during the period beginning on January 1, 1997, and ending on December 31, 1997.
(f) Sale of Coins.—

(1) Sale Price.—The coins authorized under this section shall be sold by the Secretary at a price equal to the sum of the face value of the coins, the surcharge provided in paragraph (4) with respect to such coins, and the cost of designing and issuing the coins (including labor, materials, dies, use of machinery, overhead expenses, marketing, and shipping).

(2) Bulk Sales.—The Secretary shall make bulk sales available at a reasonable discount.

(3) Prepaid Orders.—The Secretary shall accept prepaid orders for the coins authorized under this section prior to the issuance of such coins. Sales under this paragraph shall be at a reasonable discount.

(4) Surcharge Required.—All sales shall include a surcharge of $10 per coin.

(g) General Waiver of Procurement Regulations.—

(1) In General.—Except as provided in paragraph (2), no provision of law governing procurement or public contracts shall be applicable to the procurement of goods and services necessary for carrying out the provisions of this section.

(2) Equal Employment Opportunity.—Paragraph (1) shall not relieve any person entering into a contract under the authority of this section from complying with any law relating to equal employment opportunity.

(h) Audits.—The Comptroller General of the United States shall have the right to examine such books, records, documents, and other data of the National Fund for the United States Botanic Garden as may be related to the expenditures of amounts paid under subsection (g).

(i) Financial Assurances.—

(1) No Net Cost to the Government.—The Secretary shall take all actions necessary to ensure that the issuance of the coins authorized by this section shall result in no net cost to the United States Government.

(2) Adequate Security for Payment Required.—No coin shall be issued under this section unless the Secretary has received—

(A) full payment therefore;

(B) security satisfactory to the Secretary to indemnify the United States for full payment; or

(C) a guarantee of full payment satisfactory to the Secretary from a depository institution whose deposits are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration Board.
SEC. 209. MOUNT RUSHMORE COMMEMORATIVE COINS.

(a) DISTRIBUTION OF SURCHARGES.—Section 8 of the Mount Rushmore Commemorative Coin Act (104 Stat. 314; 31 U.S.C. 5112 note) is amended by striking paragraphs (1) and (2) and inserting the following:

“(1) the first $18,750,000 shall be paid during fiscal year 1994 by the Secretary to the Society to assist the Society’s efforts to improve, enlarge, and renovate the Mount Rushmore National Memorial; and

“(2) the remainder shall be returned to the Federal Treasury for purposes of reducing the national debt.”.

(b) RETROACTIVE EFFECT.—If, prior to the enactment of this Act, any amount of surcharges have been received by the Secretary of the Treasury and paid into the United States Treasury pursuant to section 8(1) of the Mount Rushmore Commemorative Coin Act, as in effect prior to the enactment of this Act, that amount shall be paid out of the Treasury to the extent necessary to comply with section 8(1) of the Mount Rushmore Commemorative Coin Act, as in effect after the enactment of this Act. Amounts paid pursuant to the preceding sentence shall be out of funds not otherwise appropriated.

(c) NUMISMATIC OPERATING PROFITS.—Nothing in this section shall be construed to affect the Secretary of the Treasury’s right to derive operating profits from numismatic programs for use in supporting the United States Mint’s numismatic operations and programs, or to allow the distribution of operating profits from the Numismatic Public Enterprise Fund to a recipient organization under any numismatic program.

SEC. 210. STUDY AND REPORT ON THE UNITED STATES FINANCIAL SERVICES SYSTEM.

(a) STUDY.—

(1) IN GENERAL.—The Secretary of the Treasury (hereafter in this section referred to as the “Secretary”) shall, after consultation with the Advisory Commission on Financial Services established under subsection (b), and consultation in accordance with paragraph (3), conduct a study of matters relating to the strengths and weaknesses of the United States financial services system in meeting the needs of the system’s users, including the needs of—

(A) individual consumers and households;

(B) communities;

(C) agriculture;

(D) small-, medium-, and large-sized businesses;

(E) governmental and nonprofit entities; and
(F) exporters and other users of international financial services.

(2) MATTERS STUDIED.—The study required under paragraph (1) shall include consideration of—

(A) the changes underway in the national and international economies and the financial services industry, and how those changes affect the financial services system's ability to efficiently meet the needs of the national economy and the system's users during the next 10 years and beyond; and

(B) the adequacy of existing statutes and regulations, and the existing regulatory structure, to meet the needs of the financial services system's users effectively, efficiently, and without unfair, anticompetitive, or discriminatory practices.

(3) CONSULTATION.—Consultation in accordance with this paragraph means consultation with—

(A) the Board of Governors of the Federal Reserve System;
(B) the Commodity Futures Trading Commission;
(C) the Comptroller of the Currency;
(D) the Director of the Office of Thrift Supervision;
(E) the Federal Deposit Insurance Corporation;
(F) the Secretary of the Department of Housing and Urban Development;
(G) the Securities and Exchange Commission;
(H) the Director of the Congressional Budget Office; and
(I) the Comptroller General of the United States.

(b) ADVISORY COMMISSION ON FINANCIAL SERVICES.—

(1) ESTABLISHMENT.—There is established the Advisory Commission on Financial Services (hereafter in this section referred to as the "Advisory Commission").

(2) MEMBERSHIP OF COMMISSION.—The Advisory Commission—

(A) shall consist of not less than 9 nor more than 14 members appointed by the Secretary from among individuals—

(i) who are—

(I) users of the financial services system; or

(II) experts in finance or on the financial services system; and

(ii) who are not employees of the Federal Government; and

(B) shall include representatives of business, agriculture, and consumers.
(3) **Chairperson.**—The Secretary or the Secretary's designee shall serve as Chairperson of the Advisory Commission.

(4) **Travel Expenses.**—Members of the Advisory Commission shall be allowed travel expenses, including per diem in lieu of subsistence, at rates authorized for employees of agencies under subchapter I of chapter 57 of title 5, United States Code, while away from their homes or regular places of business in performing services for the Advisory Commission.

(5) **Termination.**—The Advisory Commission shall terminate 30 days after the date of submission of the report required under subsection (d).

(c) **Recommendations.**—Based on the results of the study conducted under subsection (a), the Secretary shall develop such recommendations as may be appropriate for changes in statutes, regulations, and policies to improve the operation of the financial services system, including changes to better—

(1) meet the needs of, and assure access to the system for, current and potential users;
(2) promote economic growth;
(3) protect consumers;
(4) promote competition and efficiency;
(5) avoid risk to the taxpayers;
(6) control systemic risk; and
(7) eliminate discrimination.

(d) **Report.**—Not later than 15 months after the date of enactment of this Act, the Secretary shall submit to the President pro tempore of the Senate and the Speaker of the House of Representatives a report describing the study conducted under subsection (a) and any recommendations developed under subsection (c).

## 2011

### SEC. 211. FLEXIBILITY IN CHOOSING BOARDS OF DIRECTORS.

(a) **In General.**—Section 5146 of the Revised Statutes (12 U.S.C. 72) is amended in the 1st sentence, by striking "two thirds" and inserting "a majority".

(b) **Provision Repeal.**—Effective on the date of enactment of the Riegle Community Development and Regulatory Improvement Act of 1994, this section and the amendment made by this section are repealed.
DEVELOPMENTS IN THE "BANK SHARES TAX" FOR KENTUCKY

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Greenebaum Doll & McDonald
Louisville, Kentucky

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SECTION B.1
# DEVELOPMENTS IN THE "BANK SHARES TAX" FOR KENTUCKY

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I. Kentucky Bank Shares Tax -- Overview

A. The Constitution -- Section 172

1. § 172. Property to be assessed at fair cash value -- Punishment of assessor for wilful error. -- All property, not exempted from taxation by this Constitution, shall be assessed for taxation at its fair cash value, estimated at the price it would bring at a fair voluntary sale; and any officer, or other person authorized to assess values for taxation, who shall commit any wilful error in the performance of his duty, shall be deemed guilty of misfeasance, and upon conviction thereof shall forfeit his office, and be otherwise punished as may be provided by law.

B. The Statute -- KRS 136.270

1. 136.270. Tax on bank and trust company shares except banker's bank organized under KRS 287.135 -- (1) For calendar year 1984 and each year thereafter, an annual tax of ninety-five cents (95¢) is hereby imposed on each one hundred dollars ($100) of the taxable fair cash value of shares, except shares of bankers' banks organized under KRS 287.135, as determined in accordance with subsection (4) of this section. The tax shall be paid to the sheriff of the county annually by the banks and trust companies, for and on behalf of the owners of the shares of stock. The tax shall be for state purposes only, and in lieu of all other taxes upon such shares by the state, or any county, city, or other taxing district, except as provided in subsections (2) and (3) of this section.

* * * *

(4) For calendar year 1984 and each year thereafter, the fair cash value and taxable fair cash value of shares shall be determined in the following manner:
(a) The net worth (capital stock, surplus, undivided profits, and reserves for contingencies and other capital reserves) of the bank or trust company as of December 31 of each year shall be determined.

(b) The net income (after federal income taxes and before dividends) of the bank or trust company for the past five (5) years, or so many years in which there was net income (not to exceed five (5)) as are available, preceding the assessment date, shall be averaged and capitalized at a rate determined by the Revenue Cabinet.

(c) On or before September 1 of each year, the Revenue Cabinet shall provide to the banking industry the capitalization rate developed from the previous year's annual reports of banks and trust companies submitted to the cabinet. The rate shall be determined as follows:

1. Determine the ratio of each bank's five (5) year average net income to the previous year's net worth;

2. Rank the resulting ratios; and

3. The medium ratio shall be the capitalization rate.

(d) The results of the computation in paragraphs (a) and (b) of this subsection shall be added and the sum divided by two (2) to determine fair cash value. From fair cash value shall be subtracted the influence of tax-exempt United States obligations to determine taxable fair cash value of shares subject to the annual tax. The influence of tax-exempt United States obligations is to be determined from the reports of condition and income filed with the applicable supervisory agency as follows: the average amount of tax-exempt United States obligations for the calendar year, over the average amount of total assets for the calendar year multiplied by the fair cash value.
(5) In any extraordinary case where application of the formula provided by subsection (4) of this section will result in an inequitable or erroneous assessment, either with respect to the bank or the Commonwealth, the fair cash value and taxable fair cash value of shares shall be determined in accordance with other recognized criteria.

C. The Revenue Cabinet's Position

1. The Revenue Cabinet's present position in the bank shares tax is that in a great many circumstances, application of the statutory formula set out in KRS 136.270 does not result in a taxable fair cash value of shares which complies with Section 172's requirement that all property be taxed at its fair cash value. In other words, the Revenue Cabinet believes that the valuation method prescribed by the Kentucky General Assembly which has been in place for over ten years need not be complied with; rather, the Revenue Cabinet asserts it has the constitutional obligation to go outside of the statute for valuation purposes.

2. Using such position, the Revenue Cabinet is issuing tax assessments purportedly "using other recognized criteria" to produce an assessment that is "neither erroneous nor inequitable to the taxpayer or the Commonwealth." The leading method being used by the Kentucky Revenue Cabinet is based on a modification of the formula set forth in KRS 136.270.

a. Generally, the Revenue Cabinet is using a three-year weighted average (50% to the most recent year, 33% to the next year, and 17% to the remaining year) of net income (after
federal income taxes and before dividends). This figure is then capitalized at a "fair" rate (.1011 has been used), as determined solely by the Revenue Cabinet.

b. This "capitalized net income" figure is then added to the taxpayer's net worth, with the sum divided by two to yield a value which the Revenue Cabinet asserts is the taxable fair cash value.

II. Issues Presented

A. Does the Burden of Proof Shift?

1. Since the Revenue Cabinet is operating directly contra to existing statutory law in Kentucky law, which must be presumed to be constitutional, the question is presented as to whether the Revenue Cabinet must assume the burden of proof when valuing a taxpayer's bank shares through the use of any method other than the statutorily prescribed calculations set forth in KRS 136.270.

a. The Revenue Cabinet should bear the burden of proof in establishing that an "extraordinary case" exists, as used under KRS 136.270(5).

b. The Revenue Cabinet should bear the burden of proof that its weighted average method used to determine average net income to be capitalized constitutes "other recognized criteria" for valuing bank shares.
B. Can Revenue Simply Disregard The Statute's Requirements?

1. a. KRS 136.270 mandates the use of the statutory method of valuation. Is it possible for an executive branch, cabinet level administrative agency to disregard the prescribed law in Kentucky in circumstances where it sees fit?

   b. Can an administrative agency simply ignore the law of the Commonwealth, all under the guise of upholding the Constitution, or at least its interpretation of the Constitution?

C. Revenue Is Now Attempting To Do What The General Assembly Would Not Let It Do

1. During the 1994 Regular Session of the Kentucky General Assembly, the House of Representatives considered a Revenue Cabinet sponsored amendment/repeal of KRS 136.270. See 1994 Regular Session General Assembly HB 82. HB 82, were it enacted, would have provided that effective January 1, 1995 and each year thereafter, the fair cash value and the taxable fair cash value of bank shares would be determined by the Revenue Cabinet; present KRS 136.270 would have been repealed.

   a. The Revenue Cabinet sought General Assembly permission to take the kind of activity which it now administratively asserts. Clearly, if Revenue had the power to do what it now seeks to do, it would not have sought the legislative authorization in the 1994 Regular Session.

   b. The Revenue Cabinet's attempt to legislate and superimpose its own administratively created
formula to increase the tax burden in the face of an express rejection by the Kentucky General Assembly raises serious questions about the Revenue Cabinet's actions.

D. Exclusion of "Loss Years" From Capitalization Computation

1. The Revenue Cabinet has also been taking the position that a taxpayer may not include a "loss year" in the statutory capitalization formula used in KRS 136.270.

2. Further, the Revenue Cabinet has begun to take the position that a taxpayer may not put "zero" into the income capitalization formula used by the statute in lieu of a negative (loss) figure.

3. Lastly, in circumstances where the "older" years are "loss years," the Revenue Cabinet is showing a tendency to disregard those years and focus on the profitable years -- thus, using a three-year average or weighted average, rather than a four or five year average or weighted average. The effect is to increase the taxable fair cash value by eliminating any effect the early loss years may have on the income approach valuation.

III. Disputes

A. Protests -- In 1994, the Revenue Cabinet received 164 total protests. Out of the total banks subject to tax, this represents 48.9% of all taxpayers. Look for more protests in 1995 as Revenue will be asserting the same positions.
B. Litigation -- *First American Bank v. Revenue Cabinet*, File No. K94-R-3 (KBTA). This is the lead case. The Revenue Cabinet and taxpayers hope this sets a precedent on the issue of whether Revenue may deviate from the requests of KRS 136.270.
Representative Marshall Long prefilled the following bill for introduction on the first day of the 1994 regular session.
AN ACT relating to property taxation.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

Section 1. KRS 136.270 is amended to read as follows:

1. (1) For calendar year 1984 and each year thereafter, an annual tax of ninety-five cents ($0.95) is hereby imposed on each one hundred dollars ($100) of the taxable fair cash value of shares of banks or trust companies, except shares of bankers' banks organized under KRS 287.135, as determined in accordance with subsection (4) of this section. The tax shall be paid to the sheriff of the county annually by the banks and trust companies, for and on behalf of the owners of the shares of stock. The tax shall be for state purposes only, and in lieu of all other taxes upon the [such] shares by the state, or any county, city, or other taxing district, except as provided in subsections (2) and (3) of this section.

2. (2) The county in which the bank or trust company is located may impose a tax on each one hundred dollars ($100) of the taxable fair cash value of shares of the [such] bank or trust company, except shares of bankers' banks organized under KRS 287.135, at a rate not to exceed a rate to be determined by multiplying nineteen cents ($0.19) by a fraction, the numerator of which is the fair cash value of shares of all banks or trust companies within the county and the denominator of which is the taxable fair cash value of shares of all banks or trust companies within the county.

3. (3) The city in which the bank or trust company is located may impose a tax on each one hundred dollars ($100) of the taxable fair cash value of the shares of the [such] bank or trust company, except shares of bankers' banks organized under KRS 287.135, at a rate not to exceed a rate to be determined by multiplying nineteen cents ($0.19) by a fraction, the numerator of which is the fair cash value of shares of all banks or trust companies within the city and the denominator of which is the taxable fair cash value of shares of all banks or trust companies within the city.

4. (4) Effective January 1, 1985 (For-calendar-year-1984) and each year thereafter, the
fair cash value and taxable fair cash value of shares shall be determined by the
Revenue Cabinet in the following manner:

(a) The net worth (capital stock, surplus, undivided profits, and reserves for
contingencies and other capital reserves) of the bank or trust company as of
December 31 of each year shall be determined:

(b) The net income (after federal income taxes and before dividends) of the bank
or trust company for the past five (5) years, or so many years in which there
was net income (not to exceed five (5)) as are available, preceding the
assessment date, shall be averaged and capitalized at a rate determined by the
Revenue Cabinet:

(c) On or before September 1 of each year, the Revenue Cabinet shall provide to
the banking industry the capitalization rate developed from the previous year's
annual reports of banks and trust companies submitted to the cabinet. The rate
shall be determined as follows:

1. Determine the ratio of each bank's five (5) year average net income to the
previous year's net worth;

2. Rank the resulting ratios; and

3. The medium ratio shall be the capitalization rate:

(d) The results of the computation in paragraphs (a) and (b) of this subsection
shall be added and the sum divided by two (2) to determine fair cash value:
From fair cash value shall be subtracted the influence of tax-exempt United
States obligations to determine taxable fair cash value of shares subject to the
annual tax. The influence of tax-exempt United States obligations is to be
determined from the reports of condition and income filed with the applicable
supervisory agency as follows: the average amount of tax-exempt United
States obligations for the calendar year, over the average amount of total
assets for the calendar year multiplied by the fair cash value:
(5) In any extraordinary case where application of the formula provided by subsection (4) of this section will result in an inequitable or erroneous assessment, either with respect to the bank or the Commonwealth, the fair-cash-value and taxable-fair-cash value of shares shall be determined in accordance with other recognized criteria.
BANKRUPTCY REFORM ACT OF 1994
Dramatic Amendments To The Bankruptcy Code
Necessitate Changes In Banking Practices

Lisa Koch Bryant
Rubin Hays & Foley
Louisville, Kentucky

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SECTION C
# BANKRUPTCY REFORM ACT OF 1994

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## SECTION C
The Bankruptcy Reform Act of 1994, H.R. 5116, P.L. 103–394, 108 Stat. 4106, went into effect immediately upon its signing by the President, on October 22, 1994. All cases filed thereafter are subject to the Bankruptcy Reform Act of 1994. There are important changes for both commercial and consumer cases. The general consensus is that the changes in the commercial area tend to be beneficial to creditors, whereas the changes affecting consumer cases are more favorable to the debtors.

I. REVISED PROCEDURES FOR REAFFIRMATION AGREEMENTS

§103 of the Reform Act deals with new reaffirmation procedures. §524(d) has been amended to provide (and/or clarify) that reaffirmation hearings will no longer be necessary if the debtor is represented by counsel "during the course of negotiating such agreement".

However, additional disclosures and changes to the Reaffirmation Agreement are necessary, as set forth in the amendments to §524(c). The Reaffirmation Agreement must disclose conspicuously that the Reaffirmation Agreement is voluntary, as follows:

"(B) such agreement contains a clear and conspicuous statement which advises the debtor that such agreement is not required under this title, under nonbankruptcy law, or under any agreement not in accordance with the provisions of this subsection;"

Additionally, the "Affidavit or Declaration" of the debtor's attorney must include this new requirement:

"(C) the attorney fully advised the debtor of the legal effect and consequences of—

"(i) an agreement of the kind specified in this subsection; and

"(ii) any default under such an agreement;".
We have drafted the following two paragraphs in an attempt to comply with these new requirements. (Please be advised, however, that these come with "no warranties, express or implied"!)

**THIS AGREEMENT IS VOLUNTARY. REAFFIRMATION AGREEMENTS ARE NOT REQUIRED TO BE EXECUTED UNDER THE BANKRUPTCY CODE, UNDER ANY OTHER FEDERAL OR STATE LAW, OR UNDER ANY AGREEMENT NOT IN ACCORDANCE WITH THE PROVISIONS OF 11 U.S.C. §524(c).**

I, ____________________, attorney for the Debtor in the above-captioned bankruptcy proceeding declare that I represented the Debtor during the negotiation of the foregoing Agreement and that said Agreement represents a fully informed and voluntary agreement by the Debtor and that the Agreement does not impose an undue hardship on the Debtor or a dependent of the Debtor. The Debtor was fully advised of the legal effect and consequence of executing this Agreement and the consequences of any default under the Agreement.

Date___________________________

ATTORNEY FOR DEBTOR

**II. INCREASED CHAPTER 13 ELIGIBILITY**

§108(a) more than doubles the dollar amount of debt that a Chapter 13 debtor may owe. Previously, the debt ceilings for Chapter 13 eligibility were $100,000 "unsecured" and $350,000 "secured". This has been increased dramatically, to a total of $1,000,000, divided into $250,000 "unsecured" and $750,000 "secured". Thus, the number of debtors who can take advantage of Chapter 13 will be greatly increased.

**III. LATE-FILED CLAIMS DISALLOWED**

§213 of the Reform Act amends §502(b) to provide that late-filed claims will no longer be allowed. This amendment is designed to legislatively over-rule the judicial ruling of In Re Hausladen, 146 B.R. 557 (Bankr. D. Minn. 1992).
IV. ALIMONY AND CHILD SUPPORT GIVEN "PRIORITY" STATUS

§304 of the Reform Act grants "priority" status to alimony, maintenance, and child support obligations. This means that claims for child support and alimony will be paid ahead of general unsecured claims, such as credit cards, signature loans, etc. This is relevant to bankers and their counsel with respect to the decision to grant credit. Be aware that a loan applicant's delinquent (or potentially delinquent) support and maintenance obligations will be paid by a bankruptcy trustee before the bank's unsecured claims.

V. HOME MORTGAGES IN CHAPTER 11

§206 of the Reform Act is a good change. Although located in the "Commercial Bankruptcy" section of the Reform Act, it involves residential real estate mortgages. §206 amends §1123(b) of the Code to provide that Chapter 11 debtors cannot modify home mortgages. Chapter 11 debtors could previously "re-write" the terms of their home mortgages, by "writing down" the secured portion of the debt to the fair market value, by reducing the interest rate to the "market" rate, by extending the maturity, etc., to reduce their monthly payments. §206 extends to Chapter 11 debtors the prohibition against modifying post-petition payments on home mortgages, which previously existed only in Chapter 13.

VI. CURING HOME MORTGAGE DEFAULT

§301 of the Reform Act amends §1322 of the Code to clarify when a debtor's right to cure home mortgage arrearages is extinguished. §301 clarifies that a debtor may cure mortgage arrearages through a Chapter 13 plan so long as the bankruptcy petition is filed prior to the actual foreclosure sale. This is not a change in our local practice, because the §301 amendment is consistent with the Sixth Circuit's holding in In Re Glenn, 760 F.2d 1428 (6th Cir.)
1985). However, it specifically over-rules the Third Circuit's decision in Matter of Roach, 824 F.2d 1370 (3rd Cir. 1987), which extinguished the debtor's right to cure when the foreclosure judgment was entered.

§301 also amends §1322 by adding a new subsection (c)(2), as follows:

"(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title."

This subsection is cryptic, and deals with those home mortgages on which the final payment comes due during the term of the Chapter 13 plan. It is believed that this new amendment only permits modification of the home mortgage to the extent of curing the pre-petition arrearage over the term of the plan, and it should not permit the debtor to extend the maturity date of the mortgage to the end of the plan (as to post-petition payments).

VII. EXCEPTIONS TO DISCHARGE

§306 of the Reform Act amends §523(a)(2)(C) of the Code, by increasing the presumption of nondischargeability for "luxury goods" and cash advances, to include those luxury goods and cash advances incurred 60 days pre-petition. Under the old law, these time periods were 40 days and 20 days, respectively.

However, the definition of "luxury goods" has unfortunately been re-defined as those items "aggregating more than $1,000" (as opposed to $500, under the old law).

§221 of the Reform Act adds a new Subsection (14) to §523 of the Code, to render nondischargeable those loans which are used for payment of non-dischargeable federal taxes. However, the burden of proof will be on the bank which objects to discharge to prove that its
loan proceeds were used to retire non-dischargeable federal taxes. Thus, documentation of the loan proceeds at closing may be critical.

VIII. EFFECT OF CONVERSION FROM CHAPTER 13 TO CHAPTER 7

§311 of the Reform Act amends §348 of the Code to add the following language:

Section 348 of title 11, United States Code, is amended by adding at the end the following:

"(f)(1) Except as provided in paragraph (2), when a case under Chapter 13 of this title is converted to a case under another chapter under this title —

"(A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion; and

"(B) valuations of property and of allowed secured claims in the chapter 13 case shall apply in the converted case, with allowed secured claims reduced to the extent that they have been paid in accordance with the chapter 13 plan.

"(2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property in the converted case shall consist of the property of the estate as of the date of conversion."

Subsection (f)(1)(A) provides that debtors essentially "get to have their cake and eat it, too" by providing that upon conversion from Chapter 13 to Chapter 7, "property of the estate" does not include property acquired after the Chapter 13 filing (but prior to conversion to Chapter 7). Yet presumably, the debtor may include post-petition debts in the estate. . . Does this seem fair and equitable?

Worse yet, Subsection (f)(1)(B) apparently seeks to undo all the gains recently achieved in the Sixth Circuit case of Liberty National Bank and Trust Company of Kentucky v.
Burba, Case No. 93–6479. This new amendment would seem to indicate that when a debtor converts from Chapter 13 to Chapter 7 before completion of plan payments, the valuation of secured claims in the Chapter 13 will carry over in the converted Chapter 7, and the secured claims will be reduced by any payments made in Chapter 13. This would arguably permit the debtor to then redeem for the Chapter 13 collateral valuation, less payments received in the Chapter 13 (as opposed to the debtor having to pay the remaining balance owed on the loan, as required under Burba, supra).

IX. CHANGES RELATIVE TO ARTICLE 9

A. Perfection of Purchase–Money Security Interest

§203 of the Reform Act is amended to bring §547 of the Code (regarding trustees' "lien–avoiding powers") into conformance with most states' UCC Article 9 law. Previously, a bankruptcy trustee could avoid any purchase money security interest which was not perfected within 10 days after the debtor received the collateral. Because this provision of §547 was inconsistent with most state law, the Reform Act grants purchase money lenders 20 days to perfect their liens.

B. Continued Perfection

Section 204 of the Reform Act provides that lenders can now file continuation statements under Article 9, without violating the automatic stay of §362 of the Code. Lenders will not be required to file continuation statements during the pendency of a bankruptcy case, but will be able to do so permissively.
X. EXPEDITED HEARING ON AUTOMATIC STAY

§101 of the Reform Act sounds good, but may not really make any significant difference, as a practical matter. It provides that the final hearing to terminate the automatic stay must now be "concluded" (rather than merely "commenced") not later than 30 days after the conclusion of the preliminary hearing. However, the judge does have an "out", if he determines that "compelling circumstances" exist to continue the automatic stay. Thus, those judges who are reluctant to terminate the stay will simply find "compelling circumstances" (or else they may just "take the matter under advisement" indefinitely!).

XI. SERVICE OF PROCESS ON INSURED DEPOSITORY INSTITUTIONS

§114 of the Reform Act is unusual in that it amends the Bankruptcy Rules (not the Code). It amends B.R. 7004 to require that service of process to an "insured depository institution" (as defined in Section 3 of the Federal Deposit Insurance Act) must be made by certified mail in an "adversary proceeding" or "contested matter". Previously, such service of process could be made by sending summons and notices by regular first class mail.

XII. SMALL BUSINESS BANKRUPTCIES IN CHAPTER 11

Rather than enact a new Chapter 10, as rumored, Congress amended Chapter 11, to expedite (theoretically) the reorganization process for "small businesses". §217 of the Reform Act amends §101 of the Code to define "small business" as follows:

"(51C) 'small business' means a person engaged in commercial or business activities (but does not include a person whose primary activity is the business of owning or operating real property and activities incidental thereto) whose aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition do not exceed $2,000,000;"

§217 further amends §1121 and §1125 of the Code, as follows:
(d) WHO MAY FILE A PLAN.—Section 1121 of title 11, United States Code, is amended by adding at the end the following:

"(e) In a case in which the debtor is a small business and elects to be considered a small business —

"(1) only the debtor may file a plan until after 100 days after the date of the order for relief under this chapter.

"(2) all plans shall be filed within 160 days after the date of the order for relief; and

"(3) on request of a party in interest made within the respective periods specified in paragraphs (1) and (2) and after notice and a hearing, the court may —

"(A) reduce the 100-day period or the 160-day period specified in paragraph (1) or (2) for cause; and

"(B) increase the 100-day period specified in paragraph (1) if the debtor shows that the need for an increase is caused by circumstances for which the debtor should not be held accountable".

(e) POSTPETITION DISCLOSURE.—Section 1125 of title 11, United States Code, is amended by adding at the end the following:

"(f) Notwithstanding subsection (b), in a case in which the debtor has elected under Section 1121(e) to be considered a small business—

"(1) the court may conditionally approve a disclosure statement subject to final approval after notice and a hearing;

"(2) acceptances and rejections of a plan may be solicited based on a conditionally approved disclosure statement as long as the debtor provides adequate information to each holder of a claim or interest that is solicited, but a conditionally approved disclosure statement shall be mailed at least 10 days prior to the date of the hearing on confirmation of the plan; and

"(3) a hearing on the disclosure statement may be combined with a hearing on confirmation of a plan."

"Small businesses" may dispense with the formation of a "creditors committee"; they must file their plans within 100 days (as opposed to 120 days); and they can combine the
"disclosure statement hearing" with the "plan confirmation hearing". However, these perceived benefits of reduced time and expense are only available if the debtor elects to be treated as a "small business", and most Chapter 11 debtors probably do not want to speed up the process. Instead, many debtors want to use Chapter 11 for delay, so these debtors will not want to elect to be put on the "small business" fast-track.

If a debtor does elect the small business treatment, the combining of the disclosure statement hearing with the confirmation hearing is troublesome. The entire Chapter 11 plan process is premised on voting by informed creditors. If the creditors think the disclosure statement contains inadequate information, how can they make an informed vote on whether the plan should be confirmed?

XIII. SINGLE ASSET REAL ESTATE CASES

§218 of the Reform Act contains significant revisions to §101 and §362 of the Code, regarding "definitions" and the "automatic stay", respectively. A "single asset real estate" debtor is defined as follows:

"(51B) 'single asset real estate' means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, liquidated secured debts in an amount no more than $4,000,000."

§362 is amended to provide that the automatic stay will be terminated against a "single asset real estate debtor" if the debtor has not, within 90 days of filing the petition, either filed a "feasible" reorganization plan or if the debtor has not commenced certain monthly payments to secured creditors, as follows:
(b) AUTOMATIC STAY. Section 362(d) of title 11, United States Code, is amended—

(1) in paragraph (1) by striking "or" at the end,

(2) in paragraph (2) by striking the period at the end and inserting "; or", and

(3) by adding at the end the following:

"(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period)—

"(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

"(B) the debtor has commenced monthly payments to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate."

This is an important (and welcome) change, designed to keep Chapter 11 cases from languishing indefinitely (as they have tended to do ever since the U.S. Supreme Court's decision eviscerating the concept of interest payments as "adequate protection" in In Re Timbers of Inwood Forest Associates, Ltd., 793 F.2d 1380, (5th Cir.), vacated, 802 F.2d 777 (5th Cir. 1986), reinstated, 808 F.2d 363, (5th Cir. 1987), aff'd, 484 U.S. 365, 108 S.Ct. 626, 98 L. Ed. 2d 740, (1988).

However, this new amendment will undoubtedly spawn considerable litigation over at least five (5) issues, i.e.,
1) does the debtor's plan have a "reasonable possibility of being confirmed in a reasonable time"?

2) What is the "current fair market rate" of interest to be paid (particularly by "distressed" borrowers)?

3) What is the value of the creditor's interest in the real estate, on which these monthly payments are calculated?

4) How are these monthly payments to be applied by the creditor (since these monthly payments are apparently not "interest", but rather "payments in an amount equal to interest")?

5) How do you determine the $4,000,000 "secured" debt ceiling, i.e., by the total debt owed on the real estate, or by that portion of the debt which is collateralized? (In other words, banks will want the dollar amount of "secured" debt determined by the value of the real estate.)

XIV. OVER–RULING OF DEPREZIO

§202 of the Reform Act overrules the so-called "Deprezio" case (Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186 (7th Cir. 1989)). This section amends §550 of the Code to provide that a trustee may not recover from a transferee of the debtor that was not an "insider" if the transfer was made between 90 days and one (1) year before the petition was filed and was avoided under §547(b), even if the transfer benefitted a creditor that was an insider at the time of transfer.

This is a significant change to Sixth Circuit practice, because the Deprezio case had been adopted by the Sixth Circuit in the so-called "C.L. Cartage" case, Ray v. City Bank and
Trust Co., (In Re C.L. Cartage Co.), 899 F.2d 1490 (6th Cir. 1990). The Deprezio and C.L. Cartage cases held that payments to banks within a year of bankruptcy could be recovered by the trustee, even though the banks were not "insiders", if those bank payments benefitted "insiders" (personal guarantors who were directors, officers, etc.). The Deprezio and C.L. Cartage cases had the practical effect of making banks leery of taking personal guaranties, since the preference period for such guaranteed loans was being judicially extended from 90 days to a full year. §202 of the Reform Act is designed to reduce the banks' exposure to preference actions.

XV. LEASES OF PERSONAL PROPERTY

§219 of the Reform Act amends §365(d) of the Code to require the trustee or debtor-in-possession to commence lease payments on an equipment lease within 60 days from entry of the order for relief. This is perceived as a change which is beneficial to creditors/lessors.

XVI. DISCRIMINATORY TREATMENT AGAINST STUDENT LOAN APPLICANTS

§313 of the Reform Act is particularly note-worthy because of what it does not say... It amends §525 of the Code, ostensibly to prohibit discrimination against applicants for student loans based on prior bankruptcy. However, a literal reading would seem to indicate that banks whose portfolios include guaranteed student loans may not deny credit to persons who have filed bankruptcy!

§313 reads as follows:

SEC. 313. PROTECTION AGAINST DISCRIMINATORY TREATMENT OF APPLICATIONS FOR STUDENT LOANS

Section 525 of title 11, United States Code, is amended by adding at the end the following:
"(c)(1) A governmental unit that operates a student grant or loan program and a person engaged in a business that includes the making of loans guaranteed or insured under a student loan program may not deny a grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, or another person with whom the debtor or bankrupt has been associated, because the debtor or bankrupt is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of a case under this title or during the pendency of the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.

"(2) In this section, 'student loan program' means the program operated under part B, D, or E of title IV of the Higher Education Act of 1965 or a similar program operated under State or local law."

Surely, this must be a mistake!
THE BANKRUPTCY REFORM ACT OF 1994

H. R. 5116

Public Law 103 - 394

October 22, 1994
An Act

To amend title 11 of the United States Code.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

(a) SHORT TITLE.—This Act may be cited as the “Bankruptcy Reform Act of 1994”.

(b) TABLE OF CONTENTS.—The table of contents is as follows:

Sec. 1. Short title.

TITLE I—IMPROVED BANKRUPTCY ADMINISTRATION

Sec. 101. Expedited hearing on automatic stay.
Sec. 102. Jurisdiction to review interlocutory orders increasing or reducing certain time periods for filing plan.
Sec. 103. Expedited procedure for reaffirmation of debts.
Sec. 104. Powers of bankruptcy courts.
Sec. 105. Participation by bankruptcy administrator at meetings of creditors and equity security holders.
Sec. 106. Definition relating to eligibility to serve on chapter 11 committees.
Sec. 107. Increased incentive compensation for trustees.
Sec. 108. Dollar adjustments.
Sec. 109. Premerger notification.
Sec. 110. Allowance of creditor committee expenses.
Sec. 111. Supplemental injunctions.
Sec. 112. Authority of bankruptcy judges to conduct jury trials in civil proceedings.
Sec. 113. Sovereign immunity.
Sec. 114. Service of process in bankruptcy proceedings on an insured depository institution.
Sec. 115. Meetings of creditors and equity security holders.
Sec. 116. Tax assessment.
Sec. 117. Additional trustee compensation.
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TITLE II—COMMERCIAL BANKRUPTCY ISSUES
Sec. 201. Aircraft equipment and vessels; rolling stock equipment.
Sec. 202. Limitation on liability of non-insider transferee for avoided transfer.
Sec. 203. Perfection of purchase-money security interest.
Sec. 204. Continued perfection.
Sec. 205. Rejection of unexpired leases of real property or timeshare interests.
Sec. 206. Contents of plan.
Sec. 207. Priority for independent sales representatives.
Sec. 208. Exclusion from the estate of interests in liquid and gaseous hydrocarbons transferred by the debtor pursuant to production payment agreements.
Sec. 209. Seller's right to reclaim goods.
Sec. 211. Election of trustee under chapter 11.
Sec. 212. Rights of partnership trustee against general partners.
Sec. 213. Impairment of claims and interests.
Sec. 214. Protection of security interest in post-petition rents and lodging payments.
Sec. 215. Amendment to definition of swap agreement.
Sec. 216. Limitation on avoiding powers.
Sec. 217. Small businesses.
Sec. 218. Single asset real estate.
Sec. 219. Leases of personal property.
Sec. 220. Exemption for small business investment companies.
Sec. 221. Payment of taxes with borrowed funds.
Sec. 222. Return of goods.
Sec. 223. Proceeds of money order agreements.
Sec. 224. Trustee duties; professional fees.
Sec. 225. Notices to creditors.

TITLE III—CONSUMER BANKRUPTCY ISSUES
Sec. 301. Period for curing default relating to principal residence.
Sec. 302. Nondischargeability of fine under chapter 13.
Sec. 303. Impairment of exemptions.
Sec. 304. Protection of child support and alimony.
Sec. 305. Interest on interest.
Sec. 306. Exception to discharge.
Sec. 308. Bankruptcy petition preparers.
Sec. 309. Fairness to condominium and cooperative owners.
Sec. 310. Nonavoidability of fixing of lien on tools and implements of trade, animals, and crops.
Sec. 311. Conversion of case under chapter 13.
Sec. 312. Bankruptcy fraud.
Sec. 313. Protection against discriminatory treatment of applications for student loans.

TITLE IV—GOVERNMENTAL BANKRUPTCY ISSUES
Sec. 401. Exception from automatic stay for post-petition property taxes.
Sec. 402. Municipal bankruptcy.

TITLE V—TECHNICAL CORRECTIONS
Sec. 501. Amendments to bankruptcy definitions, necessitated by enactment of Public Law 101-647.
Sec. 502. Title 28 of the United States Code.

TITLE VI—BANKRUPTCY REVIEW COMMISSION
Sec. 601. Short title.
Sec. 602. Establishment.
Sec. 603. Duties of the Commission.
Sec. 604. Membership.
Sec. 605. Compensation of the Commission.
Sec. 606. Staff of Commission; experts and consultants.
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Sec. 607. Powers of the Commission.
Sec. 608. Report.
Sec. 609. Termination.
Sec. 610. Authorization of appropriations.

TITLE VII—SEVERABILITY; EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

Sec. 701. Severability.
Sec. 702. Effective date; application of amendments.

TITLE I—IMPROVED BANKRUPTCY ADMINISTRATION

SEC. 101. EXPEDITED HEARING ON AUTOMATIC STAY.

The last sentence of section 362(e) of title 11, United States Code, is amended—

(1) by striking "commenced" and inserting "concluded", and
(2) by inserting before the period at the end the following:
"
”, unless the 30-day period is extended with the consent of the parties in interest or for a specific time which the court finds is required by compelling circumstances”.

SEC. 102. JURISDICTION TO REVIEW INTERLOCUTORY ORDERS INCREASING, OR REDUCING CERTAIN TIME PERIODS FOR FILING PLAN.

Section 158(a) of title 28, United States Code, is amended by striking "from" the first place it appears and all that follows through "decrees,”, and inserting the following:
"(1) from final judgments, orders, and decrees;
"(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and
"(3) with leave of the court, from other interlocutory orders and decrees;”.

SEC. 103. EXPEDITED PROCEDURE FOR REAFFIRMATION OF DEBTS.

(a) REAFFIRMATION.—Section 524(c) of title 11, United States Code, is amended—

(1) in paragraph (2)—
(A) by inserting “(A)” after “(2)”,
(B) by adding “and” at the end, and
(C) by inserting after subparagraph (A), as so designated, the following:
"(B) such agreement contains a clear and conspicuous statement which advises the debtor that such agreement is not required under this title, under nonbankruptcy law, or under any agreement not in accordance with the provisions of this subsection;”, and
(2) in paragraph (3)—
(A) in the matter preceding subparagraph (A) by striking “such agreement” the last place it appears,
(B) in subparagraph (A)—
(ii) by striking “and” at the end,
(C) in subparagraph (B)—
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(i) by inserting "such agreement" after "(B)", and
(ii) by adding "and" at the end, and
(3) by adding at the end the following:

"(C) the attorney fully advised the debtor of the legal effect and consequences of—

"(i) an agreement of the kind specified in this subsection; and

"(ii) any default under such an agreement;".

(b) EFFECT OF DISCHARGE.—The third sentence of section 524(d) of title 11, United States Code, is amended in the matter preceding paragraph (1) by inserting "and was not represented by an attorney during the course of negotiating such agreement" after "this section".

SEC. 104. POWERS OF BANKRUPTCY COURTS.

(a) STATUS CONFERENCES.—Section 105 of title 11, United States Code, is amended by adding at the end the following:

"(d) The court, on its own motion or on the request of a party in interest, may—

"(1) hold a status conference regarding any case or proceeding under this title after notice to the parties in interest; and

"(2) unless inconsistent with another provision of this title or with applicable Federal Rules of Bankruptcy Procedure, issue an order at any such conference prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically, including an order that—

"(A) sets the date by which the trustee must assume or reject an executory contract or unexpired lease; or

"(B) in a case under chapter 11 of this title—

"(i) sets a date by which the debtor, or trustee if one has been appointed, shall file a disclosure statement and plan;

"(ii) sets a date by which the debtor, or trustee if one has been appointed, shall solicit acceptances of a plan;

"(iii) sets the date by which a party in interest other than a debtor may file a plan;

"(iv) sets a date by which a proponent of a plan, other than the debtor, shall solicit acceptances of such plan;

"(v) fixes the scope and format of the notice to be provided regarding the hearing on approval of the disclosure statement; or

"(vi) provides that the hearing on approval of the disclosure statement may be combined with the hearing on confirmation of the plan.”.

(b) ABSTENTION.—Section 1334 of title 28, United States Code, is amended—

(1) by redesignating subsection (d) as subsection (e), and

(2) in the second sentence of subsection (c)(2)—

(A) by inserting "(other than a decision not to abstain in a proceeding described in subsection (c)(2)"

(B) by striking "Any" and inserting the following:

"(d) Any”.

(c) ESTABLISHMENT, OPERATION, AND TERMINATION OF BANKRUPTCY APPELLATE PANEL SERVICE.—Section 158(b) of title 28, United States Code, is amended—

(1) by striking paragraphs (3) and (4),
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(2) by redesignating paragraph (2) as paragraph (4),
(3) by striking paragraph (1) and inserting the following:

“(1) The judicial council of a circuit shall establish a bankruptcy appellate panel service composed of bankruptcy judges of the districts in the circuit who are appointed by the judicial council in accordance with paragraph (3), to hear and determine, with the consent of all the parties, appeals under subsection (a) unless the judicial council finds that—

“(A) there are insufficient judicial resources available in the circuit;

or

“(B) establishment of such service would result in undue delay or increased cost to parties in cases under title 11.

Not later than 90 days after making the finding, the judicial council shall submit to the Judicial Conference of the United States a report containing the factual basis of such finding.

“(2) (A) A judicial council may reconsider, at any time, the finding described in paragraph (1).

“(B) On the request of a majority of the district judges in a circuit for which a bankruptcy appellate panel service is established under paragraph (1), made after the expiration of the 1-year period beginning on the date such service is established, the judicial council of the circuit may determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.

“(C) On its own motion, after the expiration of the 3-year period beginning on the date a bankruptcy appellate panel service is established under paragraph (1), the judicial council of the circuit may determine whether a circumstance specified in subparagraph (A) or (B) of such paragraph exists.

“(D) If the judicial council finds that either of such circumstances exists, the judicial council may provide for the completion of the appeals then pending before such service and the orderly termination of such service.

“(3) Bankruptcy judges appointed under paragraph (1) shall be appointed and may be reappointed under such paragraph.”

(4) by inserting after paragraph (4), as so redesignated, the following:

“(5) An appeal to be heard under this subsection shall be heard by a panel of 3 members of the bankruptcy appellate panel service, except that a member of such service may not hear an appeal originating in the district for which such member is appointed or designated under section 152 of this title.

“(6) Appeals may not be heard under this subsection by a panel of the bankruptcy appellate panel service unless the district judges for the district in which the appeals occur, by majority vote, have authorized such service to hear and determine appeals originating in such district.”.

(d) APPEALS TO BE HEARD BY BANKRUPTCY APPELLATE PANEL SERVICE.—Section 158 of title 28, United States Code, is amended—

(1) in subsection (c) by striking “(c)” and inserting “(2)”, and

(2) by inserting after subsection (b) the following:

“(c) (1) Subject to subsection (b), each appeal under subsection (a) shall be heard by a 3-judge panel of the bankruptcy appellate panel service established under subsection (b)(1) unless—

“(A) the appellant elects at the time of filing the appeal; or

“(B) any other party elects, not later than 30 days after service of notice of the appeal;

to have such appeal heard by the district court.”.

(e) RULES OF PROCEDURE AND EVIDENCE; METHOD OF PRESCRIBING.—Section 2073 of title 28, United States Code, is amended—
(1) in subsection (a)(2) by striking "section 2072" and inserting "sections 2072 and 2075", and
(2) in subsections (d) and (e) by inserting "or 2075" after "2072" each place it appears.

(f) EFFECTIVE DATE OF BANKRUPTCY RULES.—The third undesignated paragraph of section 2075 of title 28, United States Code, is amended to read as follows:

"The Supreme Court shall transmit to Congress not later than May 1 of the year in which a rule prescribed under this section is to become effective a copy of the proposed rule. The rule shall take effect no earlier than December 1 of the year in which it is transmitted to Congress unless otherwise provided by law.".

SEC. 105. PARTICIPATION BY BANKRUPTCY ADMINISTRATOR AT MEETINGS OF CREDITORS AND EQUITY SECURITY HOLDERS.

(a) PRESIDING OFFICER.—A bankruptcy administrator appointed under section 302(d)(3)(I) of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 (28 U.S.C. 581 note; Public Law 99-554; 100 Stat. 3123), as amended by section 317(a) of the Federal Courts Study Committee Implementation Act of 1990 (Public Law 101-650; 104 Stat. 5115), or the bankruptcy administrator's designee may preside at the meeting of creditors convened under section 341(a) of title 11, United States Code. The bankruptcy administrator or the bankruptcy administrator's designee may preside at any meeting of equity security holders convened under section 341(b) of title 11, United States Code.

(b) EXAMINATION OF THE DEBTOR.—The bankruptcy administrator or the bankruptcy administrator's designee may examine the debtor at the meeting of creditors and may administer the oath required under section 343 of title 11, United States Code.

SEC. 106. DEFINITION RELATING TO ELIGIBILITY TO SERVE ON CHAPTER 11 COMMITTEES.

Section 101(41) of title 11, United States Code, is amended to read as follows:

"(41) 'person' includes individual, partnership, and corporation, but does not include governmental unit, except that a governmental unit that—

"(A) acquires an asset from a person—

"(i) as a result of the operation of a loan guarantee agreement; or

"(ii) as receiver or liquidating agent of a person;

"(B) is a guarantor of a pension benefit payable by or on behalf of the debtor or an affiliate of the debtor; or

"(C) is the legal or beneficial owner of an asset of—

"(i) an employee pension benefit plan that is a governmental plan, as defined in section 414(d) of the Internal Revenue Code of 1986; or

"(ii) an eligible deferred compensation plan, as defined in section 457(b) of the Internal Revenue Code of 1986; shall be considered, for purposes of section 1102 of this title, to be a person with respect to such asset or such benefit;".
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SEC. 107. INCREASED INCENTIVE COMPENSATION FOR TRUSTEES.
Section 326(a) of title 11, United States Code, is amended by striking "fifteen" and all that follows through "$3,000" the last place it appears, and inserting the following:
"25 percent on the first $5,000 or less, 10 percent on any amount in excess of $5,000 but not in excess of $50,000, 5 percent on any amount in excess of $50,000 but not in excess of $1,000,000, and reasonable compensation not to exceed 3 percent of such moneys in excess of $1,000,000".

SEC. 108. DOLLAR ADJUSTMENTS.
(a) WHO MAY BE A DEBTOR UNDER CHAPTER 13.—Section 109(e) of title 11, United States Code, is amended—
(1) by striking "$100,000" each place it appears and inserting "$250,000"; and
(2) by striking "$350,000" each place it appears and inserting "$750,000".
(b) INVOLUNTARY CASES.—Section 303(b) of title 11, United States Code, is amended—
(1) in paragraph (1) by striking "$5,000" and inserting "$10,000"; and
(2) in paragraph (2) by striking "$5,000" and inserting "$10,000".
(c) PRIORITIES.—Section 507(a) of title 11, United States Code, is amended—
(1) in paragraph (4)(B)(i) by striking "$2,000" and inserting "$4,000";
(2) in paragraph (5) by striking "$2,000" and inserting "$4,000"; and
(3) in paragraph (6) by striking "$900" and inserting "$1,800".
(d) EXEMPTIONS.—Section 522(d) of title 11, United States Code, is amended—
(1) in paragraph (1) by striking "$7,500" and inserting "$15,000";
(2) in paragraph (2) by striking "$1,200" and inserting "$2,400";
(3) in paragraph (3)—
(A) by striking "$200" and inserting "$400"; and
(B) by striking "$4,000" and inserting "$8,000";
(4) in paragraph (4) by striking "$500" and inserting "$1,000";
(5) in paragraph (5)—
(A) by striking "$400" and inserting "$800"; and
(B) by striking "$3,750" and inserting "$7,500";
(6) in paragraph (6) by striking "$750" and inserting "$1,500";
(7) in paragraph (8) by striking "$4,000" and inserting "$8,000"; and
(8) in paragraph (11)(D) by striking "$7,500" and inserting "$15,000".
(e) FUTURE ADJUSTMENTS.—Section 104 of title 11, United States Code, is amended—
(1) by inserting "(a)" before "The", and
(2) by adding at the end the following:
"(b)(1) On April 1, 1998, and at each 3-year interval ending on April 1 thereafter, each dollar amount in effect under sections 109(e), 303(b), 507(a), 522(d), and 523(a)(2)(C) immediately before such April 1 shall be adjusted—
"(A) to reflect the change in the Consumer Price Index for All Urban Consumers, published by the Department of Labor, for the most recent
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3-year period ending immediately before January 1 preceding such April 1, and

“(B) to round to the nearest $25 the dollar amount that represents such change.

“(2) Not later than March 1, 1998, and at each 3-year interval ending on March 1 thereafter, the Judicial Conference of the United States shall publish in the Federal Register the dollar amounts that will become effective on such April 1 under sections 109(e), 303(b), 507(a), 522(d), and 523(a)(2)(C) of this title.

“(3) Adjustments made in accordance with paragraph (1) shall not apply with respect to cases commenced before the date of such adjustments.”.

SEC. 109. PREMERGER NOTIFICATION.

Subparagraphs (A) and (B) of section 363(b)(2) of title 11, United States Code, are amended to read as follows:

“(A) notwithstanding subsection (a) of such section, the notification required by such subsection to be given by the debtor shall be given by the trustee; and

“(B) notwithstanding subsection (b) of such section, the required waiting period shall end on the 15th day after the date of the receipt, by the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, of the notification required under such subsection (a), unless such waiting period is extended—

“(i) pursuant to subsection (e)(2) of such section, in the same manner as such subsection (e)(2) applies to a cash tender offer;

“(ii) pursuant to subsection (g)(2) of such section; or

“(iii) by the court after notice and a hearing.”.

SEC. 110. ALLOWANCE OF CREDITOR COMMITTEE EXPENSES.

Section 503(b)(3) of title 11, United States Code, is amended—

(1) in subparagraph (D) by striking “or” at the end,

(2) in subparagraph (E) by inserting “or” at the end, and

(3) by adding at the end the following:

“(F) a member of a committee appointed under section 1102 of this title, if such expenses are incurred in the performance of the duties of such committee;”.

SEC. 111. SUPPLEMENTAL INJUNCTIONS.

(a) SUPPLEMENTAL INJUNCTIONS.—Section 524 of title 11, United States Code, is amended by adding at the end the following:

“(g)(1)(A) After notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section.

“(B) An injunction may be issued under subparagraph (A) to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust described in paragraph (2)(B)(i), except such legal actions as are expressly allowed by the injunction, the confirmation order, or the plan of reorganization.

“(2)(A) Subject to subsection (h), if the requirements of subparagraph (B) are met at the time an injunction described in paragraph (1) is entered, then after entry of such injunction, any proceeding that involves the validity, application, construction, or modification of such injunction, or of this subsection
with respect to such injunction, may be commenced only in the district court in which such injunction was entered, and such court shall have exclusive jurisdiction over any such proceeding without regard to the amount in controversy.

“(B) The requirements of this subparagraph are that —

“(i) the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization—

“(I) is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products;

“(II) is to be funded in whole or in part by the securities of 1 or more debtors involved in such plan and by the obligation of such debtor or debtors to make future payments, including dividends;

“(III) is to own, or by the exercise of rights granted under such plan would be entitled to own if specified contingencies occur, a majority of the voting shares of—

“(aa) each such debtor;

“(bb) the parent corporation of each such debtor; or

“(cc) a subsidiary of each such debtor that is also a debtor; and

“(IV) is to use its assets or income to pay claims and demands; and

“(ii) subject to subsection (h), the court determines that—

“(I) the debtor is likely to be subject to substantial future demands for payment arising out of the same or similar conduct or events that gave rise to the claims that are addressed by the injunction;

“(II) the actual amounts, numbers, and timing of such future demands cannot be determined;

“(III) pursuit of such demands outside the procedures prescribed by such plan is likely to threaten the plan’s purpose to deal equitably with claims and future demands;

“(IV) as part of the process of seeking confirmation of such plan—

“(aa) the terms of the injunction proposed to be issued under paragraph (1)(A), including any provisions barring actions against third parties pursuant to paragraph (4)(A), are set out in such plan and in any disclosure statement supporting the plan; and

“(bb) a separate class or classes of the claimants whose claims are to be addressed by a trust described in clause (i) is established and votes, by at least 75 percent of those voting, in favor of the plan; and

“(V) subject to subsection (h), pursuant to court orders or otherwise, the trust will operate through mechanisms such as structured, periodic, or supplemental payments, pro rata distributions, matrices, or periodic review of estimates of the numbers and values of present claims and future demands, or other comparable mechanisms, that provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner.

“(3)(A) If the requirements of paragraph (2)(B) are met and the order confirming the plan of reorganization was issued or affirmed by the district court
that has jurisdiction over the reorganization case, then after the time for appeal of the order that issues or affirms the plan—

“(i) the injunction shall be valid and enforceable and may not be revoked or modified by any court except through appeal in accordance with paragraph (6);

“(ii) no entity that pursuant to such plan or thereafter becomes a direct or indirect transferee of, or successor to any assets of, a debtor or trust that is the subject of the injunction shall be liable with respect to any claim or demand made against such entity by reason of its becoming such a transferee or successor; and

“(iii) no entity that pursuant to such plan or thereafter makes a loan to such a debtor or trust or to such a successor or transferee shall, by reason of making the loan, be liable with respect to any claim or demand made against such entity, nor shall any pledge of assets made in connection with such a loan be upset or impaired for that reason;

“(B) Subparagraph (A) shall not be construed to—

“(i) imply that an entity described in subparagraph (A)(ii) or (iii) would, if this paragraph were not applicable, necessarily be liable to any entity by reason of any of the acts described in subparagraph (A);

“(ii) relieve any such entity of the duty to comply with, or of liability under, any Federal or State law regarding the making of a fraudulent conveyance in a transaction described in subparagraph (A)(ii) or (iii); or

“(iii) relieve a debtor of the debtor's obligation to comply with the terms of the plan of reorganization, or affect the power of the court to exercise its authority under sections 1141 and 1142 to compel the debtor to do so.

“(4)(A)(i) Subject to subparagraph (B), an injunction described in paragraph (1) shall be valid and enforceable against all entities that it addresses.

“(ii) Notwithstanding the provisions of section 524(e), such an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction (by name or as part of an identifiable group) and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor to the extent such alleged liability of such third party arises by reason of—

“(I) the third party's ownership of a financial interest in the debtor, a past or present affiliate of the debtor, or a predecessor in interest of the debtor;

“(II) the third party's involvement in the management of the debtor or a predecessor in interest of the debtor, or service as an officer, director or employee of the debtor or a related party;

“(III) the third party's provision of insurance to the debtor or a related party; or

“(IV) the third party's involvement in a transaction changing the corporate structure, or in a loan or other financial transaction affecting the financial condition, of the debtor or a related party, including but not limited to—

“(aa) involvement in providing financing (debt or equity), or advice to an entity involved in such a transaction; or

“(bb) acquiring or selling a financial interest in an entity as part of such a transaction.

“(iii) As used in this subparagraph, the term ‘related party’ means—

“(I) a past or present affiliate of the debtor;
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“(II) a predecessor in interest of the debtor; or
“(III) any entity that owned a financial interest in—
“(aa) the debtor;
“(bb) a past or present affiliate of the debtor; or
“(cc) a predecessor in interest of the debtor.
“(B) Subject to subsection (h), if, under a plan of reorganization, a kind of demand described in such plan is to be paid in whole or in part by a trust described in paragraph (2)(B)(i) in connection with which an injunction described in paragraph (1) is to be implemented, then such injunction shall be valid and enforceable with respect to a demand of such kind made, after such plan is confirmed, against the debtor or debtors involved, or against a third party described in subparagraph (A)(ii), if—
“(i) as part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands of such kind, and
“(ii) the court determines, before entering the order confirming such plan, that identifying such debtor or debtors, or such third party (by name or as part of an identifiable group), in such injunction with respect to such demands for purposes of this subparagraph is fair and equitable with respect to the persons that might subsequently assert such demands, in light of the benefits provided, or to be provided, to such trust on behalf of such debtor or debtors or such third party.
“(5) In this subsection, the term 'demand' means a demand for payment, present or future, that—
“(A) was not a claim during the proceedings leading to the confirmation of a plan of reorganization;
“(B) arises out of the same or similar conduct or events that gave rise to the claims addressed by the injunction issued under paragraph (1); and
“(C) pursuant to the plan, is to be paid by a trust described in paragraph (2)(B)(i).
“(6) Paragraph (3)(A)(i) does not bar an action taken by or at the direction of an appellate court on appeal of an injunction issued under paragraph (1) or of the order of confirmation that relates to the injunction.
“(7) This subsection does not affect the operation of section 1144 or the power of the district court to refer a proceeding under section 157 of title 28 or any reference of a proceeding made prior to the date of the enactment of this subsection.
“(h) APPLICATION TO EXISTING INJUNCTIONS.—For purposes of subsection (g)—
“(1) subject to paragraph (2), if an injunction of the kind described in subsection (g)(1)(B) was issued before the date of the enactment of this Act, as part of a plan of reorganization confirmed by an order entered before such date, then the injunction shall be considered to meet the requirements of subsection (g)(2)(B) for purposes of subsection (g)(2)(A), and to satisfy subsection (g)(4)(A)(ii), if—
“(A) the court determined at the time the plan was confirmed that the plan was fair and equitable in accordance with the requirements of section 1129(b);
“(B) as part of the proceedings leading to issuance of such injunction and confirmation of such plan, the court had appointed a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands described in subsection (g)(4)(B) with respect to such plan; and

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"(C) such legal representative did not object to confirmation of such plan or issuance of such injunction; and

"(2) for purposes of paragraph (1), if a trust described in subsection (g)(2)(B)(i) is subject to a court order on the date of the enactment of this Act staying such trust from settling or paying further claims—

"(A) the requirements of subsection (g)(2)(B)(ii)(V) shall not apply with respect to such trust until such stay is lifted or dissolved; and

"(B) if such trust meets such requirements on the date such stay is lifted or dissolved, such trust shall be considered to have met such requirements continuously from the date of the enactment of this Act."

(b) RULE OF CONSTRUCTION.—Nothing in subsection (a), or in the amendments made by subsection (a), shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization.

SEC. 112. AUTHORITY OF BANKRUPTCY JUDGES TO CONDUCT JURY TRIALS IN CIVIL PROCEEDINGS.

Section 157 of title 28, United States Code, is amended by adding at the end the following:

"(e) If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if specially designated to exercise such jurisdiction by the district court and with the express consent of all the parties."

SEC. 113. SOVEREIGN IMMUNITY.

Section 106 of title 11, United States Code, is amended to read as follows:

"§ 106. Waiver of sovereign immunity

"(a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:


"(2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.

"(3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(2)(A) of title 28.

"(4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States.

"(5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.
“(b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

“(c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.”.

SEC. 114. SERVICE OF PROCESS IN BANKRUPTCY PROCEEDINGS ON AN INSURED DEPOSITORY INSTITUTION.

Rule 7004 of the Federal Rules of Bankruptcy Procedure is amended—

(1) in subdivision (b) by striking “In addition” and inserting “Except as provided in subdivision (h), in addition”, and

(2) by adding at the end the following:

“(h) SERVICE OF PROCESS ON AN INSURED DEPOSITORY INSTITUTION.—Service on an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act) in a contested matter or adversary proceeding shall be made by certified mail addressed to an officer of the institution unless—

“(1) the institution has appeared by its attorney, in which case the attorney shall be served by first class mail;

“(2) the court orders otherwise after service upon the institution by certified mail of notice of an application to permit service on the institution by first class mail sent to an officer of the institution designated by the institution; or

“(3) the institution has waived in writing its entitlement to service by certified mail by designating an officer to receive service.”.

SEC. 115. MEETINGS OF CREDITORS AND EQUITY SECURITY HOLDERS.

Section 341 of title 11, United States Code, is amended by adding at the end the following:

“(d) Prior to the conclusion of the meeting of creditors or equity security holders, the trustee shall orally examine the debtor to ensure that the debtor in a case under chapter 7 of this title is aware of—

“(1) the potential consequences of seeking a discharge in bankruptcy, including the effects on credit history;

“(2) the debtor’s ability to file a petition under a different chapter of this title;

“(3) the effect of receiving a discharge of debts under this title; and

“(4) the effect of reaffirming a debt, including the debtor’s knowledge of the provisions of section 524(d) of this title.”.

SEC. 116. TAX ASSESSMENT.

Section 362(b)(9) of title 11, United States Code, is amended to read as follows:

“(9) under subsection (a), of—

“(A) an audit by a governmental unit to determine tax liability;

“(B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;

“(C) a demand for tax returns; or

“(D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment (but any tax lien that would otherwise attach to property of the estate by
reason of such an assessment shall not take effect unless such tax is a debt of the debtor that will not be discharged in the case and such property or its proceeds are transferred out of the estate to, or otherwise revested in, the debtor)".

SEC. 117. ADDITIONAL TRUSTEE COMPENSATION.
Section 330(b) of title 11, United States Code, is amended—
(1) by inserting "(1)" after "(b)", and
(2) by adding at the end thereof the following:
"(2) The Judicial Conference of the United States—
"(A) shall prescribe additional fees of the same kind as prescribed under section 1914(b) of title 28; and
"(B) may prescribe notice of appearance fees and fees charged against distributions in cases under this title;
to pay $15 to trustees serving in cases after such trustees' services are rendered. Beginning 1 year after the date of the enactment of the Bankruptcy Reform Act of 1994, such $15 shall be paid in addition to the amount paid under paragraph (1))."

TITLE II—COMMERCIAL BANKRUPTCY ISSUES

SEC. 201. AIRCRAFT EQUIPMENT AND VESSELS; ROLLING STOCK EQUIPMENT.
(a) AMENDMENT OF SECTION 1110.—Section 1110 of title 11, United States Code, is amended to read as follows:

§ 1110. Aircraft equipment and vessels
"(a)(1) The right of a secured party with a security interest in equipment described in paragraph (2) or of a lessor or conditional vendor of such equipment to take possession of such equipment in compliance with a security agreement, lease, or conditional sale contract is not affected by section 362, 363, or 1129 or by any power of the court to enjoin the taking of possession unless—
"(A) before the date that is 60 days after the date of the order for relief under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after the date of the order under such security agreement, lease, or conditional sale contract; and
"(B) any default, other than a default of a kind specified in section 365(b)(2), under such security agreement, lease, or conditional sale contract—
"(i) that occurs before the date of the order is cured before the expiration of such 60-day period; and
"(ii) that occurs after the date of the order is cured before the later of—
"(I) the date that is 30 days after the date of the default; or
"(II) the expiration of such 60-day period.
"(2) Equipment is described in this paragraph if it is—
"(A) an aircraft, aircraft engine, propeller, appliance, or spare part (as defined in section 40102 of title 49) that is subject to a security interest granted by, leased to, or conditionally sold to a debtor that is a citizen of the United States (as defined in section 40102 of title 49) holding an air carrier operating certificate issued by the Secretary of Transportation pur-
suant to chapter 447 of title 49 for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo; or

"(B) a documented vessel (as defined in section 30101(1) of title 46) that is subject to a security interest granted by, leased to, or conditionally sold to a debtor that is a water carrier that holds a certificate of public convenience and necessity or permit issued by the Interstate Commerce Commission.

"(3) Paragraph (1) applies to a secured party, lessor, or conditional vendor acting in its own behalf or acting as trustee or otherwise in behalf of another party.

"(b) The trustee and the secured party, lessor, or conditional vendor whose right to take possession is protected under subsection (a) may agree, subject to the court's approval, to extend the 60-day period specified in subsection (a)(1).

"(c) With respect to equipment first placed in service on or prior to the date of enactment of this subsection, for purposes of this section—

"(1) the term 'lease' includes any written agreement with respect to which the lessor and the debtor, as lessee, have expressed in the agreement or in a substantially contemporaneous writing that the agreement is to be treated as a lease for Federal income tax purposes; and

"(2) the term 'security interest' means a purchase-money equipment security interest.

(b) AMENDMENT OF SECTION 1168.—Section 1168 of title 11, United States Code, is amended to read as follows:

"§ 1168. Rolling stock equipment

"(a)(1) The right of a secured party with a security interest in or of a lessor or conditional vendor of equipment described in paragraph (2) to take possession of such equipment in compliance with an equipment security agreement, lease, or conditional sale contract is not affected by section 362, 363, or 1129 or by any power of the court to enjoin the taking of possession, unless—

"(A) before the date that is 60 days after the date of commencement of a case under this chapter, the trustee, subject to the court's approval, agrees to perform all obligations of the debtor that become due on or after the date of commencement of the case under such security agreement, lease, or conditional sale contract; and

"(B) any default, other than a default of a kind described in section 365(b)(2), under such security agreement, lease, or conditional sale contract—

"(i) that occurs before the date of commencement of the case and is an event of default therewith is cured before the expiration of such 60-day period; and

"(ii) that occurs or becomes an event of default after the date of commencement of the case is cured before the later of—

"(I) the date that is 30 days after the date of the default or event of default; or

"(II) the expiration of such 60-day period.

"(2) Equipment is described in this paragraph if it is rolling stock equipment or accessories used on such equipment, including superstructures and racks, that is subject to a security interest granted by, leased to, or conditionally sold to the debtor.

"(3) Paragraph (1) applies to a secured party, lessor, or conditional vendor acting in its own behalf or acting as trustee or otherwise in behalf of another party.
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“(b) The trustee and the secured party, lessor, or conditional vendor whose right to take possession is protected under subsection (a) may agree, subject to the court’s approval, to extend the 60-day period specified in subsection (a)(1).

“(c) With respect to equipment first placed in service on or prior to the date of enactment of this subsection, for purposes of this section—

“(1) the term ‘lease’ includes any written agreement with respect to which the lessor and the debtor, as lessee, have expressed in the agreement or in a substantially contemporaneous writing that the agreement is to be treated as a lease for Federal income tax purposes; and

“(2) the term ‘security interest’ means a purchase-money equipment security interest.

“(d) With respect to equipment first placed in service after the date of enactment of this subsection, for purposes of this section, the term ‘rolling stock equipment’ includes rolling stock equipment that is substantially rebuilt and accessories used on such equipment.”.

SEC. 202. LIMITATION ON LIABILITY OF NON-INSIDER TRANSFEREE FOR AVOIDED TRANSFER.

Section 550 of title 11, United States Code, is amended—

(1) by redesignating subsections (c), (d), and (e) as subsections (d), (e), and (f), respectively, and

(2) by inserting after subsection (b) the following:

“(c) If a transfer made between 90 days and one year before the filing of the petition—

“(1) is avoided under section 547(b) of this title; and

“(2) was made for the benefit of a creditor that at the time of such transfer was an insider;

the trustee may not recover under subsection (a) from a transferee that is not an insider.”.

SEC. 203. PERFECTION OF PURCHASE-MONEY SECURITY INTEREST.

Section 547 of title 11, United States Code, is amended—

(1) in subsection (c)(3)(B) by striking “10” and inserting “20”, and

(2) in subsection (e)(2)(A) by inserting “, except as provided in subsection (c)(3)(B)” before the semicolon at the end.

SEC. 204. CONTINUED PERFECTION.

(a) AUTOMATIC STAY.—Section 362(b)(3) of title 11, United States Code, is amended by inserting “, or to maintain or continue the perfection of,” after “to perfect”.

(b) LIMITATIONS ON AVOIDING POWERS.—Section 546(b) of title 11, United States Code, is amended to read as follows:

“(b)(1) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that—

“(A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or

“(B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.

“(2) If—
"(A) a law described in paragraph (1) requires seizure of such property or commencement of an action to accomplish such perfection, or maintenance or continuation of perfection of an interest in property; and

"(B) such property has not been seized or such an action has not been commenced before the date of the filing of the petition; such interest in such property shall be perfected, or perfection of such interest shall be maintained or continued, by giving notice within the time fixed by such law for such seizure or such commencement.”.

SEC. 205. REJECTION OF UNEXPIRED LEASES OF REAL PROPERTY OR TIMESHARE INTERESTS.

(a) AMENDMENT TO SECTION 365.—Section 365(h) of title 11, United States Code, is amended to read as follows:

"(h)(1)(A) If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and—

"(i) if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or

"(ii) if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

"(B) If the lessee retains its rights under subparagraph (A)(ii), the lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease and for the term of any renewal or extension of such lease, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such lease, but the lessee shall not have any other right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.

"(C) The rejection of a lease of real property in a shopping center with respect to which the lessee elects to retain its rights under subparagraph (A)(ii) does not affect the enforceability under applicable nonbankruptcy law of any provision in the lease pertaining to radius, location, use, exclusivity, or tenant mix or balance.

"(D) In this paragraph, ‘lessee’ includes any successor, assign, or mortgagee permitted under the terms of such lease.

"(2)(A) If the trustee rejects a timeshare interest under a timeshare plan under which the debtor is the timeshare interest seller and—

"(i) if the rejection amounts to such a breach as would entitle the timeshare interest purchaser to treat the timeshare plan as terminated under its terms, applicable nonbankruptcy law, or any agreement made by timeshare interest purchaser, the timeshare interest purchaser under the timeshare plan may treat the timeshare plan as terminated by such rejection; or

"(ii) if the term of such timeshare interest has commenced, then the timeshare interest purchaser may retain its rights in such timeshare interest for the balance of such term and for any term of renewal or extension of
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such timeshare interest to the extent that such rights are enforceable under applicable nonbankruptcy law.

“(B) If the timeshare interest purchaser retains its rights under subparagraph (A), such timeshare interest purchaser may offset against the moneys due for such timeshare interest for the balance of the term after the date of the rejection of such timeshare interest, and the term of any renewal or extension of such timeshare interest, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such timeshare plan, but the timeshare interest purchaser shall not have any right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.”.

(b) TECHNICAL AMENDMENT.—Section 553(b)(1) of title 11, United States Code, is amended by striking “365(h)(2)” and inserting “365(h)

SEC. 206. CONTENTS OF PLAN.

Section 1123(b) of title 11, United States Code, is amended—
(1) in paragraph (4) by striking “and” at the end,
(2) by redesignating paragraph (5) as paragraph (6), and
(3) by inserting after paragraph (4) the following:
“(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and”.

SEC. 207. PRIORITY FOR INDEPENDENT SALES REPRESENTATIVES.

Section 507(a)(3) of title 11, United States Code, is amended to read as follows:
“(3) Third, allowed unsecured claims, but only to the extent of $4,000 for each individual or corporation, as the case may be, earned within 90 days before the date of the filing of the petition or the date of the cessation of the debtor’s business, whichever occurs first, for—
“(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or
“(B) sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor’s business if, and only if, during the 12 months preceding that date, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor in the sale of goods or services was earned from the debtor;”.

SEC. 208. EXCLUSION FROM THE ESTATE OF INTERESTS IN LIQUID AND GASEOUS HYDROCARBONS TRANSFERRED BY THE DEBTOR PURSUANT TO PRODUCTION PAYMENT AGREEMENTS.

(a) DEFINITION.—Section 101 of title 11, United States Code, is amended—
(1) by inserting after paragraph (42) the following:
“(42A) ‘production payment’ means a term overriding royalty satisifiable in cash or in kind—
“(A) contingent on the production of a liquid or gaseous hydrocarbon from particular real property; and
“(B) from a specified volume, or a specified value, from the liquid or gaseous hydrocarbon produced from such property, and determined without regard to production costs;”, and
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(2) by inserting after the first paragraph (56) the following:

"(56A) 'term overriding royalty' means an interest in liquid or gaseous hydrocarbons in place or to be produced from particular real property that entitles the owner thereof to a share of production, or the value thereof, for a term limited by time, quantity, or value realized;”.

(b) PROPERTY OF THE ESTATE.—Section 541(b)(4) of title 11, United States Code, is amended—

(1) in subparagraph (A) by striking “(A)” and inserting “(A)(i)”,
(2) in subparagraph (B)—
(A) by striking “(B)” and inserting “(ii)”,
(B) by striking “such interest” and inserting “the interest referred to in clause (i)”, and
(C) by striking the period at the end and inserting “; or”, and
(3) by adding at the end the following:

“(B)(i) the debtor has transferred such interest pursuant to a written conveyance of a production payment to an entity that does not participate in the operation of the property from which such production payment is transferred; and

“(ii) but for the operation of this paragraph, the estate could include the interest referred to in clause (i) only by virtue of section 542 of this title;”.

SEC. 209. SELLER'S RIGHT TO RECLAIM GOODS.

Section 546(c)(1) of title 11, United States Code, is amended to read as follows:

“(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods—

“(A) before 10 days after receipt of such goods by the debtor; or

“(B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and”.

SEC. 210. INVESTMENT OF MONEY OF THE ESTATE.

Section 345(b) of title 11, United States Code, is amended—

(1) in paragraph (2) by striking the period at the end and inserting a semicolon, and
(2) by adding at the end the following:

“unless the court for cause orders otherwise.”.

SEC. 211. ELECTION OF TRUSTEE UNDER CHAPTER 11.

(a) ELECTION AUTHORIZED.—Section 1104 of title 11 of the United States Code is amended—

(1) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively, and
(2) by inserting after subsection (a) the following:

“(b) Except as provided in section 1163 of this title, on the request of a party in interest made not later than 30 days after the court orders the appointment of a trustee under subsection (a), the United States trustee shall convene a meeting of creditors for the purpose of electing one disinterested person to serve as trustee in the case. The election of a trustee shall be conducted in the manner provided in subsections (a), (b), and (c) of section 702 of this title.”

(b) CONFORMING AMENDMENT.—Section 1106(b) of title 11, United States Code, is amended by striking “1104(c)” and inserting “1104(d)”.

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SEC. 212. RIGHTS OF PARTNERSHIP TRUSTEE AGAINST GENERAL PARTNERS.

Section 723(a) of title 11, United States Code, is amended by striking "for the full amount of the deficiency" and inserting "to the extent that under applicable nonbankruptcy law such general partner is personally liable for such deficiency".

SEC. 213. IMPAIRMENT OF CLAIMS AND INTERESTS.

(a) OBJECTION TO CLAIMS FILED UNTIMELY.—Section 502(b) of title 11, United States Code, is amended—

(1) in paragraph (7) by striking "or" at the end,

(2) in paragraph (8) by striking the period at the end and inserting "; or", and

(3) by adding at the end the following:

"(9) proof of such claim is not timely filed, except to the extent tardily filed as permitted under paragraph (1), (2), or (3) of section 726(a) of this title or under the Federal Rules of Bankruptcy Procedure, except that a claim of a governmental unit shall be timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide."

(b) TARDILY FILED PRIORITY CLAIMS.—Section 726(a)(1) of title 11, United States Code, is amended by adding before the semicolon the following: 

", proof of which is timely filed under section 501 of this title or tardily filed before the date on which the trustee commences distribution under this section."

(c) FILING OF REQUEST FOR ADMINISTRATIVE EXPENSES.—Section 503(a) of title 11, United States Code, is amended—

(1) by inserting "timely" after "may", and

(2) by inserting ", or may tardily file such request if permitted by the court for cause" before the period at the end.

(d) IMPAIRMENT OF CLAIMS OR INTERESTS.—Section 1124 of title 11, United States Code, is amended—

(1) in paragraph (1) by inserting "or" at the end,

(2) in paragraph (2) by striking "; or" at the end and inserting a period, and

(3) by striking paragraph (3).

SEC. 214. PROTECTION OF SECURITY INTEREST IN POST-PETITION RENTS AND LODGING PAYMENTS.

(a) POSTPETITION EFFECT OF SECURITY INTEREST.—Section 552(b) of title 11, United States Code, is amended—

(1) by inserting "(1)" after "(b)",

(2) by striking "rents," each place it appears, and

(3) by adding at the end the following:

"(2) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, and notwithstanding section 546(b) of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such secu-
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“(B) increase the 100-day period specified in paragraph (1) if the debtor shows that the need for an increase is caused by circumstances for which the debtor should not be held accountable.”.

(e) POSTPETITION DISCLOSURE.—Section 1125 of title 11, United States Code, is amended by adding at the end the following:

“(f) Notwithstanding subsection (b), in a case in which the debtor has elected under section 1121(e) to be considered a small business—

“(1) the court may conditionally approve a disclosure statement subject to final approval after notice and a hearing;

“(2) acceptances and rejections of a plan may be solicited based on a conditionally approved disclosure statement as long as the debtor provides adequate information to each holder of a claim or interest that is solicited, but a conditionally approved disclosure statement shall be mailed at least 10 days prior to the date of the hearing on confirmation of the plan; and

“(3) a hearing on the disclosure statement may be combined with a hearing on confirmation of a plan.”.

SEC. 218. SINGLE ASSET REAL ESTATE.

(a) DEFINITION.—Section 101 of title 11, United States Code, is amended by inserting after paragraph (51) the following:

“(51B) ‘single asset real estate’ means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, liquidated secured debts in an amount no more than $4,000,000;”.

(b) AUTOMATIC STAY.—Section 362(d) of title 11, United States Code, is amended—

(1) in paragraph (1) by striking “or” at the end,

(2) in paragraph (2) by striking the period at the end and inserting “; or”, and

(3) by adding at the end the following:

“(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period)—

“(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

“(B) the debtor has commenced monthly payments to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor’s interest in the real estate.”.

SEC. 219. LEASES OF PERSONAL PROPERTY.

(a) ASSUMPTION.—Section 365(b)(2) of title 11, United States Code, is amended—

(1) in subparagraph (B) by striking “or” at the end,

(2) in subparagraph (C) by striking the period and inserting “; or”, and

(3) by adding at the end the following:
“(D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.”.

(b) PERFORMANCE.—Section 365(d) of title 11, United States Code, is amended by adding at the end the following:

“(10) The trustee shall timely perform all of the obligations of the debtor, except those specified in section 365(b)(2), first arising from or after 60 days after the order for relief in a case under chapter 11 of this title under an unexpired lease of personal property (other than personal property leased to an individual primarily for personal, family, or household purposes), until such lease is assumed or rejected notwithstanding section 503(b)(1) of this title, unless the court, after notice and a hearing and based on the equities of the case, orders otherwise with respect to the obligations or timely performance thereof. This subsection shall not be deemed to affect the trustee’s obligations under the provisions of subsection (b) or (f). Acceptance of any such performance does not constitute waiver or relinquishment of the lessor’s rights under such lease or under this title.”.

(c) LIMITATION.—Section 363(e) of title 11, United States Code is amended by adding at the end the following:

“This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).”.

SEC. 220. EXEMPTION FOR SMALL BUSINESS INVESTMENT COMPANIES.

Section 109(b)(2) of title 11, United States Code, is amended by inserting after “homestead association,” the following: “a small business investment company licensed by the Small Business Administration under subsection (c) or (d) of section 301 of the Small Business Investment Act of 1958,”.

SEC. 221. PAYMENT OF TAXES WITH BORROWED FUNDS.

Section 523(a) of title 11, United States Code, is amended—

(1) in paragraph (13) by striking the period at the end and inserting a semicolon, and

(2) by adding at the end the following:

“(14) incurred to pay a tax to the United States that would be non-dischargeable pursuant to paragraph (1);”.

SEC. 222. RETURN OF GOODS.

(a) LIMITATION ON AVOIDING POWERS.—Section 546 of title 11, United States Code, is amended by adding at the end the following:

“(g) Notwithstanding the rights and powers of a trustee under sections 544(a), 545, 547, 549, and 553, if the court determines on a motion by the trustee made not later than 120 days after the date of the order for relief in a case under chapter 11 of this title and after notice and a hearing, that a return is in the best interests of the estate, the debtor, with the consent of a creditor, may return goods shipped to the debtor by the creditor before the commencement of the case, and the creditor may offset the purchase price of such goods against any claim of the creditor against the debtor that arose before the commencement of the case.”.

(b) SETOFF.—Section 553(b)(1) is amended by inserting “546(h),” after “365(h),”.

SEC. 223. PROCEEDS OF MONEY ORDER AGREEMENTS.

Section 541(b) of title 11, United States Code, is amended—
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(1) in paragraph (3) by striking "or" at the end and inserting a semicolon,
(2) in paragraph (4) by striking the period at the end and inserting "; or", and
(3) by inserting after paragraph (4) the following:
"(5) any interest in cash or cash equivalents that constitute proceeds of a sale by the debtor of a money order that is made—
"(A) on or after the date that is 14 days prior to the date on which the petition is filed; and
"(B) under an agreement with a money order issuer that prohibits the commingling of such proceeds with property of the debtor (notwithstanding that, contrary to the agreement, the proceeds may have been commingled with property of the debtor), unless the money order issuer had not taken action, prior to the filing of the petition, to require compliance with the prohibition.".

SEC. 224. TRUSTEE DUTIES; PROFESSIONAL FEES.

(a) TRUSTEE'S DUTIES.—Section 586(a)(3)(A) of title 28, United States Code, is amended to read as follows:

"(A)(i) reviewing, in accordance with procedural guidelines adopted by the Executive Office of the United States Trustee (which guidelines shall be applied uniformly by the United States trustee except when circumstances warrant different treatment), applications filed for compensation and reimbursement under section 330 of title 11; and

"(ii) filing with the court comments with respect to such application and, if the United States Trustee considers it to be appropriate, objections to such application."

(b) PROFESSIONAL FEES.—Section 330(a) of title 11, United States Code, is amended to read as follows:

"(a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103—

"(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and

"(B) reimbursement for actual, necessary expenses.

"(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

"(3)(A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including—

"(A) the time spent on such services;

"(B) the rates charged for such services;

"(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

"(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and
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"(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

"(4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for—

"(i) unnecessary duplication of services; or

"(ii) services that were not—

"(I) reasonably likely to benefit the debtor's estate; or

"(II) necessary to the administration of the case.

"(B) In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

"(5) The court shall reduce the amount of compensation awarded under this section by the amount of any interim compensation awarded under section 331, and, if the amount of such interim compensation exceeds the amount of compensation awarded under this section, may order the return of the excess to the estate.

"(6) Any compensation awarded for the preparation of a fee application shall be based on the level and skill reasonably required to prepare the application."

SEC. 225. NOTICES TO CREDITORS.

Section 342 of title II, United States Code, is amended by adding at the end the following:

"(c) If notice is required to be given by the debtor to a creditor under this title, any rule, any applicable law, or any order of the court, such notice shall contain the name, address, and taxpayer identification number of the debtor, but the failure of such notice to contain such information shall not invalidate the legal effect of such notice."

TITLE III—CONSUMER BANKRUPTCY ISSUES

SEC. 301. PERIOD FOR CURING DEFAULT RELATING TO PRINCIPAL RESIDENCE.

Section 1322 of title II, United States Code, is amended—

(1) by redesignating subsection (c) as subsection (d), and

(2) by inserting after subsection (b) the following:

"(c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law—

"(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law; and

"(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title."

SEC. 302. NONDISCHARGEABILITY OF FINE UNDER CHAPTER 13.

Section 1328(a)(3) of title 11, United States Code, is amended by inserting "or a criminal fine." after "restitution".

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-SEC. 303. IMPAIRMENT OF EXEMPTIONS.

Section 522(f) of title 11, United States Code, is amended—

(1) in paragraph (2)—

(A) by redesignating subparagraphs (A), (B), and (C) as clauses (i), (ii), and (iii), respectively, and

(B) by striking "(2)" and inserting "(B)";

(2) by redesigning paragraph (1) as subparagraph (A),

(3) by inserting "(1)" before "Notwithstanding", and

(4) by adding at the end the following:

"(2)(A) For the purposes of this subsection, a lien shall be considered to impair an exemption to the extent that the sum of—

(i) the lien;

(ii) all other liens on the property; and

(iii) the amount of the exemption that the debtor could claim if there were no liens on the property;

exceeds the value that the debtor’s interest in the property would have in the absence of any liens.

"(B) In the case of a property subject to more than 1 lien, a lien that has been avoided shall not be considered in making the calculation under subparagraph (A) with respect to other liens.

"(C) This paragraph shall not apply with respect to a judgment arising out of a mortgage foreclosure."

SEC. 304. PROTECTION OF CHILD SUPPORT AND ALIMONY.

(a) DEFINITION.—Section 101 of title 11, United States Code, is amended by inserting after paragraph (12) the following:

"(12A) ‘debt for child support’ means a debt of a kind specified in section 523(a)(5) of this title for maintenance or support of a child of the debtor;"

(b) RELIEF FROM AUTOMATIC STAY.—Section 362(b)(2) of title 11, United States Code, is amended to read as follows:

"(2) under subsection (a) of this section—

(A) of the commencement or continuation of an action or proceeding for—

"(i) the establishment of paternity; or

"(ii) the establishment or modification of an order for alimony, maintenance, or support; or

"(B) of the collection of alimony, maintenance, or support from property that is not property of the estate;"

(c) PRIORITY OF CLAIMS.—Section 507(a) of title 11, United States Code, is amended—

(1) in paragraph (8) by striking "(8) Eighth" and inserting "(9) Ninth",

(2) in paragraph (7) by striking "(7) Seventh" and inserting "(8) Eighth", and

(3) by inserting after paragraph (6) the following:

"(7) Seventh, allowed claims for debts to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt—
(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support.

(d) PROTECTION OF LIENS.—Section 522(f)(1)(A) of title 11, United States Code, as amended by section 303, is amended by inserting after “lien” the following:

“other than a judicial lien that secures a debt—

(i) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement; and

(ii) to the extent that such debt—

(I) is not assigned to another entity, voluntarily, by operation of law, or otherwise; and

(II) includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support.”.

(e) EXCEPTION TO DISCHARGE.—Section 523 of title 11, United States Code, as amended by section 221, is amended by adding at the end the following:

“(15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, a determination made in accordance with State or territorial law by a governmental unit unless—

(A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or

(B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor;”.

(2) in subsection (c)(1) by striking “or (6)” each place it appears and inserting “(6), or (15)”.

(f) PROTECTION AGAINST TRUSTEE AVOIDANCE.—Section 547(c) of title 11, United States Code, is amended—

(1) in paragraph (6) by striking “or” at the end,

(2) by redesignating paragraph (7) as paragraph (8), and

(3) by inserting after paragraph (6) the following:

“(7) to the extent such transfer was a bona fide payment of a debt to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt—

(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or
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"(B) includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support; or";

(g) APPEARANCE BEFORE COURT.—Child support creditors or their representatives shall be permitted to appear and intervene without charge, and without meeting any special local court rule requirement for attorney appearances, in any bankruptcy case or proceeding in any bankruptcy court or district court of the United States if such creditors or representatives file a form in such court that contains information detailing the child support debt, its status, and other characteristics.

(h) CONFORMING AMENDMENTS.—Title 11 of the United States Code is amended—

(1) in section 502(i) by striking "507(a)(7)" and inserting "507(a)(8)",
(2) in section 503(b)(1)(B)(i) by striking "507(a)(7)" and inserting "507(a)(8)",
(3) in section 523(a)(1)(A) by striking "507(a)(7)" and inserting "507(a)(8)",
(4) in section 724(b)(2) by striking "or 507(a)(6)" and inserting "507(a)(6), or 507(a)(7)",
(5) in section 726(b) by striking "or (7)" and inserting ", (7), or (8)",
(6) in section 1123(a)(1) by striking "507(a)(7)" and inserting "507(a)(8)",
(7) in section 1129(a)(9)—
   (i) in subparagraph (B) by striking "or 507(a)(6)" and inserting "507(a)(6), or 507(a)(7)", and
   (ii) in subparagraph (C) by striking "507(a)(7)" and inserting "507(a)(8)".

SEC. 305. INTEREST ON INTEREST.

(a) CHAPTER 11.—Section 1123 of title 11, United States Code, is amended by adding at the end the following:

"(d) Notwithstanding subsection (a) of this section and sections 506(b), 1129(a)(7), and 1129(b) of this title, if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."

(b) CHAPTER 12.—Section 1222 of title 11, United States Code, is amended by adding at the end the following:

"(d) Notwithstanding subsection (b)(2) of this section and sections 506(b) and 1225(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default, shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."

(c) CHAPTER 13.—Section 1322 of title 11, United States Code, is amended by adding at the end the following:

"(e) Notwithstanding subsection (b)(2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default, shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."

SEC. 306. EXCEPTION TO DISCHARGE.

Section 523(a)(2)(C) of title 11, United States Code, is amended—

(1) by striking "$500" and inserting "$1,000",
(2) by striking "forty" and inserting "60", and
(3) by striking "twenty" and inserting "60".

Section 1326(a)(2) of title 11, United States Code, is amended in the second sentence by striking the period and inserting "as soon as practicable."

SEC. 308. BANKRUPTCY PETITION PREPARERS.

(a) AMENDMENT OF CHAPTER 1.—Chapter 1 of title 11, United States Code, is amended by adding at the end the following:

"§ 110. Penalty for persons who negligently or fraudulently prepare bankruptcy petitions

(a) In this section—

(1) 'bankruptcy petition preparer' means a person, other than an attorney or an employee of an attorney, who prepares for compensation a document for filing; and

(2) 'document for filing' means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title.

(b)(1) A bankruptcy petition preparer who prepares a document for filing shall sign the document and print on the document the preparer's name and address.

(2) A bankruptcy petition preparer who fails to comply with paragraph (1) may be fined not more than $500 for each such failure unless the failure is due to reasonable cause.

(c)(1) A bankruptcy petition preparer who prepares a document for filing shall place on the document, after the preparer's signature, an identifying number that identifies individuals who prepared the document.

(2) For purposes of this section, the identifying number of a bankruptcy petition preparer shall be the Social Security account number of each individual who prepared the document or assisted in its preparation.

(3) A bankruptcy petition preparer who fails to comply with paragraph (1) may be fined not more than $500 for each such failure unless the failure is due to reasonable cause.

(d)(1) A bankruptcy petition preparer shall not later than the time at which a document for filing is presented for the debtor's signature, furnish to the debtor a copy of the document.

(2) A bankruptcy petition preparer who fails to comply with paragraph (1) may be fined not more than $500 for each such failure unless the failure is due to reasonable cause.

(e)(1) A bankruptcy petition preparer shall not execute any document on behalf of a debtor.

(2) A bankruptcy petition preparer may be fined not more than $500 for each document executed in violation of paragraph (1).

(f)(1) A bankruptcy petition preparer shall not use the word 'legal' or any similar term in any advertisements, or advertise under any category that includes the word 'legal' or any similar term.

(2) A bankruptcy petition preparer shall be fined not more than $500 for each violation of paragraph (1).

(g)(1) A bankruptcy petition preparer shall not collect or receive any payment from the debtor or on behalf of the debtor for the court fees in connection with filing the petition.

(2) A bankruptcy petition preparer shall be fined not more than $500 for each violation of paragraph (1).

(h)(1) Within 10 days after the date of the filing of a petition, a bankruptcy petition preparer shall file a declaration under penalty of perjury disclos-
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ing any fee received from or on behalf of the debtor within 12 months immediately prior to the filing of the case, and any unpaid fee charged to the debtor.

“(2) The court shall disallow and order the immediate turnover to the bankruptcy trustee of any fee referred to in paragraph (1) found to be in excess of the value of services rendered for the documents prepared. An individual debtor may exempt any funds so recovered under section 522(b).

“(3) The debtor, the trustee, a creditor, or the United States trustee may file a motion for an order under paragraph (2).

“(4) A bankruptcy petition preparer shall be fined not more than $500 for each failure to comply with a court order to turn over funds within 30 days of service of such order.

“(i)(1) If a bankruptcy case or related proceeding is dismissed because of the failure to file bankruptcy papers, including papers specified in section 521(1) of this title, the negligence or intentional disregard of this title or the Federal Rules of Bankruptcy Procedure by a bankruptcy petition preparer, or if a bankruptcy petition preparer violates this section or commits any fraudulent, unfair, or deceptive act, the bankruptcy court shall certify that fact to the district court, and the district court, on motion of the debtor, the trustee, or a creditor and after a hearing, shall order the bankruptcy petition preparer to pay to the debtor—

“(A) the debtor’s actual damages;
“(B) the greater of—
“(i) $2,000; or
“(ii) twice the amount paid by the debtor to the bankruptcy petition preparer for the preparer’s services; and
“(C) reasonable attorneys’ fees and costs in moving for damages under this subsection.

“(2) If the trustee or creditor moves for damages on behalf of the debtor under this subsection, the bankruptcy petition preparer shall be ordered to pay the movant the additional amount of $1,000 plus reasonable attorneys’ fees and costs incurred.

“(j)(1) A debtor for whom a bankruptcy petition preparer has prepared a document for filing, the trustee, a creditor, or the United States trustee in the district in which the bankruptcy petition preparer resides, has conducted business, or the United States trustee in any other district in which the debtor resides may bring a civil action to enjoin a bankruptcy petition preparer from engaging in any conduct in violation of this section or from further acting as a bankruptcy petition preparer.

“(2)(A) In an action under paragraph (1), if the court finds that—
“(i) a bankruptcy petition preparer has—
“(I) engaged in conduct in violation of this section or of any provision of this title a violation of which subjects a person to criminal penalty;
“(II) misrepresented the preparer’s experience or education as a bankruptcy petition preparer; or
“(III) engaged in any other fraudulent, unfair, or deceptive conduct; and
“(ii) injunctive relief is appropriate to prevent the recurrence of such conduct,
the court may enjoin the bankruptcy petition preparer from engaging in such conduct.

“(B) If the court finds that a bankruptcy petition preparer has continually engaged in conduct described in subclause (I), (II), or (III) of clause (i) and that an injunction prohibiting such conduct would not be sufficient to prevent

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such person's interference with the proper administration of this title, or has not paid a penalty imposed under this section, the court may enjoin the person from acting as a bankruptcy petition preparer.

“(3) The court shall award to a debtor, trustee, or creditor that brings a successful action under this subsection reasonable attorney's fees and costs of the action, to be paid by the bankruptcy petition preparer.

“(k) Nothing in this section shall be construed to permit activities that are otherwise prohibited by law, including rules and laws that prohibit the unauthorized practice of law.”.

(b) The chapter analysis for chapter 1 of title 11, United States Code, is amended by adding at the end the following new item:

“110. Penalty for persons who negligently or fraudulently prepare bankruptcy petitions.”.

SEC. 309. FAIRNESS TO CONDOMINIUM AND COOPERATIVE OWNERS.

Section 523(a) of title 11, United States Code, as amended by sections 221 and 304, is amended by adding at the end the following:

“(16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a dwelling unit that has condominium ownership or in a share of a cooperative housing corporation, but only if such fee or assessment is payable for a period during which—

“(A) the debtor physically occupied a dwelling unit in the condominium or cooperative project; or

“(B) the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period,

but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case.”.

SEC. 310. NONAVOIDABILITY OF FIXING OF LIEN ON TOOLS AND IMPLEMENTS OF TRADE, ANIMALS, AND CROPS.

Section 522(f) of title 11, United States Code, as amended by sections 303 and 304, is amended—

(1) in paragraph (1) by inserting “but subject to paragraph (3)” after “waiver of exemptions”, and

(2) by adding at the end the following:

“(3) In a case in which State law that is applicable to the debtor—

“(A) permits a person to voluntarily waive a right to claim exemptions under subsection (d) or prohibits a debtor from claiming exemptions under subsection (d); and

“(B) either permits the debtor to claim exemptions under State law without limitation in amount, except to the extent that the debtor has permitted the fixing of a consensual lien on any property or prohibits avoidance of a consensual lien on property otherwise eligible to be claimed as exempt property;

the debtor may not avoid the fixing of a lien on an interest of the debtor or a dependent of the debtor in property if the lien is a nonpossessory, nonpurchase-money security interest in implements, professional books, or tools of the trade of the debtor or a dependent of the debtor or farm animals or crops of the debtor or a dependent of the debtor to the extent the value of such implements, professional books, tools of the trade, animals, and crops exceeds $5,000.”.
SEC. 311. CONVERSION OF CASE UNDER CHAPTER 13.

Section 348 of title 11, United States Code, is amended by adding at the end the following:

“(f)(1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title—

“(A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion; and

“(B) valuations of property and of allowed secured claims in the chapter 13 case shall apply in the converted case, with allowed secured claims reduced to the extent that they have been paid in accordance with the chapter 13 plan.

“(2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property in the converted case shall consist of the property of the estate as of the date of conversion.”.

SEC. 312. BANKRUPTCY FRAUD.

(a) IN GENERAL.—

(1) OFFENSES.—Chapter 9 of title 18, United States Code, is amended—

(A) by amending sections 152, 153, and 154 to read as follows:

“§ 152. Concealment of assets; false oaths and claims; bribery

“A person who—

“(1) knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor;

“(2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11;

“(3) knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, in or in relation to any case under title 11;

“(4) knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney;

“(5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11;

“(6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11;

“(7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation;

“(8) after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, docu-
ments, records, and papers) relating to the property or financial affairs of a debtor; or

“(9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor,

shall be fined not more than $5,000, imprisoned not more than 5 years, or both.

“§ 153. Embezzlement against estate

“(a) OFFENSE.—A person described in subsection (b) who knowingly and fraudulently appropriates to the person’s own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor shall be fined not more than $5,000, imprisoned not more than 5 years, or both.

“(b) PERSON TO WHOM SECTION APPLIES.—A person described in this subsection is one who has access to property or documents belonging to an estate by virtue of the person’s participation in the administration of the estate as a trustee, custodian, marshal, attorney, or other officer of the court or as an agent, employee, or other person engaged by such an officer to perform a service with respect to the estate.

“§ 154. Adverse interest and conduct of officers

“A person who, being a custodian, trustee, marshal, or other officer of the court—

“(1) knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11;

“(2) knowingly refuses to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of estates in the person’s charge by parties when directed by the court to do so; or

“(3) knowingly refuses to permit a reasonable opportunity for the inspection by the United States Trustee of the documents and accounts relating to the affairs of an estate in the person’s charge,

shall be fined not more than $5,000 and shall forfeit the person’s office, which shall thereupon become vacant.”; and

(B) by adding at the end the following:

“§ 156. Knowing disregard of bankruptcy law or rule

“(a) DEFINITIONS.—In this section—

‘bankruptcy petition preparer’ means a person, other than the debtor’s attorney or an employee of such an attorney, who prepares for compensation a document for filing.

‘document for filing’ means a petition or any other document prepared for filing by a debtor in a United States bankruptcy court or a United States district court in connection with a case under this title.

“(b) OFFENSE.—If a bankruptcy case or related proceeding is dismissed because of a knowing attempt by a bankruptcy petition preparer in any manner to disregard the requirements of title 11, United States Code, or the Federal Rules of Bankruptcy Procedure, the bankruptcy petition preparer shall be fined under this title, imprisoned not more than 1 year, or both.

“§ 157. Bankruptcy fraud

“A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so—
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“(1) files a petition under title 11;
“(2) files a document in a proceeding under title 11; or
“(3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title, shall be fined under this title, imprisoned not more than 5 years, or both.”.

(2) TECHNICAL AMENDMENTS.—The chapter analysis for chapter 9 of title 18, United States Code, is amended—

(A) by amending the item relating to section 153 to read as follows:
“Sec. 153. Embezzlement against estate.”;
and
(B) by adding at the end the following new items:
“Sec. 156. Knowing disregard of bankruptcy law or rule.
“Sec. 157. Bankruptcy fraud.”;
(b) RICO.—Section 1961(1)(D) of title 18, United States Code, is amended by inserting “(except a case under section 157 of that title)” after “title 11”.

SEC. 313. PROTECTION AGAINST DISCRIMINATORY TREATMENT OF APPLICATIONS FOR STUDENT LOANS.

Section 525 of title 11, United States Code, is amended by adding at the end the following:
“(c)(1) A governmental unit that operates a student grant or loan program and a person engaged in a business that includes the making of loans guaranteed or insured under a student loan program may not deny a grant, loan, loan guarantee, or loan insurance to a person that is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, or another person with whom the debtor or bankrupt has been associated, because the debtor or bankrupt is or has been a debtor under this title or a bankrupt or debtor under the Bankruptcy Act, has been insolvent before the commencement of a case under this title or during the pendency of the case but before the debtor is granted or denied a discharge, or has not paid a debt that is dischargeable in the case under this title or that was discharged under the Bankruptcy Act.
“(2) In this section, ‘student loan program’ means the program operated under part B, D, or E of title IV of the Higher Education Act of 1965 or a similar program operated under State or local law.”.

TITLE IV—GOVERNMENTAL BANKRUPTCY ISSUES

SEC. 401. EXCEPTION FROM AUTOMATIC STAY FOR POST-PETITION PROPERTY TAXES.

Section 362(b) of title 11, United States Code, is amended by inserting after paragraph (16) the following:
“(18) under subsection (a) of the creation or perfection of a statutory lien for an ad valorem property tax imposed by the District of Columbia, or a political subdivision of a State, if such tax comes due after the filing of the petition.”.
SEC. 402. MUNICIPAL BANKRUPTCY.

Section 109(c)(2) of title 11, United States Code, is amended by striking "generally authorized" and inserting "specifically authorized, in its capacity as a municipality or by name."

TITLE V—TECHNICAL CORRECTIONS

SEC. 501. AMENDMENTS TO BANKRUPTCY DEFINITIONS, NECESSITATED BY ENACTMENT OF PUBLIC LAW 101-647.

(a) ALPHABETIZING AND REDESIGNATING DEFINITIONS.—Section 101 of title 11 of the United States Code, as amended by sections 208, 217, 218, and 304, is amended—

(1) by redesignating paragraph (3) as paragraph (21B) and transferring such paragraph so as to insert it after paragraph (21A),

(2) by redesignating paragraph (39) as paragraph (51A) and transferring such paragraph so as to insert it after paragraph (51),

(3) by redesignating paragraphs (54) through (57), as so redesignated by section 2522(e) of Public Law 101-647, as paragraphs (53A) through (53D), respectively,

(4) by redesignating paragraph (56) as in effect immediately before the enactment of Public Law 101-647, as paragraph (35A) and transferring such paragraph so as to insert it after paragraph (35), and

(5) by redesignating paragraph (57), as in effect immediately before the enactment of Public Law 101-647, as paragraph (39) and transferring such paragraph so as to insert it after paragraph (38).

(b) CONFORMING AND RELATED AMENDMENTS TO TITLE 11 OF THE UNITED STATES CODE, BASED ON REDESIGNATED DEFINITIONS.—(1) Section 101 of title 11 of the United States Code, as amended by subsection (a), is amended—

(A) in paragraph (6) by striking "section 761(9)" and inserting "section 761",

(B) in paragraph (22) by striking "section 741(7)" and inserting "section 741",

(C) in paragraph (35)(B) by striking "paragraphs (3)" and inserting "paragraphs (21B)",

(D) in paragraph (49)(B)(ii) by striking "section 761(13)" and inserting "section 761", and

(E) in paragraph (53A)(A), as so redesignated, by striking "section 741(2)" and inserting "section 741".

(2) Section 362(b) of title 11, United States Code, is amended—

(A) in paragraph (6)—

(i) by striking "section 761(4)" and inserting "section 761",

(ii) by striking "section 741(7)" and inserting "section 741",

(iii) by striking "section 101(34), 741(5), or 761(15)" and inserting "section 101, 741, or 761", and

(iv) by striking "section 101(35) or 741(8)" and inserting "section 101 or 741", and

(B) in paragraph (7)—

(i) by striking "section 741(5) or 761(15)" and inserting "section 741 or 761", and

(ii) by striking "section 741(8)" and inserting "section 741".

(3) Section 507(a)(5) of title 11, United States Code, is amended—
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(A) by striking "section 557(b)(1)" and inserting "section 557(b)", and

(B) by striking "section 557(b)(2)" and inserting "section 557(b)".

(4) Section 546 of title 11, United States Code, is amended—
(A) in subsection (e)—
(i) by striking "section 101(34), 741(5), or 761(15)" and inserting "section 101, 741, or 761"; and
(ii) by striking "section 101(35) or 741(8)" and inserting "section 101 or 741"; and
(B) in subsection (f)—
(i) by striking "section 741(5) or 761(15)" and inserting "section 741 or 761"; and
(ii) by striking "section 741(8)" and inserting "section 741".

(5) Section 548(d)(2) of title 11, United States Code, is amended—
(A) in subparagraph (B)—
(i) by striking "section 101(34), 741(5) or 761(15)" and inserting "section 101, 741, or 761"; and
(ii) by striking "section 101(35) or 741(8)" and inserting "section 101 or 741"; and
(B) in subparagraph (C)—
(i) by striking "section 741(5) or 761(15)" and inserting "section 741 or 761"; and
(ii) by striking "section 741(8)" and inserting "section 741".

(6) Section 555 of title 11, United States Code, is amended by striking "section 741(7)" and inserting "section 741 of this title".

(7) Section 556 of title 11, United States Code, is amended by striking "section 761(4)" and inserting "section 761 of this title".

(c) CONFORMING AMENDMENTS TO OTHER LAWS BASED ON REDESIGNED DEFINITIONS.—(1) Section 207(c)(8)(D) of the Federal Credit Union Act (12 U.S.C. 1787(c)(8)(D)) is amended—
(A) in clause (ii)(I) by striking "section 741(7)" and inserting "section 741";
(B) in clause (iii) by striking "section 101(24)" and inserting "section 101";
(C) in clause (iv)(I) by striking "section 101(41)" and inserting "section 101"; and
(D) in clause (v) by striking "section 101(50)" and inserting "section 101".

(2) Section 11(e)(8)(D) of the Federal Deposit Insurance Act (12 U.S.C. 1821(e)(8)(D)) is amended—
(A) in clause (ii)(I) by striking "section 741(7)" and inserting "section 741";
(B) in clause (iii) by striking "section 761(4)" and inserting "section 761";
(C) in clause (iv) by striking "section 101(24)" and inserting "section 101";
(D) in clause (v)(I) by striking "section 101(41)" and inserting "section 101"; and
(E) in clause (viii) by striking "section 101(50)" and inserting "section 101".

(d) OTHER TECHNICAL AMENDMENTS.—Title 11 of the United States Code is amended—
(1) in section 101—
(A) in paragraph (33)—
   (i) in subparagraph (A) by striking "(12 U.S.C. 1813(u))", and
   (ii) in subparagraph (B) by striking "(12 U.S.C. 1786(r))",
(B) in paragraph (34) by striking "(12 U.S.C. 1752(7))",
(C) in paragraph (35)(A) by striking "(12 U.S.C. 1813(c)(2))",
(D) in paragraph (48)—
   (i) by striking "(15 U.S.C. 78q-l)", and
   (ii) by striking "(15 U.S.C. 78c(12))",
(E) in paragraph (49)—
   (i) in subparagraph (A)(xii)—
      (I) by striking "(15 U.S.C. 77a et seq.)", and
      (II) by striking "(15 U.S.C. 77c(b))", and
   (ii) in subparagraph (B)(vi) by striking "(15 U.S.C. 77c(b))", and
(F) in paragraph (53D), as so redesignated by subsection (a), by striking the period at the end and inserting a semicolon,
(2) in section 109(b)(2) by striking "(12 U.S.C. 1813(h))",
(3) in section 322(a) by striking "1302, or 1202" and inserting "1202, or 1302",
(4) in section 346—
   (A) in subsection (a) by striking "Internal Revenue Code of 1954 (26 U.S.C. 1 et seq.)" and inserting "Internal Revenue Code of 1986", and
   (B) in subsection (g)(1)(C) by striking "Internal Revenue Code of 1954 (26 U.S.C. 371)" and inserting "Internal Revenue Code of 1986",
(5) in section 348—
   (A) in subsection (b) by striking "1301(a), 1305(a), 1201(a), 1221, and 1228(a)" and inserting "1201(a), 1221, 1228(a), 1301(a), and 1305(a)", and
   (B) in subsections (b), (c), (d), and (e) by striking "1307, or 1208" each place it appears and inserting "1208, or 1307",
(6) in section 349(a) by striking "109(f)" and inserting "109(g)",
(7) in section 362—
   (A) in subsection (a) by striking "(15 U.S.C. 78eee(a)(3))", and
   (B) in subsection (b)—
      (i) by striking "(15 U.S.C. 78eee(a)(3))",
      (ii) in paragraph (10) by striking "or" at the end,
      (iii) in paragraph (12)—
         (I) by striking "the Ship Mortgage Act, 1920 (46 App. U.S.C. 911 et seq.)" and inserting "section 31325 of title 46", and
         (II) by striking "(46 App. U.S.C. 1117 and 1271 et seq., respectively)",
      (iv) in paragraph (13)—
         (I) by striking "the Ship Mortgage Act, 1920 (46 App. U.S.C. 911 et seq.)" each place it appears and inserting "section 31325 of title 46",
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(II) by striking "(46 App. U.S.C. 1117 and 1271 et seq., respectively)", and
(III) by striking "or" at the end,
(v) in paragraph (15), as added by Public Law 101-508,
by striking "or" at the end,
(vi) in paragraph (16), as added by Public Law 101-508—
(I) by striking "(20 U.S.C. 1001 et seq.)", and
(II) by striking the period at the end and inserting a semicolon, and
(vii) in paragraph (14), as added by Public Law 101-311—
(I) by striking the period at the end and inserting "; or",
(II) by redesignating such paragraph as paragraph (17), and
(III) by transferring such paragraph so as to insert such paragraph after paragraph (16),
(8) in section 363—
(A) in subsection (b)(2) by striking "(15 U.S.C. 18a)";
(B) in subsection (c)(1) by striking "1304, 1203, or 1204" and inserting "1203, 1204, or 1304",
(9) in section 364—
(A) in subsection (a) by striking "1304, 1203, or 1204" and inserting "1203, 1204, or 1304",
(B) in subsection (f)—
(i) by striking "(15 U.S.C. 77e)";
(ii) by striking "(15 U.S.C. 77aaa et seq.)",
(10) in section 365—
(A) in subsection (d)(6)(C) by striking "the Federal Aviation Act of 1958 (49 U.S.C. 1301)" and inserting "section 40102 of title 49",
(B) in subparagraphs (A) and (B) of subsection (g)(2) by striking "1307, or 1208" each place it appears and inserting "1208, or 1307",
(C) in subsection (n)(1)(B) by striking "to to" and inserting "to",
(D) in subsection (o) by striking "the Federal" the first place it appears and all that follows through "successors," and inserting "a Federal depository institutions regulatory agency (or predecessor to such agency)", and
(E) by striking subsection (p),
(11) in section 507, as amended by section 304—
(A) in subsection (a)(9) by striking "the Federal" the first place it appears and all that follows through "successors," and inserting "a Federal depository institutions regulatory agency (or predecessor to such agency)", and
(B) in subsection (d) by striking "or (a)(6)" and inserting "(a)(6), (a)(7), (a)(8), or (a)(9)",
(12) in section 522—
(A) in subsection (b) by striking "Bankruptcy Rules" and inserting "Federal Rules of Bankruptcy Procedure", and
(B) in subsection (d)(10)(E)(iii) —
   (i) by striking "408, or 409" the first place it appears and inserting "or 408", and
   (ii) by striking "Internal Revenue Code of 1954 (26 U.S.C. 401(a), 403(a), 403(b), 408, or 409)" and inserting "Internal Revenue Code of 1986",
(13) in section 523 —
   (A) in subsection (a) —
      (i) by striking "1141," and inserting "1141," and
      (ii) in paragraph (2)(C) by striking "(15 U.S.C. 1601 et seq.)",
   (B) in subsection (b) —
      (i) by striking "(20 U.S.C. 1087-3)", and
      (ii) by striking "(42 U.S.C. 294f)", and
   (C) in subsection (e) by striking "depository institution or insured credit union" and inserting "insured depository institution",
(14) in section 524 —
   (A) in subsection (a)(3) by striking "1328(c)(1)" and inserting "1328(a)(1)",
   (B) in subsection (c)(4) by striking "recession" and inserting "rescission", and
   (C) in subsection (d)(1)(B)(ii) by adding "and" at the end,
(15) in section 525(a) —
   (A) by striking "(7 U.S.C. 499a-499s)",
   (B) by striking "(7 U.S.C. 181-229)",
   (C) by striking "(57 Stat. 422; 7 U.S.C. 204)",
(16) in section 542(e) by striking "to to" and inserting "to",
(17) in section 543(d)(1) by striking "section," and inserting "section",
(18) in section 549(b) inserting "the trustee may not avoid under subsection (a) of this section after "involuntary case,",
(19) in section 553 —
   (A) in subsection (a)(1) by striking "other than under section 502(b)(3) of this title", and
   (B) in subsection (b)(1) by striking "362(b)(14)," and inserting "362(b)(14),",
(20) in section 555 by striking "(15 U.S.C. 78aaa et seq.)",
(21) in section 559 by striking "(15 U.S.C. 78aaa et seq.)",
(22) in section 706(a) by striking "1307, or 1208" and inserting "1208, or 1307",
(23) in section 724(d) by striking "Internal Revenue Code of 1954 (26 U.S.C. 6323)" and inserting "Internal Revenue Code of 1986",
(24) in section 726(b) —
   (A) inserting a comma after "section 1112", and
   (B) by inserting "1009," after "chapter under section",
(26) in section 742 by striking "(15 U.S.C. 78aaa et seq.)",
(27) in section 743 by striking "342(a)" and inserting "342",
(28) in section 745(c) by striking "Internal Revenue Code of 1954 (26 U.S.C. 1 et seq.)" and inserting "Internal Revenue Code of 1986",
(29) in section 761 —
   (A) in paragraph (1) by striking "(7 U.S.C. 1 et seq.)",

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The Bankruptcy Reform Act of 1994

(B) in paragraph (5) by striking “(7 U.S.C. 6c(b))”, and
(C) in paragraph (13) by striking “(7 U.S.C. 23)”,

(30) in section 1104(d), as redesignated by section 211, inserting a comma after “interest”,
(31) in section 1123(a)(1) inserting a comma after “title” the last place it appears,
(32) in section 1129—
   (A) in subsection (a)—
      (i) in paragraph (4) by striking the semicolon at the end and inserting a period, and
      (ii) in paragraph (12) inserting “of title 28” after “section 1930”, and
   (B) in subsection (d) by striking “(15 U.S.C. 77e)”,
(33) in section 1145—
   (A) in subsection (a)—
      (i) by striking “does” and inserting “do”,
      (ii) by striking “(15 U.S.C. 77e)”, and
      (iii) in paragraph (3)(B)(i) by striking “(15 U.S.C. 78m or 78o(d))”,
   (B) in subsection (b)(1) by striking “(15 U.S.C. 77b(11))”,
and
(C) in subsection (d) by striking “(15 U.S.C. 77aaa et seq.)”,
(34) in section 1166(2) by striking “(45 U.S.C. 791(b))”,
(35) in section 1167—
   (A) by striking “(45 U.S.C. 151 et seq.)”, and
   (B) by striking “(45 U.S.C. 156)”,
(36) in section 1226(b)(2)—
   (A) by striking “1202(d)” and inserting “1202(c)”, and
   (B) by striking “1202(e)” and inserting “1202(d)”,
(37) in section 1302(b)(3) by striking “and” at the end,
(38) in section 1328(a)—
   (A) in paragraph (2) by striking “(5) or (8)” and inserting “(5), (8), or (9)”, and
   (B) by striking the last paragraph (3), and
(39) in the table of chapters by striking the item relating to chapter 15.

SEC. 502. TITLE 28 OF THE UNITED STATES CODE.
Section 586(a)(3) of title 28, United States Code, is amended in the matter preceding subparagraph (A) by inserting “12,” after “11.”.

TITLE VI—BANKRUPTCY REVIEW COMMISSION

SEC. 601. SHORT TITLE.
This title may be cited as the “National Bankruptcy Review Commission Act”.

SEC. 602. ESTABLISHMENT.
There is established the National Bankruptcy Review Commission (referred to as the “Commission”).
SEC. 603. DUTIES OF THE COMMISSION.

The duties of the Commission are—

(1) to investigate and study issues and problems relating to title 11, United States Code (commonly known as the "Bankruptcy Code");

(2) to evaluate the advisability of proposals and current arrangements with respect to such issues and problems;

(3) to prepare and submit to the Congress, the Chief Justice, and the President a report in accordance with section 608; and

(4) to solicit divergent views of all parties concerned with the operation of the bankruptcy system.

SEC. 604. MEMBERSHIP.

(a) NUMBER AND APPOINTMENT.—The Commission shall be composed of 9 members as follows:

(1) Three members appointed by the President, 1 of whom shall be designated as chairman by the President.

(2) One member shall be appointed by the President pro tempore of the Senate.

(3) One member shall be appointed by the Minority Leader of the Senate.

(4) One member shall be appointed by the Speaker of the House of Representatives.

(5) One member shall be appointed by the Minority Leader of the House of Representatives.

(6) Two members appointed by the Chief Justice.

Members of Congress, and officers and employees of the executive branch, shall be ineligible for appointment to the Commission.

(b) TERM.—Members of the Commission shall be appointed for the life of the Commission.

(c) QUORUM.—Five members of the Commission shall constitute a quorum, but a lesser number may conduct meetings.

(d) APPOINTMENT DEADLINE.—The first appointments made under subsection (a) shall be made within 60 days after the date of enactment of this Act.

(e) FIRST MEETING.—The first meeting of the Commission shall be called by the chairman and shall be held within 210 days after the date of enactment of this Act.

(f) VACANCY.—A vacancy on the Commission resulting from the death or resignation of a member shall not affect its powers and shall be filled in the same manner in which the original appointment was made.

(g) CONTINUATION OF MEMBERSHIP.—If any member of the Commission who was appointed to the Commission as an officer or employee of a government leaves that office, or if any member of the Commission who was not appointed in such a capacity becomes an officer or employee of a government, the member may continue as a member of the Commission for not longer than the 90-day period beginning on the date the member leaves that office or becomes such an officer or employee, as the case may be.

(h) CONSULTATION PRIOR TO APPOINTMENT.—Prior to the appointment of members of the Commission, the President, the President pro tempore of the Senate, the Speaker of the House of Representatives, and the Chief Justice shall consult with each other to ensure fair and equitable representation of various points of view in the Commission and its staff.
SEC. 605. COMPENSATION OF THE COMMISSION.

(a) PAY.—

(1) NONGOVERNMENT EMPLOYEES.—Each member of the Commission who is not otherwise employed by the United States Government shall be entitled to receive the daily equivalent of the annual rate of basic pay payable for level IV of the Executive Schedule under section 5315 of title 5, United States Code, for each day (including travel time) during which he or she is engaged in the actual performance of duties as a member of the Commission.

(2) GOVERNMENT EMPLOYEES.—A member of the Commission who is an officer or employee of the United States Government shall serve without additional compensation.

(b) TRAVEL.—Members of the Commission shall be reimbursed for travel, subsistence, and other necessary expenses incurred by them in the performance of their duties.

SEC. 606. STAFF OF COMMISSION; EXPERTS AND CONSULTANTS.

(a) STAFF.—

(1) APPOINTMENT.—The chairman of the Commission may, without regard to the civil service laws and regulations, appoint, and terminate an executive director and such other personnel as are necessary to enable the Commission to perform its duties. The employment of an executive director shall be subject to confirmation by the Commission.

(2) COMPENSATION.—The chairman of the Commission may fix the compensation of the executive director and other personnel without regard to the provisions of chapter 51 and subchapter II of chapter 53 of title 5, United States Code, relating to classification of positions and General Schedule pay rates, except that the rate of pay for the executive director and other personnel may not exceed the rate payable for level V of the Executive Schedule under section 5316 of that title.

(b) EXPERTS AND CONSULTANTS.—The Commission may procure temporary and intermittent services of experts and consultants under section 3109(b) of title 5, United States Code.

SEC. 607. POWERS OF THE COMMISSION.

(a) HEARINGS AND MEETINGS.—The Commission or, on authorization of the Commission, a member of the Commission, may hold such hearings, sit and act at such time and places, take such testimony, and receive such evidence, as the Commission considers appropriate. The Commission or a member of the Commission may administer oaths or affirmations to witnesses appearing before it.

(b) OFFICIAL DATA.—The Commission may secure directly from any Federal department, agency, or court information necessary to enable it to carry out this title. Upon request of the chairman of the Commission, the head of a Federal department or agency or chief judge of a Federal court shall furnish such information, consistent with law, to the Commission.

(c) FACILITIES AND SUPPORT SERVICES.—The Administrator of General Services shall provide to the Commission on a reimbursable basis such facilities and support services as the Commission may request. Upon request of the Commission, the head of a Federal department or agency may make any of the facilities or services of the agency available to the Commission to assist the Commission in carrying out its duties under this title.

(d) EXPENDITURES AND CONTRACTS.—The Commission or, on authorization of the Commission, a member of the Commission may make expenditures and enter into contracts for the procurement of such supplies, services, and property as the Commission or member considers appropriate for the purposes
of carrying out the duties of the Commission. Such expenditures and contracts may be made only to such extent or in such amounts as are provided in appropriation Acts.

(e) MAILS.—The Commission may use the United States mails in the same manner and under the same conditions as other Federal departments and agencies of the United States.

(f) GIFTS.—The Commission may accept, use, and dispose of gifts or donations of services or property.

SEC. 608. REPORT.

The Commission shall submit to the Congress, the Chief Justice, and the President a report not later than 2 years after the date of its first meeting. The report shall contain a detailed statement of the findings and conclusions of the Commission, together with its recommendations for such legislative or administrative action as it considers appropriate.

SEC. 609. TERMINATION.

The Commission shall cease to exist on the date that is 30 days after the date on which it submits its report under section 608.

SEC. 610. AUTHORIZATION OF APPROPRIATIONS.

There is authorized to be appropriated $1,500,000 to carry out this title.

TITLE VII—SEVERABILITY; EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

SEC. 701. SEVERABILITY.

If any provision of this Act or amendment made by this Act or the application of such provision or amendment to any person or circumstance is held to be unconstitutional, the remaining provisions of and amendments made by this Act and the application of such other provisions and amendments to any person or circumstance shall not be affected thereby.

SEC. 702. EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE.—Except as provided in subsection (b), this Act shall take effect on the date of the enactment of this Act.

(b) APPLICATION OF AMENDMENTS.—(1) Except as provided in paragraph (2), the amendments made by this Act shall not apply with respect to cases commenced under title 11 of the United States Code before the date of the enactment of this Act.

(2)(A) Paragraph (1) shall not apply with respect to the amendment made by section 111.

(B) The amendments made by sections 113 and 117 shall apply with respect to cases commenced under title 11 of the United States Code before, on, and after the date of the enactment of this Act.

(C) Section 1110 of title 11, United States Code, as amended by section 201 of this Act, shall apply with respect to any lease, as defined in such section 1110(c) as so amended, entered into in connection with a settlement of any proceeding in any case pending under title 11 of the United States Code on the date of the enactment of this Act.

(D) The amendments made by section 305 shall apply only to agreements entered into after the date of enactment of this Act.
Regulatory Update
FAIR LENDING

Leonard A. Watkins
PNC Bank, Kentucky, Inc.
Louisville, Kentucky

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SECTION D
# FAIR LENDING

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**SECTION D**
I. Fair Lending Laws and Regulations

A. Fair Housing Act - (1968) - Title VIII of the Civil Rights Act of 1968, as amended by the Fair Housing Amendments Act of 1988. Prohibits discrimination on the basis of race, color, religion, sex, national origin, handicap, or familial status in all aspects of sale, financing, rental and advertising of housing.

B. Equal Credit Opportunity Act (ECOA) - (1974) - Enacted in 1974 and became effective on October 28, 1975 to insure that various financial institutions and other firms engaged in the extension of credit exercise their responsibility to make credit available with fairness, impartiality and without discrimination on the basis of sex or marital status. In 1976, ECOA was amended to include the following additional prohibited bases for credit discrimination:

- Race
• Color
• Religion
• National Origin
• Age (provided the applicant has the capacity to contract)
• Whether all or a part of the applicant's income derives from public assistance.
• Whether the applicant has in good faith, exercised any right under the Consumer Credit Protection Act.

C. Home Mortgage Disclosure Act (HMDA) - (1975) - The Home Mortgage Disclosure Act of 1975 (HMDA) was enacted on December 31, 1975 and became effective July 26, 1976. The passage of HMDA was predicated on the belief that lending institutions had been systematically disinvesting in older, blue-collar, ethnic neighborhoods, thereby making it impossible for existing owners in such areas to rehabilitate their properties and for potential purchasers interested in maintaining or improving the neighborhoods to buy.

Congress chose to attack this problem by regulating disclosure of lending information that would reveal which institutions were lending in which neighborhoods. Once this information was available, pressure could be brought to bear by depositors, community leaders, and public officials to reverse the perceived trend toward disinvestment.
HMDA contains no provision requiring specific loans to be made or penalties for failing to make loans in particular geographical areas. In addition, HMDA provides that institutions are not encouraged to participate in unsound or unsafe lending practices or in the allocation of credit.

D. Community Reinvestment Act (CRA) - (1977) - The CRA was enacted as Title VIII of the Housing and Community Development Act of 1977. The regulations which carry-out the directives of the CRA (FDIC, 12 CFR 345/OCC, 12 CFR 25) are designed to:

- encourage banks to help meet the credit needs of their local communities;
- provide guidance to banks on how the regulatory agencies will assess their efforts and records in satisfying continuing and affirmative obligations to help meet the credit needs of their local communities, including low and moderate income neighborhoods, consistent with safe and sound banking practices;
- provide for regulators to weigh those records when reviewing applications for acquisitions, mergers and other regulated activities.
The Equal Credit Opportunity Act was targeted toward providing credit to individuals for their improvement opportunities, while the Community Reinvestment Act targeted providing credit opportunities in neighborhoods and communities for its improvement.

II. Enforcement of Fair Lending

A. Federal Regulators of Financial Institutions

1. Office of the Comptroller of the Currency (OCC)
2. Federal Reserve Bank (FRB)
3. Federal Deposit Insurance Corporation (FDIC)

B. U.S. Department of Justice (DOJ)

III. Recent Discrimination Findings

In 1992, three significant events occurred that indicated that discrimination may be occurring in lending practices and, in response, that regulatory and enforcement agencies are increasing their scrutiny of banks' lending practices.
A. Barry Leeds and Associates, Inc. Study - A financial marketing research firm in New York, conducted a survey to determine if racial discrimination occurs at the pre-application stage of the mortgage loan process. (See Exhibit 1)

B. Federal Reserve Bank of Boston Study - Commonly known as the "Boston Fed Study", took a comprehensive look at many variables that affect mortgage lenders' decisions in the Boston area. Many of the variables (e.g., financial, employment, and property characteristics) were not examined in analyses data released under the Home Mortgage Disclosure Act. (See Exhibit 1)

C. Decatur Federal Savings and Loan Case - For the first time in history, the Department of Justice filed a lawsuit against a major home mortgage lender (Decatur Federal Savings and Loan, Decatur, GA) claiming the lender engaged in a pattern or practice of discrimination against prospective black homebuyers. (See Exhibit 1)

IV. What Constitutes Discrimination

A. Differential Treatment - Actions or inactions by employees because of an applicant's characteristics:
Employees must treat all applicants the same, including the greetings and common courtesies extended an individual.

B. Blatant Discrimination

Under the Fair Housing Act, discrimination is prohibited on the basis of race, color, religion, sex, handicap, familial status, or national origin, in all aspects of the sale, financing, rental and advertising of housing.

The Equal Credit Opportunity Act prohibits discrimination in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract), receipt of income (totally or partially) from public assistance programs, and good faith exercise of any right under the Consumer Credit Protection Act; all of which constitute "prohibited basis".

C. Lending Standards - Loan standards should allow flexibility to match the characteristics of the communities served by the lender. These standards
should avoid:

- Minimum loan amounts
- Minimum property values
- Maximum property age
- Minimum unit size
- Minimum building lot size

Such standards could exclude older, ethnic, blue collar communities as well as many minority neighborhoods.

D. **Differential Loan Terms** - When applied to specific geographical areas, differential loan terms could have the effect of discrimination on a prohibited basis. Loan terms to avoid are:

- different interest rates
- special fees
- higher fees on smaller loans
- length of amortization periods
- downpayment requirements

E. **Subjective Lending Criteria** - Provide specific loan criteria. Avoid subjective
terminology:

- applicant must have an "excellent" credit rating; must have "adequate" time on the job; cannot have "questionable" character; or must have "good" income.
- Property must be in a "stable" or "growing" area; should have an "attractive" appearance.
- Neighborhoods should be "desirable"; or neighborhoods should be "mixed".

F. **Credit History and Employment Stability** - Specifically define credit history required without penalizing for the use of finance companies. Do not penalize for limited credit resources. Frequent job changes may suggest an applicant's efforts to improve his income, so be careful of requiring "at least two years on the job".

G. **Credit Exceptions** - Many lenders establish committees to review all exceptions made to rejected loan applicants. This allows uniformity in how exceptions may be granted.

V. Impact on Financial Institutions
A. Board of Directors

1. Distribution of Loans
   - Race
   - Census tract

2. Diversity of bank staff

B. Employees - The staff of any organization determines the opinion all individuals have about that institution. The employees become "The Bank" and the image of the "The Bank" will be the same as the image presented by its employees.

1. Training - Ongoing training for employees will be as critical as investment in technology.

2. Loan Approvals - Denial rates by race and income will become an even more critical benchmark for measuring a bank's performance in its communities.

3. Processing Times - Loan processing will have similar effects as loan
approvals but will be used in evaluating how eager the banks are to serving the communities.

C. **Branches** - The distribution of branches have become increasingly important in the community’s tools for determining if its credit needs are being served.

D. **Marketing/Advertising** - Efforts to attract business from all segments of a bank’s market may require a more targeted approach to advertising, marketing, and community outreach. Advertising development must increase to design advertisements to reflect the ethnic/racial make-up of the communities.

E. **Costs** - Profitability of banks will be strained more than ever because of the additional diversity in advertising, additional efforts in loan origination and approvals, increased training, market testing, and possibly smaller loans with reduced margins at return.

VI. Regulatory Performance

A. **Federal Agency Training** - Many financial institutions have accepted the fact that "Regulatory reform is imminent". All regulators should receive the same
training for evaluating a bank’s performance in fair lending.

B. Clarity of Enforcement - All financial institutions should be able to read and implement regulations and expect all regulators to review the institutions performance in a totally objective process. All objectives should be clearly defined and explicitly described what is required to achieve each rating level.

C. Non-Bank Lenders - A level playing field should be developed for both banks and non-bank lenders. Both types of institutions exist in communities and play equally important roles in that community’s credit needs being met.

VII. Closing

Many legal issues exist in fair lending because of change in how fair lending is evaluated and regulated. The field of competition becomes larger, the regulatory players roles have changed while the measuring stick for performance floats in a raging sea of water.
EXHIBIT 1

DISCRIMINATION IN MORTGAGE LENDING

*Barry Leeds and Associates, Inc. Study

*Federal Reserve Bank of Boston Study

*Decatur Federal Savings and Loan Case
DISCRIMINATION IN MORTGAGE LENDING

INTRODUCTION

In the past, analysis of lending patterns and practices was based primarily on information required by the Home Mortgage Disclosure Act. Although the information indicated a disparity in the treatment of minorities, lenders debated the reliability of the raw data and claimed that their institutions treat all credit applicants equally regardless of race. With the implementation of more sophisticated analysis methods and the inclusion of additional variables, these arguments are weakening.

In 1992, three significant events occurred that indicate that discrimination may be occurring in lending practices and, in response, that regulatory and enforcement agencies are increasing their scrutiny of banks' lending practices:

- Two studies were conducted to create a more thorough picture of why a credit application might be rejected and to determine if discrimination occurs during the mortgage loan process. In general, the "Mortgage Preapplication Bias Survey" (conducted by Barry Leeds and Associates, Inc.) and the "Boston Fed Study" (conducted by the Federal Reserve Bank of Boston) found strong evidence of racial bias among mortgage lenders.

- In addition, for the first time in history, the Department of Justice filed a lawsuit against a major home mortgage lender (Decatur Federal Savings and Loan) claiming that the lender engaged in a pattern or practice of discrimination against prospective black homebuyers.
In early 1992, Barry Leeds and Associates, Inc., a financial marketing research firm in New York, conducted a survey to determine if racial discrimination occurs at the pre-application stage of the mortgage loan process. The survey found that bank service representatives often show subtle forms of racial discrimination in their treatment of minority prospective mortgage applicants compared to white consumers with similar financial profiles.

In general, the Mortgage Preapplication Bias Survey shows a consistent pattern of discrimination, despite the bank's mortgage lending policy. Subtle levels of discrimination are found in bank representatives' tendency to:

- provide less complete explanations of mortgage products;
- provide less mention of mortgage characteristics; and
- show less interest in helping minority consumers than whites.

NOTE: Seven overheads have been provided (Exhibit I) and can be used in the presentation of this information. It is recommended that a copy of the overheads be distributed to each participant.
SURVEY OBJECTIVE

The primary objective was to determine if racial discrimination occurs at the pre-application stage of the mortgage loan process.

SURVEY DESIGN

The Mortgage Preapplication Bias Survey analyzed 100 shopping "visits" to 50 different bank branches in non-minority, middle income neighborhoods.

Each branch was visited separately by a white and a minority "shopper," with similar financial profiles and qualifying ratios, acting as a first-time home buyer and inquiring about a conventional fixed-rate mortgage with a 10% down payment.
The "shoppers" were actually specially trained, professional market research interviewers, acting as prospective mortgage customers. The "shoppers" were instructed to:

- provide profile information only when probed by the bank service representative; and

- prompt the representative only on specific issues (such as down-payment requirements, etc.).

The "shoppers" were unaware of the discrimination aspect of the study.
SUMMARY OF FINDINGS

OVERHEAD #4: Summary of Findings

The key findings of the Mortgage Preapplication Bias Survey are as follows:

- **Overall service satisfaction was substantially lower among minority mortgage shoppers (28%) compared with their white counterparts (48%).**

Minorities were more likely than whites to encounter bank mortgage representatives speaking on the telephone or busy with another staff member while they were waiting. White shoppers experienced the briefest waiting time for service; the longest waits were experienced by black shoppers.

Some minority shoppers commented that the bank representative did not appear to be interested in their business or that the representative was late for their appointment and was not personable or friendly.

- **Among white shoppers, 80% felt the explanation of mortgage choices provided was "clear and careful," while only 50% of minorities expressed the same feeling.**

OVERHEAD #5: Mortgage Types Mentioned to Shopper

Bank representatives were less likely to explain the differences among types of mortgages to minority shoppers and more likely to do so for whites. Whites were also more likely to receive information on alternatives to the conventional fixed-rate mortgage.
SUMMARY OF FINDINGS continued

- OVERHEAD #6: Mortgage Characteristics Mentioned

Bank representatives made a more active effort with white shoppers to recommend a specific type of mortgage (90% whites; 68% minorities) and mentioned more mortgage characteristics to them.

- Minorities who claimed they had a higher income were treated more favorably than were those who claimed a lower income.

Bank representatives spent a similar amount of time with white shoppers, regardless of income level. Among minority shoppers, however, representatives spent a greater amount of time if the shopper indicated a higher income level, specifically, over $85,000.

- Minorities were quoted a slightly longer approval time than whites.

- OVERHEAD #7: Approval Time Mentioned

A study by the Federal Reserve Bank of Boston ("Boston Fed Study") took a comprehensive look at many variables that affect mortgage lenders' decisions in the Boston area. Many of the variables (e.g., financial, employment, and property characteristics) were not examined in analyses of data released under the Home Mortgage Disclosure Act.

Overall, the findings of the study reinforce the concept that discrimination was entrenched in lending practices of mortgage lenders in the Boston area. At the conclusion of the study, Richard F. Syron, president of the Federal Reserve Bank of Boston, stated: "The results indicate that a significant problem exists in the market for mortgage loans. Unfortunately, race plays a role, perhaps an unconscious and unintentional role, but a role nonetheless in mortgage lending decisions."

STUDY OBJECTIVES

The objectives of the study were:

- to present a more thorough picture of why an application might be rejected; and
- to determine if race is a key factor in rejections.

STUDY METHODOLOGY

In the Boston Fed Study, researchers asked 131 financial institutions for data on 38 variables not included in the 1990 HMDA surveys for more than 3,000 mortgage loan applications. The variables included debt and credit histories, loan-to-value ratios, risks of default, employment histories and neighborhoods. Using a statistical model, researchers were able to predict with surprising accuracy whether a loan application would be approved or rejected.
SUMMARY OF FINDINGS

• The extent of racial bias among mortgage lenders may have been exaggerated, but confirmed that discrimination is a serious problem.

  - The HMDA analysis found that black and Hispanic applicants were 2.7 times as likely to be turned down than whites.

  - The Boston Fed Study found that black and Hispanic applicants were 1.6 times as likely to be turned down than whites.

• Minority applicants, on average, have greater debt burdens, higher loan-to-value ratios, and weaker credit histories. They are also less likely to buy single-family homes. These factors account for about two-thirds of the difference in denial rates; no factor other than race could account for the remaining gap.

• Of all the variables examined, only history of bankruptcy and denial of private mortgage insurance turned out to be more important predictors of loan denial than race.

• There was little or no indication of discrimination involving approved loans. Minorities with unblemished credentials are 97% certain of being approved.
SUMMARY OF FINDINGS continued

- However, the majority of applicants (both white and minority) had some problems with their applications and this is where race appeared to have a big impact. For the same imperfections:

  - white applicants appeared to enjoy a general presumption of credit-worthiness that black and Hispanic applicants did not; and

  - lenders appeared to be more willing to overlook flaws for white applicants than for minority applicants.

Overall, lenders appeared to be more flexible when working with white applicants and more willing to find ways to get the application approved.

Source: "American Banker," American Bankers Association, October 9, 1992
In September 1992, the Department of Justice filed a complaint against Decatur Federal Savings and Loan (one of the largest providers of home mortgage loans in the Atlanta, Georgia area) alleging that the lender engaged in a pattern or practice of discrimination against prospective black homebuyers when marketing its home mortgage loan products and deciding whether or not to grant mortgage loan applications. The suit is the first such pattern or practice lawsuit brought by the government against a mortgage lender.

The accompanying agreement involved significant financial and other business commitments to increase Decatur Federal's mortgage lending in predominantly black neighborhoods.

SUMMARY OF ALLEGATIONS

The lawsuit against Decatur Federal Savings and Loan contained the following allegations:

- Since January 1988, Decatur Federal rejected black applicants for mortgage loans at almost three times the rate at which it rejected white applicants. Over 95% of its mortgage loans were originated in predominately white neighborhoods.

- A review and analysis of over 4,000 loan application files revealed that, even after controlling for possible differences in income, credit history, debt levels, and other underwriting variables, race was a significant factor in Decatur Federal's loan decisions.

- In early 1979, Decatur Federal purposefully defined its relevant lending market to exclude large portions of the black community in Fulton County, and the institution rarely or never advertised for home mortgage loans through media oriented to the black community.
SUMMARY OF ALLEGATIONS continued

- Decatur Federal allegedly employed a virtually all-white staff of commissioned account executives to solicit loans from real estate agents active in white neighborhoods, but rarely made sales calls on agents active in black neighborhoods.

- Since its founding in 1927, Decatur Federal placed 42 out of 43 branch and regional loan offices in predominantly white neighborhoods at the time they opened for business.

SUMMARY OF RESOLUTION

According to the consent decree, Decatur Federal has committed to do the following:

1. Provide $1 million to 48 black individuals whose home mortgage loan applications were rejected between January 1988 and May 20, 1992.

2. Expand its lending territory to include all of Fulton County, which includes most of the city of Atlanta and advertise extensively in black-oriented newspapers and radio stations.

3. Target sales calls to real estate agents and builders active in black neighborhoods and implement a pay structure that increases incentives for its account executives to obtain business in these neighborhoods.

4. Make future decisions regarding branch locations only after consideration of the lender's obligations to meet the credit needs of low and moderate income neighborhoods.

5. Within one year of the date of the decree, open a branch or regional loan office in south Fulton County, a predominantly black section of Atlanta.
SUMMARY OF RESOLUTION continued

6. Re-train all of its home mortgage personnel and require all home mortgage lenders to complete an application checklist for each loan applicant to ensure they solicit all necessary information and evaluate this information fairly.

7. Appoint a review underwriter to re-examine every initially rejected application and a review appraiser to re-examine every appraisal that does not support the loan requested.

8. To ensure future compliance, enter into a contract with an independent testing organization that will send black and white individuals posing as home mortgage applicants to test for racial discrimination.

9. For three years, send regular reports regarding all of its lending activities to the Department of Justice.

Following the announcement of the consent decree, Attorney General William P. Barr said "the consent decree reflects the Department's commitment to the vigorous enforcement of the Fair Housing Act and Equal Credit Opportunity Act."

John R. Dunne, Assistant Attorney General in charge of the Civil Rights Division stated: "This investigation was complex and required a serious commitment of personnel and financial resources. As a result, we now have a model for investigating the mortgage lending practices of other institutions. Based on the Decatur experience, we will be able to conduct future investigations much more quickly and efficiently."
"We have been meeting with the federal regulatory agencies who have initial supervisory responsibility over lending institutions, and have shared with them our approach in conducting mortgage lending investigations. We have invited them to conduct joint investigations with us in the future.

"All mortgage lenders should be on notice of our resolve to ensure nondiscrimination in the mortgage lending process and to fully enforce the requirements of the Fair Housing Act and the Equal Credit Opportunity Act."

Source: Department of Justice/Press Release dated September 17, 1992
To determine if racial discrimination occurs at the mortgage loan application stage of the mortgage loan process.

Matched pair testing - one minority and one white shopper

Similar financial profiles - Same qualifying ratios - Same home locations

Inquiry for Conventional Fixed Rate Loan

First time home buyers with 100% down payment

The transactions were conducted by specially trained interviewers acting as customers. Instructions for the survey and rules to follow in the branches were clearly explained at a specially conducted training session.

Interviewers were instructed to:
- Provide profile information only when probed by the representative
- Prompt the representative only on specific issues

Branches were visited by one white and one minority shopper

Interviewers were unaware of the discrimination aspect of the study

Minorities were less satisfied with their transaction than whites. Minorities were more likely to indicate that they felt the representative was not interested in their business. Minority shoppers waited longer for service than white shoppers. White shoppers were significantly more likely to describe the explanation they received as "clear and careful." Minority shoppers were less satisfied with their transaction than whites.

Representatives discussed a wider variety of mortgages with whites. Representatives mentioned more mortgage characteristics to whites who claimed they had a higher income than those who claimed a lower income. Minorities were quoted a slightly longer approval time than whites. Minorities were treated more favorably than were those who were treated more favorably than were whites.

MORTGAGE CHARACTERISTICS MENTIONED

- Interest Rates
- Monthly Payment
- Points
- Closing Costs
- Appraisal Fees
- Application Fees
- Available Terms
- Pre-Qualification
- Lifetime Cap

Under 1 Week
1 - 2 Weeks
2 - 3 Weeks
3 - 4 Weeks
Over 4 Weeks
Did Not Specify


10 20 30 40 50 60 70 80 90 100

0

100

Approval Time Mentioned

Under 1 Week
1 - 2 Weeks
2 - 3 Weeks
3 - 4 Weeks
Over 4 Weeks
Did Not Specify

Regulatory Update

FLOOD DISASTER PROTECTION

Thomas W. Grundy
Kentucky Bankers Association
Louisville, Kentucky

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FLOOD DISASTER PROTECTION

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SECTION E
FLOOD DISASTER PROTECTION

Thomas W. Grundy  
Director of Compliance  
Kentucky Bankers Association

I. FEDERAL AGENCY REGULATIONS

A. 12 CFR 22 - Office of the Comptroller of the Currency  
B. 12 CFR 208 - Federal Reserve Board  
C. 12 CFR 339 - Federal Deposit Insurance Corporation

II. LEGISLATIVE HISTORY

A. National Flood Insurance Act of 1968 (NFIA) created the National Flood Insurance Program (NFIP).

B. Flood Disaster Protection Act of 1973 (FDPA) - the purpose of the FDPA essentially is to:

1. To provide adequate amounts of federally subsidized flood insurance to owners of improved real property located in flood hazard areas of communities that participate in the NFIP.

2. To reduce or avoid future flood losses and provide a preventive alternative to massive doses of federal disaster relief funds normally made available to flood stricken areas.

3. requires regulators of federal financial institutions to promulgate regulations prohibiting:

   a. Federally regulated lending institutions from making, increasing, extending or renewing any loan secured by improved real estate or a residential mobile home located or to be located in a flood hazard area of a community participating in the national flood insurance program (NFIP), unless the property securing the loan is covered by flood insurance.

   b. The use of federal financial assistance for acquisition or construction of a structure in a flood hazard area, unless the community participates in the national flood insurance program and flood insurance program and flood insurance has been purchased. The term "federal financial assistance" includes loans, grants, guarantees, and similar forms of direct and
indirect assistance from federal agencies, such as FHA or VA mortgage insurance. For communities participating in the NFIP, that term also includes conventional loans from federally insured, supervised or approved lending institutions.

C. "Jones Amendment" to the Housing and Community Development Act of 1974 - This amendment required federally regulated or insured lenders to notify prospective borrowers before settlement if the property is located in a special flood hazard area (regardless of community status).

D. "Eagleton Amendment" to the Housing and Community Development Act of 1977. This amendment:

1. Removed the ban against conventional mortgages by federally regulated lenders in nonparticipating communities.

2. Required federally regulated or insured lenders to notify borrowers whether federal disaster assistance would be available for flood-related damages to buildings. Such relief will not be available so long as the community is not enrolled in the NFIP, and has been identified as a community with special flood hazard areas.

E. National Flood Insurance Reform Act of 1994 (NFIRA)

On September 23, 1994, President Clinton signed the Riegle Community Development and Regulatory Improvement Act of 1994. Title V of this new law is the National Flood Insurance Reform Act of 1994. Issues resulting from this legislation include added emphasis on notice requirements, a new Standard Hazard Determination Form, expanded coverage, civil money penalties, forced placement authority by lenders, escrow requirements for flood insurance payments, and fees charged by lenders for making a determination. These issues are covered in section XIV of this outline.

III. OVERVIEW AND SCOPE

A. The federal government makes flood insurance available to property owners in communities which participate in the NFIP.

B. Participating communities must adopt floodplain management programs regulating new construction and development in "Special Flood Hazard Areas," which are designated by the Federal Emergency Management Agency (FEMA) on flood insurance maps issued for communities, lenders, insurance agents, and the general public to use.
C. The are approximately 17,500 participating communities. In the combined direct NFIP book of business and the Write Your Own (WYO) book of business, there are around 2 million policies in force; 120,000 agents; approximately 8,000 independent adjusters; $143 billion of insurance coverage in force; and over $4 billion in paid claims.

D. The NFIP is administered by the Federal Insurance Administration (FIA), initially under the Department of Housing and Urban Development. In 1979, FIA was transferred by a Presidential reorganization to FEMA.

E. FEMA is the insurer indicated on the Standard Flood Insurance Policy (SFIP), unless the policy is one issued by a WYO company.

F. The FDPA expands the provisions of the NFIA by:

1. Requiring flood-prone communities to participate in the national flood insurance program as a condition of future federal financial assistance for flood-related damage to property.

2. Requiring land use measures in certain flood-prone areas as a condition for making flood insurance available in those areas.

3. Directing financial regulatory agencies to ensure that their institutions do not make loans secured by real estate or mobile homes located, or to be located, in a flood-prone area, if that area is participating in the national flood insurance program and such property is not covered by federal flood insurance.

4. Directing financial regulatory agencies to require their institutions, as a condition to making flood-related loans, to notify the purchaser or lessee of the availability of federal disaster relief assistance and of the possibility of flood hazards.

5. Directing federal agencies, such as FHA and VA, not to subsidize, insure, guarantee, or approve any flood-related loan, if the property in connection with the loan is in a flood hazard area of a nonparticipating community.

IV. HOW RESPONSIBILITIES ARE IMPLEMENTED

A. Federal Emergency Management Agency

1. Federal Insurance Administration administers the NFIP:
a. establishes rates, terms of coverage, deductibles, etc.
b. through a servicer, issues policies, processes claims
c. identifies and maps flood hazard areas
d. develops criteria for community floodplain management programs
e. determines community eligibility and monitors compliance

2. FEMA's ten regional offices are responsible for:

a. providing technical assistance to communities to help them meet the criteria for participation
b. monitoring the performance of participating communities
c. providing information and assistance to lenders, insurance agents, and property owners

3. Flood Insurance/FEMA Information Sources:

a. For general information relating to laws, regulations and administrative policies related to the NFIP, contact:

   Federal Emergency Management Agency  
   Federal Insurance Administration  
   500 C Street, S.W.  
   Washington, D.C. 20472

b. Flood insurance questions, contact your local property insurance agents or brokers or call the National Flood Insurance Program at 1-800-638-6620.

c. To order Flood Hazard Boundary Maps, call 1-800-333-1363.

d. For information pertaining to hazard identification and flood plain management, contact:

   Federal Emergency Management Agency  
   Atlanta Regional Office  
   1371 Peachtree Street, N.E.  
   Suite 700  
   Atlanta, GA 30309  
   404-853-4416
B. Local community officials are responsible for adopting and enforcing floodplain management regulations that meet federal and state standards.

C. State coordinating agencies are responsible for assuring implementation of floodplain management regulations within that state or territory. In Kentucky, contact:

Donna Hall, State Coordinator
Department of Natural Resources
Division of Water
18 Reilly Road
Fort Boone Plaza
Frankfort, Kentucky 40601
Phone - (502) 564-3410, ext. 424
Fax - (502) 564-4245

D. Federally regulated or insured lenders are responsible for:

1. seeing that the mandatory purchase requirement is met, including maintaining coverage for the term of the loan;

2. notifying prospective borrowers that the property is located in a special flood hazard area; and

3. notifying prospective borrowers whether or not federal disaster assistance will be available in the event of flood damage.

E. Federal direct lenders such as the SBA and providers of other federal financial assistance are responsible for seeing that the mandatory purchase requirement is met.

F. Flood Insurance Agents. Licensed property and casualty insurance agents and brokers provide the main connection between the program and the insured. Licensed agents sell flood insurance, complete the insured’s application form, handle claims, and follow up with the insured for renewals.

V. COMMUNITY PARTICIPATION

A. When a community is identified by FEMA as having special flood hazard areas, a flood hazard boundary map is provided to the community.

1. Maps are developed using the best available data.

2. Maps show areas within communities that are likely to be flooded.
3. Maps become effective on the date shown on their cover page.

B. To qualify for the NFIP, a community must:

1. adopt and enforce floodplain management ordinances which regulate future development in special flood hazard areas and meet the minimum criteria established by FEMA;
2. have or create a building permit system; and
3. provide FEMA with certain relevant information.

C. A community has one year from the date of notification to qualify for the NFIP.

1. During the one-year period, there are no restrictions on loans or other federal financial assistance.
2. If the community has not entered the NFIP after one year:
   a. no federally guaranteed or insured mortgage loans can be made in the special flood hazard areas for buildings which are insurable under the NFIP; and
   b. no federal financial assistance will be available to repair damage to insurable buildings in special flood hazard areas (in some cases this applies only to flood-related damage).

D. Maps may be amended by FEMA as a result of physical changes affecting conditions, jurisdictional changes, or a variety of other reasons.

VI. FLOOD INSURANCE PROGRAMS

A. Supervision. The FDPA expands the provisions of the NFIA. Those provisions created the NFIP, originally operated by the Department of Housing and Urban Development. It is now administered by the Federal Emergency Management Agency (FEMA) and flood insurance policies are underwritten by the United States government. Direct participants of the national flood insurance program are state and local governments, lenders and insurance agents.

B. FEMA's Responsibilities. In addition to supervising the insurance aspects of the national flood insurance program, FEMA:
1. Identifies communities with special flood hazard areas.

2. Issues maps for those areas.

3. Helps communities qualify for the national flood insurance program.

4. Assists communities adopting flood plain management requirements.

C. States. In cooperation with FEMA, every state has appointed an agency that serves as a link between the federal government and communities in the state for developing the national flood insurance program. Those coordinating agencies work with FEMA in distributing program information (refer to paragraph V.C. above).

VII. PROPERTY ELIGIBLE FOR FLOOD INSURANCE

A. Coverage. The national flood insurance program covers improved real estate or mobile homes located, or to be located, in an area that has been identified by the FEMA as having special flood hazards, including:

1. Construction loans for buildings under construction that are walled and roofed.

2. Mobile homes, on or after October 1, 1982, that are affixed to a permanent site (anchored) to resist flotation, collapse, or lateral movement by providing over-the-top and frame ties to ground anchors, unless it is a mobile home on a foundation continuously insured at the same site by the National Flood Insurance Program at least since September 30, 1982.

3. Dealers' inventories of mobile homes on foundations.

4. Condominiums or townhouses that are contiguous to the ground, capable of separate ownership and having legal descriptions.

5. High-rise condominiums with common ownership.

6. Other types of residential, industrial, commercial and agricultural buildings with any walled and roofed structure that is principally above ground and affixed to a permanent site.
B. **Separate Insurance.** Each building is insured separately, as is each mobile home, including those in dealer inventories that are eligible for coverage. Policies for high-rise condominiums are issued to the condominium owners association and policies on individual units are issued to unit owners. Each unit also is eligible for contents coverage on personal property contained within a fully enclosed building.

C. **Personal Property.** Personal property insurance coverage is available for machinery, equipment, fixtures, and furnishings contained in real property or a mobile home.

**VIII. EXEMPTIONS**

A. **Insurance Unavailable.** Types of projects for which flood insurance policies are not available include:

1. Unimproved land, bridges, dams and roads.

2. Mobile homes on or after October 1, 1982, not affixed to a permanent site (anchored) to resist flotation, collapse, or lateral movement by providing over-the-top and frame ties to ground anchor.

3. Travel trailers and campers.

4. Converted buses or vans.

5. Buildings entirely in, on, or over water.

6. Buildings newly constructed or substantially improved on or after October 1, 1983, in an area designated as an undeveloped coastal barrier within the Coastal Barrier Resource System established by the Coastal Barrier Resources Act.

B. **State-owned Property.** Flood insurance is not required on any state-owned property that is covered under an adequate policy of self-insurance satisfactory to FEMA. FEMA publishes and periodically revises the list of states falling within this exemption.

**IX. FLOOD INSURANCE DETERMINATION**

A. **Location of Property.** Financial institutions must determine whether property connected with a loan application is located in a special flood hazard area. If so, the financial institution must also decide whether the property is located in a community that participates in the national flood insurance program.
B. Conditions to Lending in Flood Hazard Area. A financial institution may not make, increase, extend or renew any direct conventional loan secured by improved real estate or a mobile home located in a flood hazard area if all of the following conditions exist:

1. A flood hazard boundary map or a flood insurance rate map has been published for the community in which the property is located;

2. The community in which the area is located participates in the national flood insurance program; and

3. The property is not covered for the entire term of the loan with flood insurance.

C. Nonparticipating Communities. If the community in which the area is located does not participate in the NFIP, the financial institution is generally not restricted in making, increasing, extending or renewing a loan. Banks are not required to have the borrower purchase flood insurance in flood areas of a nonparticipating community, however, prudent banking practices suggest that as a condition to approving the loan, flood insurance should considered to protect the bank's investment.

D. Government Related Loans. Additional requirements, however, are placed on financial institutions for loans insured or guaranteed by an agency of the federal government, such as VA, FHA and SBA. If such loans, secured or unsecured, assist in the construction or acquisition of improved real estate or a mobile home located in a flood-hazard area, they cannot be made if the community in which the flood hazard area is located does not participate in the nation flood insurance program.

E. Personal Property. Flood insurance is required on personal property located in a flood hazard area if a flood hazard boundary map or a flood insurance rate map has been published for the community in which the property is located and either of the following conditions exist:

1. The personal property secures a conventional loan that is also secured by real property or a mobile home required to be covered by flood insurance; or

2. The loan for the property is insured or guaranteed by an agency of the federal government.

Note: Loans for personal property that do not involve federal financial assistance are not subject to flood insurance regardless of where the property is located.
F. Requirement Suspension. Flood insurance requirements for a particular community are altered by the issuance or withdrawal of FEMA's official flood maps. If the FEMA withdraws a flood hazard boundary map for any reason, the insurance purchase requirement is suspended during the period of withdrawal.

X. NOTICE REQUIREMENTS

A. Conditions for Making Notification. When a loan is secured by improved real estate or a mobile home located or to be located in a community that has been identified by the Director of FEMA as an area having special flood hazards, regardless of whether the community is participating or not participating in the national flood insurance program, a financial institution must mail or deliver, no later than 10 days before the closing of a flood-affected loan or the date upon which a commitment to lend is issued, if such commitment is issued less than 10 days before the close of a flood-affected loan, a written notice to the borrower which states:

1. That the property securing the loan is or will be located in a flood hazard area (in lieu of such notification, a financial institution may obtain satisfactory written assurances from a seller or lessor that the borrower has been notified, prior to the execution of any agreement for sale or lease, that the property securing the loan is or will be located in a flood hazard area; and

2. Whether federal disaster relief assistance will be available for such property in the event of damage to the property caused by flooding in a federally-declared disaster area. Whether the community participates in the national flood insurance program will determine if federal disaster relief assistance is available and which notice the borrower will receive.

B. Written Acknowledgement. A financial institution must obtain from the borrower, prior to closing, a written acknowledgement that the property securing the loan is or will be located in a flood hazard area and that the borrower has received the mandatory notice regarding federal disaster relief assistance.

XI. AMOUNT OF FLOOD INSURANCE

A. Extent of Coverage. When flood insurance is required, the policy must cover the amount of the loan or the maximum amount available under the national flood insurance program, whichever is less. When a community participates in the "emergency program" under the national flood insurance
program, the amount of flood insurance available may not cover the amount of a flood related loan since only the first layer coverage is available under the emergency program. In the event the community subsequently enters the "regular program" the financial institution has no obligation to increase the amount of flood insurance required. However, it has the option to do so to protect its investment.

B. Documentation. At the time of loan closing, a copy of the flood insurance application or the FEMA Proof of Purchase Certificate, indicating that the full premium has been paid, is sufficient evidence that application has been made for the purchase of flood insurance.

C. Waiting Period. Flood insurance is subject to the following waiting periods:

1. Transfer of title - the new owner applies for coverage at or before closing and the insurance goes into effect at 12:01 a.m. on the day following application and payment.

2. No transfer of title - the waiting period for flood insurance coverage is five days. Financial institution may close a loan during that waiting period, knowing that the policy is not yet in effect. They should, however, require the borrower to purchase coverage promptly so that the policy becomes effective on or about the date of closing.

D. Renewal Requirements. Flood insurance is written annually, and financial institutions must ensure that the coverage is renewed and maintained for the duration of the loan. If the borrower does not renew the policy, the financial institution may renew it or call the loan assuming the ability to do so is written into the contract. When designated as mortgagee, the financial institution generally receives a copy of the policy and all renewal notices.

E. Construction Loans. The loan closing and lien recording for construction loans may occur before any disbursement of funds. Flood insurance required for those loans need not exceed the amount of the financial institution's total disbursement to date. In those situations, proof of purchase is required only at the time funds are disbursed and not at the time of closing.

F. Limits of Coverage. Limits of coverage under the emergency and regular programs are listed in FEMA's latest publication concerning mandatory flood insurance purchase requirements. In general, the maximum amount of required flood insurance for covered property located in a community
participating in the emergency program is also the maximum amount of available insurance. The maximum amount of required insurance for covered property located in a community participating in the regular program is only twice that required by the emergency program, and is less than the maximum amount of available coverage.

XII. RECORDKEEPING

A. Financial Institutions must maintain sufficient records for each loan to indicate the method used to determine whether improved real estate or a mobile home offered as security for a loan is located in a flood hazard area. Such records may be:

1. Copies of official maps;
2. Written contracts between the institution and the appraiser; and
3. Written statements in each file that indicate that an appraiser has performed the flood check.

B. Institutions should also retain appropriate documents whenever the property securing the loan is in a flood hazard area. Those documents may consist of:

1. Copies of the notices provided to the borrower;
2. The borrower’s written acknowledgement of receipt; and
3. If the purchase requirement applies, a copy of the flood insurance policy. Financial institutions may choose to, but need not, indicate on their records that property securing a particular loan is not in a flood hazard area.

XIII. OTHER ISSUES

A. Other Real Estate Owned. Banks having improved other real estate owned in flood hazard areas should purchase flood insurance coverage.

B. Contract Language. The bank may wish to add sufficient language to its mortgage contract to provide authority to obtain flood insurance and charge it to the consumer when at any time during the term of the mortgage:

1. The property is determined to be located in a special flood hazard area. (Initial determination was wrong or the area has been designated as a special flood hazard area after the loan was closed.)
2. the borrower failed to renew the flood insurance policy.

C. Map Changes By Letters.

1. Purpose. Because of the federal requirement mandating the purchase of flood insurance and because the federal and local regulations governing construction of buildings in special flood hazard areas are important to persons who own or plan to construct buildings, FEMA has developed the map amendment process. Under this process, property owners may request that FEMA determine whether specific buildings or legally described parcels of undeveloped land are or would be in special flood hazard areas and, if necessary, amend the map(s) accordingly.

2. Instruments.

   a. Letter of Map Amendment (LOMA) or Letter of Map Revision (LOMR). These instruments provide a means of administratively removing properties from designated special flood hazard areas.

   b. Conditional LOMAs/LOMRs. These are issued to encourage construction of buildings which will be in compliance with NFIP and local floodplain management regulations.

3. Procedures. A property owner must submit the appropriate request to:

   a. For single lot or single building LOMA requests, submit request to the appropriate FEMA Regional Office.

   b. For multi-lot, and conditional LOMA requests, submit to:

      Federal Emergency Management Agency
      Federal Insurance Administration
      Office of Risk Assessment
      Washington, D.C. 20472

   c. In the case of a request for a single lot or single building LOMR, the request must be submitted by the property owner through the community to the appropriate FEMA Regional Office.

   d. Multi-lot and condition LOMR requests must be submitted by the property owner through the community to FEMA at the same address listed under "b" above.
FEMA will evaluate the data and, providing the conditions are met, will issue a LOMA or LOMR to the property owner. The process will take approximately eight weeks.

If FEMA issues a LOMA or LOMR and the lending institution waives the flood insurance requirement, the property owner may request a refund of the premium. To obtain a refund of premium, the borrower should submit a Certification of Redetermination signed by the lender to his/her agent or broker of record so that the agent can submit the cancellation request form with the Certification of Redetermination to the NFIP or WYO company for any eligible refund of premium. If a claim is pending or has been paid to the borrow during the current policy term, no refund will be given.

4. Lenders' Responsibilities.

a. The lender must require flood insurance as a condition of the mortgage if the effective map indicates the property is in a special flood hazard area of a participating community. Should the borrower believe this determination is incorrect, he or she may request a LOMA/LOMR.

b. It is the lender's prerogative to require flood insurance even though the property is determined not to be in a special flood hazard area. Before the borrower request a LOMA or LOMR, the lender should inform the borrow whether or not the flood insurance requirement will be waived if the LOMA/LOMR is issued.

c. It is the borrower's prerogative to apply for a LOMA/LOMR even if the lender will not waive the flood insurance requirement. Should a LOMA/LOMR be granted, the borrower's rates will be calculated using the lowest rates available based on the redetermination.

d. A copy of the LOMA/LOMR and the lender's signed waiver should be maintained in the loan file.

e. Lenders must examine all files reflecting waived insurance purchase requirements based on FEMA-issued LOMAs/LOMRs whenever the maps used for such determinations are revised. New determinations must be made as to whether the mandatory flood insurance requirements must be reimposed.
f. If a "Conditional" LOMA/LOMR has been issued, the lender has a continuing responsibility to confirm the issuance of the LOMA/LOMR upon completion of the building’s construction before waiving the flood insurance requirement. After construction the lender has the option of requiring flood insurance.

D. Redeterminations.

1. Basis for Redetermination.

a. An entire map or individual map panel may be revised because of:
   i. inaccuracies in the earlier map;
   ii. construction of flood control projects or other changes in a community that alters the floodplain boundaries; or
   iii. jurisdictional changes, etc.

b. A specific property that was located in a special flood hazard area at the time the mortgage was closed may no longer be in a special flood hazard area as a result of a map revision.

2. Procedures for Redetermination.

a. To obtain a refund of premium, the borrower should obtain a statement from the lender (or have the lender complete a FEMA Certification of Redetermination) stating that:
   i. the borrower was required to purchase and/or maintain flood insurance as a condition for federal or federally related financial assistance;
   ii. the property was located in an identified special flood hazard area as shown on the FHBM or FIRM in effect on the date the mortgage was closed;
   iii. the latest revised FHBM or FIRM excludes the property from a special flood hazard area; and
   iv. the lender now waives the mandatory flood insurance requirement.
b. If no claim under the policy has been paid or is pending during the current policy year, the borrower may request a full premium refund for the current policy year and for an additional policy year where the borrower had been required to renew the policy during the period when a revised may was being reprinted.

c. The borrower must contact the insurance agent or broker of record to request cancellation of the policy.

d. The insurance agent must submit the appropriate cancellation, with the lender's written redetermination attached, to the NFIP or the WYO company.

e. If the borrower has filed a claim for a flood loss or has been reimbursed for a flood loss during the current policy year, there will be no premium refund.

3. Lenders' Role.

a. The lender is under no obligation to release the borrower from the mandatory flood insurance requirement. The lending institution may have flood insurance requirements more stringent than the federal requirements. If the property has the suffered flood damage in the past, the lender would be wise to require continued coverage.

b. A copy of the Cancellation of Redetermination should be kept in the loan file.

XIV. SUMMARY OF NATIONAL FLOOD INSURANCE REFORM ACT OF 1994

Given the increased attention focused on this issue due to major flooding disasters in the Midwest and Southeast, as well as Hurricanes Hugo, Bob and Andrew, no bank can afford to be in noncompliance with any aspect of this Act. Though many of the provisions contained in this law reflect the existing flood insurance law, the new law is designed to increase compliance with the program. The following is a summary of key points you should know:

B. Coverage. Regulated lending institutions such as banks, savings and loans, credit unions, farm credit banks and federal land bank associations must comply. Others, such as mortgage bankers, are not directly covered. However, such lenders must comply with the flood requirements of FNMA and FHLMC, thus indirectly having to comply. Language contained in Section 522 requires that the secondary real estate market enforce flood insurance requirements.

C. Scope. Compliance is essential whenever a regulated lender makes, increases, extends or renews a loan secured by improved real estate or a mobile home. This will entail responsibility for performing a determination as to whether a property is located in a special flood hazard area. Obviously, if it is determined that the property is in a flood zone, it will be necessary to secure flood insurance for the outstanding principal for the full term of the loan.

D. Prior Determinations. Lenders may rely on a previous flood determination if it is not more than seven years old and is documented on the new Standard Hazard Determination Form, unless a remapping has occurred on that property. The new standard form must be established by regulation no later than July 1995 and lenders will be required to use the form by January 16, 1996.

E. New Escrow Requirement. An escrow must be established for flood insurance payments only if an escrow is established on the loan for other purposes such as taxes, insurance premiums or other fees. If the loan is serviced by a third party, the servicer must maintain the escrow account. Escrow accounts are subject to the provisions of Section 10 of the Real Estate Settlement Procedures Act of 1974 and its promulgating rule, Regulation X, 24 CFR 3500.17. The effective date for the escrow requirement is September 23, 1995.

F. Force placement of flood insurance. At origination or any other time during the term of the loan, the lender or servicer determines that flood insurance is required but the borrower has failed to voluntarily purchase the required coverage, the lender or servicer may purchase the insurance on behalf of the borrower and charge the borrower for the cost of premiums and fees. This incorporates a 45 day notification to the borrower to give them an opportunity to purchase the coverage voluntarily. Effective immediately upon enactment of the new law.

G. Exemption Created. Section 522 creates a new exemption for loans having both an original outstanding principal balance of $5,000 or less and a repayment term of one year or less.
H. Contested Determinations. The borrower and lender may jointly request FEMA to review the determination, supported by technical data. FEMA is required to respond in writing within 45 days of receiving a request. If FEMA does not respond within that time or by loan closing, the lender is not obligated to require flood insurance until such letter is provided.

I. Fees for Flood Determination. Any lender or servicer may charge a reasonable fee for a flood determination when making, increasing, extending or renewing a loan; or for a determination made pursuant to a flood remapping or revision of special flood hazard areas which involves the property; or results in the purchase of flood insurance because the lender is required to force-place insurance. Should the loan be transferred or purchased, the fee may be charged to the purchaser or the transferee.

J. Notice Requirement. Lenders are required to notify the borrower, if the improved property securing the loan is in a special flood hazard area, a reasonable time prior to closing and retain a record of the receipt of the notice. Furthermore, the notice must include a warning stating that the building or mobile home is located on land which is a special flood hazard area; and, a description of the flood insurance purchase requirements; a statement that flood insurance coverage may be purchased under NFIP and is also available from private insurers.

In addition, lenders must also notify FEMA of the identity of the servicer of any loan governed by NFIP. If the servicer changes, FEMA must be notified of this within 60 days of the change. This information will enable FEMA to notify servicers and lenders of the pending expiration of flood insurance coverage. Such notification must be issued by FEMA not later than 45 days before expiration of the flood insurance.

K. Examinations. Banks will be examined for flood insurance compliance by the appropriate bank regulator during regular on-site examinations.

L. Remappings. FEMA is required to publish a compendium of all flood zone remappings and LOMAs and LOMRs every six months and make this available, at cost, to lenders.

M. Penalties. The law establishes penalties for lenders, and establishes a four year statute of limitations for violations. Penalties can range from $350 per loan, up to $100,000 annually for an individual institution if a regulator determines that a pattern or practice of abuse has occurred and the lender has not voluntarily taken steps to improve compliance. Furthermore, where loans are transferred, the transferee is not liable for civil money penalties on account of violations resulting from actions of the transferor -- the transferor remains liable.
N. **Portfolio Review.** Provisions contained in previous versions of this legislation requiring lenders to review all existing loans for proper flood determinations and insurance compliance were dropped. Also, a provision requiring new flood determinations on loans sold or transferred that were five years or older was dropped from the final version of this legislation.

O. **Coverage Limits.** New flood insurance coverage limits were addressed in the new legislation. The following table contains the old and new coverage limits which are effective March 1, 1995:

<table>
<thead>
<tr>
<th></th>
<th>Emergency Program (unchanged)</th>
<th>Regular Program (old)</th>
<th>New Coverage Limits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Building</strong></td>
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<td></td>
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<tr>
<td>Single Family</td>
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<td>$185,000</td>
<td>$250,000</td>
</tr>
<tr>
<td>Other Residential</td>
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<td>250,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Nonresidential</td>
<td>100,000</td>
<td>200,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Small Business</td>
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<td>250,000</td>
<td>500,000</td>
</tr>
<tr>
<td><strong>Contents</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Residential</td>
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</tr>
<tr>
<td>Nonresidential</td>
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<tr>
<td>Small Business</td>
<td>100,000</td>
<td>300,000</td>
<td>500,000</td>
</tr>
</tbody>
</table>
To: Chief Executive Officers and Compliance Officers of National Banks, Department and Division Heads, and all Examining Personnel

Attached is a copy of the National Flood Insurance Reform Act, which was enacted on September 23, 1994. The act encompasses a wide range of issues, such as notice requirements, a new Standard Hazard Determination form, expanded coverage, civil money penalties, forced placement, escrowing, fees, etc. The narrative that follows gives a brief overview of the provisions of particular interest to national banks, and the anticipated effective date as it applies to federally regulated lenders.

SECTION 522 - EXPANDED FLOOD INSURANCE PURCHASE REQUIREMENTS
Lenders are obligated to require purchase of flood insurance at origination or at any time during the life of the loan. Effective upon enactment but existing regulations continue to apply until the new regulations are issued.

SECTION 523 - ESCROW OF FLOOD INSURANCE PAYMENTS
Requires escrowing flood insurance premiums if there is an existing escrow account. Applies to any loans made, increased, extended, or renewed one year after enactment.

SECTION 524 - PLACEMENT OF FLOOD INSURANCE BY LENDERS
Provides lenders the authority to forceably place flood insurance if the borrower has failed to purchase the insurance 45 days after being notified by the lender to do so. This section applies to all loans outstanding on or after the date of enactment.

SECTION 525 - PENALTIES FOR FAILURE TO REQUIRE FLOOD INSURANCE OR NOTIFY
The penalty for a pattern or practice of noncompliance is not to exceed $350 per loan, up to $100,000 per calendar year for any single lending institution. This section is effective upon enactment.

SECTION 526 - FEES FOR DETERMINING APPLICABILITY OF FLOOD INSURANCE PURCHASE REQUIREMENTS
Allows a lender to charge the borrower a "reasonable" fee for making a determination that flood insurance is required. Effective upon enactment.
Comptroller of the Currency
Administrator of National Banks

Subject: Flood Insurance  Description: National Flood Insurance Reform Act

SECTION 527 - NOTICE REQUIREMENTS
Requires the banking agencies to develop a regulation requiring federally regulated lenders to provide written notice of flood hazards before agreements or other documents are signed. Until new regulations are issued, the OCC will continue to enforce the current regulation.

SECTION 528 - STANDARD HAZARD DETERMINATION FORMS
FEMA, in consultation with the federal banking agencies, must develop a regulation, within nine months after enactment, requiring use of a standard formula to determine whether improved property is located in a special flood hazard area. The regulation will be effective six months after promulgation.

SECTION 529 - EXAMINATION REGARDING COMPLIANCE
The law requires that the appropriate federal banking agency assess compliance with the national flood insurance program during each scheduled on-site examination that is required by law to be performed annually or, in some cases, every 18 months. Effective upon enactment.

SECTION 573 - MAXIMUM FLOOD INSURANCE COVERAGE AMOUNTS
Increases coverage limit for residential property to $250,000 for structures and $100,000 for contents. For non-residential property, $500,000 for structures and $500,000 for contents. FEMA has indicated that they intend to issue guidelines effective March 1, 1995 to implement this section.

Stephen M. Cross
Deputy Comptroller for Compliance Management

Date: December 7, 1994
NATIONAL FLOOD INSURANCE REFORM ACT OF 1994:

Congressional Record - House
August 2, 1994
U.S.C. 4106(b) is amended by striking "Federal instrumentalities described in this subsection shall by regulation require the institutions" and inserting "Federal entity for lending regulation shall by regulation require the regulated lending institutions described in this subsection, and each Federal agency lender shall issue regulations requiring the Federal agency lender.".

SEC. 511. NATIONAL FLOOD INSURANCE ACT OF 1968

(a) In General.—Section 130(a) of the National Flood Insurance Act of 1968 (42 U.S.C. 4031(a)) is amended—

(1) in paragraph (5), by striking "and" at the end;

(2) in paragraph (6), by striking the period at the end and inserting a semicolon;

(3) by inserting after paragraph (6) the following new paragraphs:

"(7) the term "repetitive loss structure" means a structure covered by a contract for flood insurance under this title that has incurred flood-related damage on 2 occasions during a 10-year period ending on the date of the enactment of this Act for which a second claim is made, in which the cost of repair, on the average, or exceeded 25 percent of the value of the structure at the time of each such flood;

"(8) the term "Federal agency lender" means a Federal agency that makes direct loans secured by improved real estate or a mobile home, to the extent such agency acts in such capacity;

"(9) the term "Federal entity for lending regulation" means the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, and the Farm Credit Administration, and with respect to a particular regulated lending institution means the entity primarily responsible for the supervision of the institution;"

(b) In General.—Section 130(a) of the National Flood Insurance Act of 1968 (42 U.S.C. 4031(a)) is amended—

(1) in paragraph (5), by striking "and" at the end;

(2) in paragraph (6), by striking the period at the end and inserting a semicolon;

(3) by inserting after paragraph (6) the following new paragraphs:

"(7) the term "repetitive loss structure" means a structure covered by a contract for flood insurance under this title that has incurred flood-related damage on 2 occasions during a 10-year period ending on the date of the enactment of this Act for which a second claim is made, in which the cost of repair, on the average, or exceeded 25 percent of the value of the structure at the time of each such flood;

"(8) the term "Federal agency lender" means a Federal agency that makes direct loans secured by improved real estate or a mobile home, to the extent such agency acts in such capacity;

"(9) the term "Federal entity for lending regulation" means the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Office of Thrift Supervision, the National Credit Union Administration, and the Farm Credit Administration, and with respect to a particular regulated lending institution means the entity primarily responsible for the supervision of the institution;"

U.S.C. 5124(b) is amended by adding at the end the following new subsection:

"The requirements of this subsection may not be waived under section 301.".

SEC. 512. EXPANDED FLOOD INSURANCE PURCHASE REQUIREMENTS

(a) In General.—Section 102(b) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 5112(b)) is amended to read—

"(6) REQUIREMENT FOR MORTGAGE LOANS.—

"(1) REGULATED LENDING INSTITUTIONS.—Each Federal entity for lending regulation (after consultation and coordination with the National Credit Union Administration) shall, in addition to the requirements of paragraph (5), require that any loan secured by improved real estate or a mobile home located or to be located in an area that has been identified by the Director as a special flood hazard shall be made by a lender approved by the Director as a regulated lending institution unless the building or mobile home and any personal property securing such loan is covered by flood insurance in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage made available under the Act with respect to the particular area to which the loan relates.

"(2) FEDERAL AGENCY LENDERS.—A Federal agency lender may not make, increase, extend, renew, or any loan secured by improved real estate or a mobile home located or to be located in an area that has been identified by the Director as a special flood hazard unless the building or mobile home and any personal property securing such loan is covered by flood insurance in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage made available under the Act with respect to the particular area to which the loan relates.

"(3) GOVERNMENT-SUPPORTED ENTERPRISES FOR HOUSING.—The Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation shall ensure that any loan secured by improved real estate or a mobile home located or to be located in a special flood hazard area is covered by flood insurance in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage made available under the Act with respect to the particular area to which the loan relates.

"(4) PURCHASED BY SUCH ENTITY.—Any loan insured or guaranteed by any agency, instrumentality, or any other entity or organization described in paragraph (1), (2), or (3) shall be made only by an entity or organization described in paragraph (1), (2), or (3) in the absence of reasonable assurance that the entity or organization described in paragraph (1), (2), or (3) is reasonably designed to ensure that, for any loan that—

"(A) is secured by improved real estate or a mobile home located or to be located in an area that has been identified, at the time of the issuance of the loan, as a special flood hazard area or as an area having special flood risk and in which flood insurance is available under the National Flood Insurance Act of 1968, and

"(B) is purchased by such entity, the building or mobile home and any personal property securing the loan is covered for the term of the loan by flood insurance in an amount as required in paragraph (1), (2), or (3)."

"(A) EXISTING COVERAGE.—Except as provided in subparagraph (B), paragraphs (1) and (2) do not apply to any loan made, increased, extended, or renewed prior to the expiration of the 1-year period beginning on the date of enactment of the Flood Disaster Protection and Emergency Assistance Act of 1994.

"(B) NEW COVERAGE.—Paragraphs (2) and (3) shall apply only with respect to any loan made, increased, extended, or renewed after the expiration of the 1-year period beginning on the date of enactment of the Flood Disaster Protection and Emergency Assistance Act of 1994.

"(C) CONTINUED EFFECT OF REGULATIONS.—Notwithstanding any other provision of this subsection, the regulations to carry out para-
CONGRESSIONAL RECORD—HOUSE H6669

August 2, 1994

Section 102(c) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 402a(c)) is amended—

(1) to add the following new subsection:

"(4) ESCROW OF FLOOD INSURANCE PAYMENTS.—

"(a) A regulated lending institution or other servicer of the loan shall require that a borrower, and a new appraiser shall be required to test at the time of loan under the loan that the bo-""

"(2) Enforcement of section 102(c) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 402a(c)) is amended—

(1) to add the following new subsection:

"(2) Placement of Flood Insurance by Lenders.—

"(3) EFFECT OF SMALL LOANS.—Section 102(c) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 402a(c)) is amended—

"(c) Placement of Flood Insurance by Lenders.—

"(d) CIVIL MONETARY PENALTIES FOR FAILURE TO REQUIRE FLOOD INSURANCE OR NOTIFY.—

"(E) Making, increasing, extending, or renew-""

"(A) making, increasing, extending, or renew-""

"(C) Effect of Transfer on Liability.—Any sale or other transfer of a loan by a regulated lending institution that has committed a violation under paragraph (1), that occurs subsequent to the violation, shall not affect the liabil-""

"(D) DEPOSIT OF PENALTIES.—Any penalties collected under this subsection shall be paid into the National Flood Mitigation Fund under section 1307 of the National Flood Insurance Act of 1968.

"(E) ADDITIONAL PENALTIES.—Any penalties under this subsection shall be in addition to any civil remedy or criminal penalty otherwise available.

"(F) Statute of Limitations.—No penalty may be imposed under this subsection more than 5 years after the date of the occurrence of the violation for which the penalty is authorized.

"(G) Other Actions to Remedy Pattern of Noncompliance.—

"(H) Authority of Federal Entities for Lending Regulation.—A Federal entity for
Section 102 of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4012a) as amended by the provisions of the Flood Disaster Protection Act of 1988 (42 U.S.C. 4013a and 4013b) and the Flood Disaster Protection Act of 1992 (42 U.S.C. 4013c) requires that the building or mobile home be located in an area identified by the Director as an area having special flood hazards and in which flood insurance coverage is required by the Federal government for the property. For the purposes of this section, "flood insurance coverage is required" means that the Director has determined that flood insurance is required and the property owner is required to obtain flood insurance. This determination shall be made in accordance with the provisions of the Flood Disaster Protection Act of 1973 and its amendments. The determination shall be based on a survey of the area and the issuance of a certificate of occupancy by the local government. The determination shall be made in accordance with the provisions of the Flood Disaster Protection Act of 1973 and its amendments. In making the determination, the Director shall consider all relevant factors, including the location of the property, the type of structure, the construction materials, and the floodplain characteristics. The determination shall be issued in a form that is acceptable to the Federal government and is consistent with the provisions of the Flood Disaster Protection Act of 1973 and its amendments. If the determination is not made in accordance with the provisions of the Flood Disaster Protection Act of 1973 and its amendments, the Federal government shall not be required to provide flood insurance coverage for the property.
dates affecting such property occurred and such
recovery of the hazard have occurred after such
previous determination.

"(1) EFFECTIVE DATE.—The regulations under
this section requiring use of the form established
pursuant to section 102(3)(C) of the Flood Disaster
Protection Act of 1973 are adequate and being complied with,
and (B) every examination, as determined necessary by the
Director, to determine the compliance of the enter-
prises listed in section 102(3) of such Act, which shall include a
description of the methods used to determine compliance and
the types and sources of deficiencies (if any), and
identifying the action that has been taken to remedy any such deficiencies,
extcept that the information described in this
paragraph shall be included only in each of the
first, third, and fifth paragraphs under this section
required to be submitted after the expiration
of the 1-year period beginning on the
date of enactment of the Riegle Community
Improvement Act of 1994.

SEC. 530. FINANCIAL INSTITUTIONS' EXAMINA-
TIONS.

Section 1006 of the Federal Financial Institu-
tions Examination Council Act of 1978 (12 U.S.C. 365) is amended by
adding the following new subsection:

"(g) FLOOD INSURANCE.—The Council shall consult
with and assist the Federal entities for
mortgage lending, as such term is defined
in section 1100d of the National Flood Insurance
Act of 1968, in developing and coordinating
uniform standards and requirements for use by
regulated lenders under the national flood insurance program.

SEC. 531. CLERICAL AMENDMENT.

Section 102 of the Flood Disaster Protection
Act of 1973 (42 U.S.C. 4013a) is amended by
striking the section heading and inserting the
following new section heading:

"FLOOD INSURANCE PURCHASE AND COMPLIANCE
REGULATIONS: REQUIREMENTS".

Subtitle C—Ratings and Incentives for
Community Floodplain Management Programs

SEC. 541. COMMUNITY RATING SYSTEM AND IN-
CENTIVES FOR COMMUNITY FLOOD-
PLAIN MANAGEMENT.

Section 1315 of the National Flood Insurance
Act of 1968 (42 U.S.C. 4021) is amended—

"(1) by striking "After December" and insert-
ing the following:

"(a) REQUIREMENT FOR PARTICIPATION IN
FLOOD INSURANCE PURCHASE AND COMPLIANCE
PROGRAMS: REQUIREMENTS.

"(1) IN GENERAL.—After December; and

(2) by adding at the end the following
new subsection:

"(b) COMMUNITY RATING SYSTEM AND INCEN-
TIVES FOR COMMUNITY FLOODPLAIN
MANAGEMENT.

"(1) AUTHORITY AND GOALS.—The Director
shall carry out a community rating system pro-
gram under which communities participate vol-
munarily—

"(A) to provide incentives for measures that
reduce the risk of flood or erosion damage that
exceed the criteria set forth in section 1361 and
establish such measures.

"(B) to encourage adoption of more effective
measures that protect natural and beneficial
floodplain functions;

"(C) to encourage floodplain and erosion
management; and

"(D) to promote the reduction of Federal flood
insurance losses.

"(2) INCENTIVES.—The program shall provide
incentives in the form of credits on premium
rates for flood insurance coverage in commu-
nities that the Director determines have adopted
and enforced measures that reduce the risk of flood and erosion damage that exceed the cri-
teria set forth in section 1361 and
establishing such incentives under this paragraph, the Director may
provide for credits to flood insurance premium
rates in communities that the Director deter-
mines have adopted and enforced measures that protect
natural and beneficial floodplain functions.

"(3) CREDITS.—The credits on premium rates
for flood insurance coverage shall be based on
the estimated reduction in flood and erosion
damage risks resulting from the measures adopt-
ed by the community under this program. If a
community has received credits under section 1366, the credits shall be phased in
a manner determined by the Director, to recover
the amount of such assistance provided for the community.

"(4) REPORTS.—Not later than 2 years after the
date of enactment of the Riegle Community
Development and Regulatory Improvement
Act of 1994 and not less than every 2 years there-
after, the Director shall submit a report to the
Congress regarding the program under this sub-
section. Such report shall
address the cost-effectiveness of the program, any other
accomplishments or shortcomings of the pro-
gram, and any recommendations of the Director
for legislation regarding the program.

SEC. 542. FUNDING.

Section 1310(a) of the National Flood
Insurance Act of 1968 (42 U.S.C. 4017(a) is amended—

(1) in paragraphs (4), by striking "and" at the end;

(2) in paragraphs (5), by striking the period at the end
and inserting a semicolon;

and (3) by adding after paragraph (5) the following
new paragraph:

"(6) for carrying out the program under sec-
section 1315(b):

Subtitle D—Mitigation of Flood Risks

SEC. 551. REPEAL OF FLOODED PROPERTY PUR-
CHASE AND LOAN PROGRAM.

(a) REPEAL.—Section 1362 of the National
Flood Insurance Act of 1968 (42 U.S.C. 4102) is hereby
repealed.

(b) TRANSITION PHASE.—Notwithstanding sub-
section (a), during the 1-year period following
the date of enactment of this Act, the Direc-
tor of the Federal Emergency Management
Agency may enter into loan and purchase com-
mitments as provided under section 1362 of the
National Flood Insurance Act of 1968 (as in ef-
fact immediately before the enactment of this
Act).

(c) SAVINGS.—Provision notwithstanding sub-
section (a), the Director shall take any ac-
tion necessary to comply with any purchase or
loan commitment entered into before the ex-
piration of the period referred to in subsection (b)
pursuant to authority under section 1362 of the
National Flood Insurance Act of 1968 (as in ef-
fact immediately before the enactment of this
Act).

SEC. 552. TERMINATION OF EROSION-TERRA-
TURED LAND PROTECTION PROGRAM.

(a) IN GENERAL.—Section 1306 of the National
Flood Insurance Act of 1968 (42 U.S.C. 4013) is amended by
striking subsection (c),

(b) TRANSITION PHASE.—Notwithstanding sub-
section (a), during the 1-year period beginning on the
date of enactment of this Act, the Direc-
tor of the Federal Emergency Management
Agency may pay amounts under flood insurance
contracts for demolition or relocation of struc-
tures as provided in section 1306(c) of the Na-
tional Flood Insurance Act of 1968 for effect
immediately before the enactment of this
Act.

(c) SAVINGS.—Provision notwithstanding sub-
section (a), the Director may take any action
necessary to make payments under flood
insurance contracts pursuant to any commitments
made before the expiration of the period referred to
in subsection (b) pursuant to the authority under section 1306(c) of the National
Flood Insurance Act of 1968 (as of effect
immediately before the enactment of this
Act).

Sec. 563. FLOOD MITIGATION ASSISTANCE PROGRAM.

(a) IN GENERAL.—Chapter III of the National
Flood Insurance Act of 1968 (42 U.S.C. 4011 et seq.), as amended by the preceding
provisions of this Act, is further amended by adding at the end the following new section:

(E - 28)
"MITIGATION ASSISTANCE

"SEC. 1366. (a) AUTHORITY.—The Director shall carry out a program to provide financial assistance to States and communities, using amounts allocated to the National Flood Mitigation Fund under section 1367, for planning and carrying out activities designed to reduce the flood hazard or improve flood risk management and to carry out activities described in a mitigation plan submitted under subsection (c).

"(b) ELIGIBLE MITIGATION ACTIVITIES.—(1) USE OF AMOUNTS.—Amounts provided under this section may be used for activities described in paragraphs (2) through (5) and to carry out any other activities that are necessary to implement the National Flood Mitigation Fund.

"SEC. 1367. (a) ESTABLISHMENT AND AVAILABILITY.—The Director shall establish in the Treasury of the United States a fund to be known as the National Flood Mitigation Fund, which shall be credited with amounts described in subsection (b) and shall be available, to the extent provided in appropriations Acts, for providing assistance under section 1366.

"(b) CREDITS.—The National Flood Mitigation Fund shall be credited with—

"(1) any interest credited to the National Flood Insurance Fund, in amounts not exceeding—
MEMBERSHIP.—(1) In general.—The Task Force shall be composed of 10 members, who shall be the designees of:
   (A) The Federal Insurance Administrator;
   (B) The Federal Housing Commissioner;
   (C) The Secretary of Veterans Affairs;
   (D) The Administrator of the Farmers Home Administration;
   (E) The Administrator of the Small Business Administration;
   (F) The Chairman of the Board of Directors of the Farm Credit Administration;
   (G) A designee of the Financial Institutions Examination Council;
   (H) The Director of the Office of Federal Housing Enterprise Oversight;
   (I) The chairman of the Board of Directors of the Federal Home Loan Mortgage Corporation;

QUALIFICATIONS.—Members of the Task Force shall be qualified by reason of demonstrated knowledge and competence regarding the national flood insurance program.

DUTIES.—The Task Force shall carry out the following duties:

(1) RECOMMENDATIONS OF STANDARDIZED ENFORCEMENT PROCEDURES.—Make recommendations to the heads of Federal agencies and enterprises referred to under subsection (b)(1) regarding establishment or adoption of standardized enforcement procedures among such agencies and enterprises responsible for enforcing compliance with the requirements under the national flood insurance program to ensure fullest possible compliance with such requirements.

(2) STUDY OF COMPLIANCE ASSISTANCE.—Conduct a study of the extent to which Federal agencies and the secondary mortgage market can provide assistance in ensuring compliance with the requirements under the national flood insurance program and submit to the Congress a report describing the study and any conclusions.

(3) STUDY OF COMPLIANCE MODEL.—Conduct a study of the extent to which existing programs of Federal agencies and corporations for compliance with the requirements under the national flood insurance program can serve as a model for other agencies responsible for enforcing compliance, and submit to the Congress a report describing the study and any conclusions.

(4) RECOMMENDATIONS FOR ENFORCEMENT AND COMPLIANCE PROCEDURES.—Develop recommendations regarding enforcement and compliance procedures and study and comment on the findings of the Task Force, and publish such recommendations.

STUDY OF DETERMINATION FEES.—Conduct a study of—

(A) the reasonableness of fees charged pursuant to 101(h) of the Flood Disaster Protection Act of 1973 for costs of determining whether the property securing a loan is located in an area having special flood hazards; and

(B) whether the fees charged pursuant to such section by lending institutions or greater than the amounts paid by such lenders and servicers to persons actually conducting such determinations and the extent to which the fees exceed such amounts.

NONCOMPLIANCE.—Members of the Task Force shall receive no additional pay by reason of their service on the Task Force.

CHAIRPERSON.—The members of the Task Force shall elect one member as chairperson of the Task Force.

MEETINGS AND ACTION.—The Task Force shall meet at the call of the chairperson or a majority of the members of the Task Force and may take action by a vote of the majority of the members. The Federal Insurance Administrator shall coordinate and call the initial meeting of the Task Force.

OFFICERS.—The chairperson of the Task Force may appoint any officers to carry out the duties of the Task Force under subsection (c).

STAFF OF FEDERAL AGENCIES.—Upon request of the chairperson of the Task Force, the head of any of the Federal agencies and entities referred to under subsection (b)(1) may detail, on a nonreimbursable basis, any of the personnel of such agency to the Task Force to assist the Task Force in carrying out its duties under this section.

Powers.—In carrying out this section, the Task Force may hold hearings, sit and act at times and places, take evidence and assistance, provide information, and conduct research as the Task Force considers appropriate.

The Task Force shall terminate upon the expiration of the 2-year period beginning upon the designation of the last member to be designated under subsection (b)(1).

SUSPENSION OF EFFECTIVE DATE.—Sections 1311(a) and 1312(a) of the National Flood Insurance Act of 1968 (42 U.S.C. 4011(a) and 4012(a)) are amended—

(A) to redesignate subsection (b) as subsection (c); and

(B) by inserting after paragraph (a) the following new paragraph:

"(b) ADDITIONAL COVERAGE.—The national flood insurance program established pursuant to subsection (a) shall enable the purchase of an additional policy to cover the cost of compliance with land use and control measures established under section 1361 for—"

"(1) properties that are repetitive loss structures;

(2) properties that have flood damage in which the cost of repairs equals or exceeds 50 percent of the value of the structure at the time of the flood event; and

(3) properties that have sustained flood damage on multiple occasions, if the Director determines that it is cost-effective and in the best interests of the National Flood Insurance Fund to require compliance with the land use and control measures.

The Director shall impose a surcharge on each insured of not more than $15 per policy to provide cost of compliance coverage in accordance with the provisions of this subsection.

APPLICABILITY.—The provisions of subsection (a) shall apply only to properties that sustain flood-related damage after the date of enactment of this Act.

Subtitle E—Task Forces SEC. 561. FLOOD INSURANCE INTERAGENCY TASK FORCE.

(a) ESTABLISHMENT.—There is hereby established an interagency task force to be known as the Flood Insurance Task Force (in this section referred to as the "Task Force").

(b) MEMBERSHIP.—(1) In general.—The Task Force shall be composed of 10 members, who shall be the designees of—

(A) the Secretary of Housing and Urban Development;

(B) the Secretary of the Interior;

(C) the Administrator of the Small Business Administration;

(D) the Chairman of the Board of Directors of the Farm Credit Administration;

(E) the Director of the Office of Federal Housing Enterprise Oversight;

(F) the chairman of the Board of Directors of the Federal Home Loan Mortgage Corporation; and

(G) the chairman of the Board of Directors of the Federal National Mortgage Association.

QUALIFICATIONS.—Members of the Task Force shall be qualified by reason of demonstrated knowledge and competence regarding the national flood insurance program.

DUTIES.—The Task Force shall carry out the following duties:

(1) RECOMMENDATIONS OF STANDARDIZED ENFORCEMENT PROCEDURES.—Make recommendations to the heads of Federal agencies and enterprises referred to under subsection (b)(1) regarding establishment or adoption of standardized enforcement procedures among such agencies and enterprises responsible for enforcing compliance with the requirements under the national flood insurance program to ensure fullest possible compliance with such requirements.

(2) STUDY OF COMPLIANCE ASSISTANCE.—Conduct a study of the extent to which Federal agencies and the secondary mortgage market can provide assistance in ensuring compliance with the requirements under the national flood insurance program and submit to the Congress a report describing the study and any conclusions.

(3) STUDY OF COMPLIANCE MODEL.—Conduct a study of the extent to which existing programs of Federal agencies and corporations for compliance with the requirements under the national flood insurance program can serve as a model for other agencies responsible for enforcing compliance, and submit to the Congress a report describing the study and any conclusions.

(4) RECOMMENDATIONS FOR ENFORCEMENT AND COMPLIANCE PROCEDURES.—Develop recommendations regarding enforcement and compliance procedures and study and comment on the findings of the Task Force, and publish such recommendations.

STUDY OF DETERMINATION FEES.—Conduct a study of—

(A) the reasonableness of fees charged pursuant to 101(h) of the Flood Disaster Protection Act of 1973 for costs of determining whether the property securing a loan is located in an area having special flood hazards; and

(B) whether the fees charged pursuant to such section by lending institutions or greater than the amounts paid by such lenders and servicers to persons actually conducting such determinations and the extent to which the fees exceed such amounts.

NONCOMPLIANCE.—Members of the Task Force shall receive no additional pay by reason of their service on the Task Force.

CHAIRPERSON.—The members of the Task Force shall elect one member as chairperson of the Task Force.

MEETINGS AND ACTION.—The Task Force shall meet at the call of the chairperson or a majority of the members of the Task Force and may take action by a vote of the majority of the members. The Federal Insurance Administrator shall coordinate and call the initial meeting of the Task Force.

OFFICERS.—The chairperson of the Task Force may appoint any officers to carry out the duties of the Task Force under subsection (c).

STAFF OF FEDERAL AGENCIES.—Upon request of the chairperson of the Task Force, the head of any of the Federal agencies and entities referred to under subsection (b)(1) may detail, on a nonreimbursable basis, any of the personnel of such agency to the Task Force to assist the Task Force in carrying out its duties under this section.

Powers.—In carrying out this section, the Task Force may hold hearings, sit and act at times and places, take evidence and assistance, provide information, and conduct research as the Task Force considers appropriate.

The Task Force shall terminate upon the expiration of the 24-month period beginning upon the designation of the last member to be designated under subsection (b).
SEC. 575. UPDATING OF FLOOD MAPS.
Section 1360 of the National Flood Insurance Act of 1968 (42 U.S.C. 4010) is amended by adding at the end the following new subsection:

"(f) UPDATING FLOOD MAPS.—The Director shall revise and update any floodplain maps or flood-risk areas under the National Flood Insurance Program to reflect any changes in elevations or improvements or changes of a similar nature which, in the Director's judgment, significantly reduce the flood risk to property included on such maps or areas.

SEC. 576. TECHNICAL MAPPING ADVISORY COUNCIL.
(a) ESTABLISHMENT.—There is established a council to be known as the Technical Mapping Advisory Council (in this section referred to as the "Council").

(b) MEMBERSHIP.—The Council shall consist of the Director of the Federal Emergency Management Agency (in this section referred to as the "Director") or the designee of the Director, and 10 additional members to be appointed by the Director or the designee of the Director, who shall be:

(A) the Under Secretary of Commerce for Oceans and Atmosphere (or his or her designee);
(B) a member of recognized surveying and mapping professional associations and organizations;
(C) a member of recognized professional engineering associations and organizations;
(D) a member of recognized professional associations or organizations representing flood hazard and flood risk determination firms;
(E) a representative of the United States Geological Survey;
(F) a representative of State geologic survey programs;
(G) a representative of State national flood insurance coordination offices;
(H) a representative of a regulated lending institution;
(I) a representative of the Federal Home Loan Mortgage Corporation;

(c) QUALIFICATIONS.—Members of the Council shall be appointed based on their demonstrated knowledge and competence regarding surveying, cartography, remote sensing, geographic information systems, or the technical aspects of preparing and using flood insurance rate maps and flood maps.

(d) DUTIES.—The Council shall:

(1) make recommendations to the Director on how to improve in a cost-effective manner the accuracy, general quality, ease of use, and distribution of flood insurance rate maps;
(2) recommend to the Director mapping standards and guidelines for flood insurance rate maps; and
(3) submit an annual report to the Director that contains—

(A) a description of the activities of the Council;
(B) an evaluation of the status and performance of flood insurance rate maps and mapping activities to revise and update flood insurance rate maps, as established pursuant to the Flood Insurance Rate Maps Act of 1969 (12 U.S.C. 4025); and
(C) a summary of recommendations made by the Council to the Director.

(c) CHAIRPERSON.—The members of the Council shall elect 1 member to serve as the chairperson of the Council (in this section referred to as the "Chairperson").

(d) COORDINATION.—To ensure that the Council's recommendations are consistent to the maximum extent practicable with national digital spatial data collection and management standards, the Chairperson shall consult with the Chairperson of the Federal Geographic Data Committee established pursuant to OMB Circular A-16.

(e) COMPENSATION.—Members of the Council shall receive no additional compensation for reserving their services on the Council.

(f) MEETINGS AND ACTIONS.—

(1) IN GENERAL.—The Council shall meet not less than once each year at the request of the Chairperson or a majority of its members and may take action by a vote of the majority of the members present.

(2) INITIAL MEETING.—The Director, or a person designated by the Director, shall request and coordinate the initial meeting of the Council.

(h) OFFICERS.—The Chairperson may appoint officers to assist in carrying out the duties of the Council under subsection (c).
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(i) STAFF OF FEMA.—Upon the request of the Chairperson, the Director may detail, on a nonreimbursable basis, personnel of the Federal Emergency Management Agency to assist the Council in carrying out its duties.

(ii) POWERS.—In carrying out this section, the Council may hold hearings, receive evidence and assistance from the Federal Emergency Management Agency, and conduct research as it considers appropriate.

(iii) TERMINATION.—The Council shall terminate the date on which all members of the Council have been appointed under subsection (b)(1).

SEC. 871. EVALUATION OF EROSION HAZARDS. 

(p) REQUIREMENT.—The Director of the Federal Emergency Management Agency (in this section referred to as the "Director") shall submit a report under this section to the Congress that:

(A) lists all communities that are likely to be identified as having erosion hazard areas;

(B) estimates the amount of flood insurance program that are attributable to erosion;

(C) employment, including the potential loss or gain of existing and new jobs in the community;

(D) existing businesses and future economic development;

(E) the estimated cost of Federal and State disaster assistance to flood victims; and

(F) the costs of communities (or subdivisions thereof) having erosion hazard areas.

(F) PREPARATION.—The assessment required under subsection (a)(4) shall be conducted by a private independent entity selected by the Director. The private entity shall consult with a statistically significant number of communities listed pursuant to subsection (a)(1) in conducting the assessment.

(G) COMMISSION OF MAPPING.—The determination under subsection (a)(5) shall—

(1) determine the costs and benefits of mapping erosion hazard areas, based on the Director's estimate of the actual and prospective amount of flood insurance claims attributable to erosion;

(2) if the Director determines that the savings to the National Flood Insurance Fund will exceed the cost of mapping erosion hazard areas, further assess whether using flood insurance premiums to pay the costs of mapping erosion hazard areas is cost-beneficial compared to alternative uses of such amounts, including—

(a) funding the insurance program under section 1306 of the National Flood Insurance Act of 1968 (as added by section 553 of this Act); and

(b) funding the program under section 1304(b) of the National Flood Insurance Act of 1968 (as added by section 555(a) of this Act) that provides additional coverage under the National Flood insurance Program for compliance with land use and control measures; and

(C) revising, restating, and updating flood insurance rate maps and the map of each community as a whole; and

(D) using such funds for the study of the economic effects that would result from increasing premium rates for flood insurance policies made available under the national flood insurance program for pre-FIRM structures to the full actuarial risk basis premium for pre-FIRM structures; and

(E) determine the increased premium rates would have on land values and property taxes; and

(F) any other effects that the increased premium rates would have on the economy and homeowners.

(G) DEFINITION OF PRE-FIRM STRUCTURE.—For purposes of subsection (a)(5), an "existing" or "pre-FIRM structure" means a structure that was not constructed or substantially improved after the latest of:

(1) December 31, 1974; or

(2) the effective date of the initial rate map published by the Director under section 1300(b) of the National Flood Insurance Act of 1968 for the area in which such structure is located.

(H) REPORT.—The Director shall submit a report to the Congress describing and explaining the findings of the study conducted under this section. The report shall be submitted not later than 12 months after the date of enactment of this Act.

SEC. 872. EFFECTIVE DATES OF POLICIES.

(a) 30-DAY DELAY.—Section 1306 of the National Flood Insurance Act of 1968 (42 U.S.C. 4013), as amended by the preceding provisions of this title, is further amended by adding at the end the following new subsection:

(b) EFFECTIVE DATE OF POLICIES.—

"(ii) "(ii) WAITING PERIOD.—Except as provided in paragraph (2), coverage under a new contract for flood insurance coverage under this title entered into after the date of enactment of the Riegle Community Development and Regulatory Improvement Act of 1994, and any modification to a coverage under an existing flood insurance contract made after such date, shall become effective upon the expiration of the 30-day period beginning on the date that all obligations for
such coverage (including completion of the application and payment of any initial premiums or surcharges required). (2) Exception.—The provisions of paragraph (1) shall not apply to: (A) the initial purchase of flood insurance coverage under this title when the purchase of insurance is in connection with the making, increasing or retaining of a loan; or (B) the initial purchase of flood insurance coverage pursuant to a revision or updating of floodplain areas or flood-risk zones under section 1307(a) if such occurs during the 1-year period beginning upon publication of notice of the revision or updating under section 1307(a). (b) Study.—The Director of the Federal Emergency Management Agency shall conduct a study to determine the appropriateness of existing requirements regarding the effective date and time of coverage under flood insurance contracts obtained through the national flood insurance program. In conducting the study, the Director shall determine whether any delay between the time of purchase of flood insurance coverage and the time of initial effectiveness of the coverage should differ for various classes of properties (based upon the type of property, location of the property, or any other factors relating, or for various circumstances under which such insurance was purchased. Not later than the expiration of the 6-month period beginning on the date of enactment of this Act, the Director shall submit to the Congress a report on the results of the study. SEC. 580. AGRICULTURAL STRUCTURES. Section 1101(a) of the National Flood Insurance Act of 1968 (42 U.S.C. 4023(a)), as amended by the preceding provisions of this title, is further amended by adding at the end the following new paragraph: "(2) AGRICULTURAL STRUCTURES.—(A) ACTIVITY RESTRICTIONS.—Notwithstanding any other provision of law, the adequate land use and control measures required to be adopted in an area (or subdivision thereof) pursuant to paragraph (1) may provide, at the discretion of the appropriate State or local authority, for the repair and restoration to predamaged conditions of an agricultural structure that—(i) is a repetitive loss structure; or (ii) has incurred flood-related damage to the extent that the cost of restoring the structure to its predamaged condition would equal or exceed 50 percent of the market value of the structure before the damage occurred. (B) PRIORITIES AND COVERAGE.—To the extent applicable, an agricultural structure repaired or restored pursuant to paragraph (A) shall pay chargeable premium rates established under section 1307(a) of this title. If resources are available, the Director shall provide technical assistance and counseling, upon request of the owner of the structure, regarding soil-proofing and other flood damage reduction measures for agricultural structures. The Director shall not be required to make flood insurance coverage available for such an agricultural structure unless the structure is not flood-proofed through permanent means unless applied to the structure or its contents that present or provide resistance to damage from flooding by allowing flood waters to pass through the structure, as determined by the Director. (C) PROHIBITION ON DISASTER RELIEF.—Notwithstanding any other provision of law, any agent, broker, or adjusted indemnity shall be prohibited from accepting any flood insurance policy from an agricultural structure unless the structure is not floodproofed through permanent means unless applied to the structure or its contents that present or provide resistance to damage from flooding by allowing flood waters to pass through the structure, as determined by the Director. (D) DEFINITIONS.—For purposes of this paragraph—(i) the term "agricultural structure" means any structure used exclusively in connection with the production, harvesting, storage, raising, or drying of agricultural commodities; and (ii) the term "repetitive loss structure" means agricultural commodities and livestock.". SEC. 581. IMPLEMENTATION REVIEW BY DIRECTOR. Section 1320 of the National Flood Insurance Act of 1968 (42 U.S.C. 4077) is amended—(1) by striking "The Director" and inserting "(a) IN GENERAL.—The Director"; and (2) by adding at the end the following new subsection: "(b) EFFECTS OF FLOOD INSURANCE PROGRAM.—The Director shall include, as part of the biennial report submitted under subsection (a), a report on the effects of the flood insurance program observed through implementation of requirements under the Rangeland Development and Regulatory Improvement Act of 1994.". SEC. 582. PROHIBITED FLOOD DISASTER ASSISTANCE. (a) GENERAL PROHIBITION.—Notwithstanding any other provision of law, no Federal disaster relief assistance made available in a flood disaster area may be used to make a payment (in whole or in part) to a person for repair, replacement, or restoration for damage to any personal, residential, or commercial property if that person at any time has received flood disaster assistance that was conditional on the person first having obtained flood insurance under applicable Federal law and subsequently having failed to obtain and maintain flood insurance as required under applicable Federal law on such property. (b) TRANSFER OF PROPERTY.—(1) DUTY TO NOTIFY.—In the event of the transfer of any property described in paragraph (3), the transferor shall, not later than the date on which such transfer occurs, notify the transferee in writing of the requirements to—(A) obtain flood insurance in accordance with applicable Federal law with respect to such property, if the property is not so insured as of the date on which the property is transferred; and (B) maintain flood insurance in accordance with applicable Federal law with respect to such property. Such written notification shall be contained in documents evidencing the transfer of ownership of the property. (2) FAILURE TO NOTIFY.—If a transferee described in paragraph (1) fails to make a notification in accordance with such paragraph and, subsequent to the transfer of the property—(A) the transferor fails to obtain or maintain flood insurance in accordance with applicable Federal law with respect to the property; (B) the property is damaged by a flood disaster; or (C) Federal disaster relief assistance is provided for the repair, replacement, or restoration of the property as a result of such damage, the transferor shall be required to reimburse the Federal Government in an amount equal to the amount of the Federal disaster relief assistance provided with respect to the property. (3) PROPERTY DESCRIBED.—For purposes of paragraph (1), a property is described in this paragraph if it is personal, commercial, or residential property for which Federal disaster relief assistance made available in a flood disaster area has been provided, prior to the date on which the property is transferred, for repair, replacement, or restoration of the property, if such assistance was conditioned upon obtaining flood insurance in accordance with applicable Federal law with respect to such property. (c) AMENDMENT TO THE FLOOD DISASTER PROTECTION ACT OF 1973.—Section 102(a) of the Flood Disaster Protection Act of 1973 (42 U.S.C. 4021(a)) is amended—(1) by striking "during the anticipated economic or useful life of the project"; and (2) by adding at the end the following: "The requirement of maintaining flood insurance...shall apply during the life of the property, regardless of transfer of ownership of such property.". (d) DEFINITION.—For purposes of this section, the term "flood disaster area" means an area with respect to which—(1) the Secretary of Agriculture finds, or has found, to have been substantially affected by a natural disaster in the United States pursuant to section 351(a) of the Consolidated Farm and Rural Development Act (7 U.S.C. 1961a); or (2) the President declares, or has declared, the existence of a major disaster or emergency pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. 5121 et seq.), as a result of flood conditions existing in or affecting that area. (e) EFFECTIVE DATE.—This section and the amendments made by this section shall apply to disasters declared after the date of enactment of this Act. SEC. 583. REGULATIONS. The Director of the Federal Emergency Management Agency and any appropriate Federal agency may each issue any regulations necessary to carry out the applicable provisions of this title and the applicable amendments made by this title. SEC. 584. RELATION TO STATE AND LOCAL LAWS. This title and the amendments made by this title may not be construed to preempt, annul, alter, amend, or exempt any person from compliance with any other law, ordinance, or regulation of any State or local government with respect to land use, management, or control. H 6676 CONGRESSIONAL RECORD — HOUSE August 2, 1994 E - 33
Regulatory Update

REAL ESTATE SETTLEMENT PROCEDURES ACT
(RESPA)
HUD's Regulation X
24 CFR 3500

Thomas W. Grundy
Kentucky Bankers Association
Louisville, Kentucky

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SECTION F
# REAL ESTATE SETTLEMENT PROCEDURES ACT

*HUD's Regulation X - 24 CFR 3500*

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**EXHIBIT A: RESPA FORM - GOOD FAITH ESTIMATE**

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and

REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA)
HUD'S REGULATION X, 24 CFR 3500

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I. PURPOSE

Congress found that reforms were needed in the real estate settlement process to help insure that consumers are provided with proper information on the nature and costs of the settlement process. Furthermore, this law is intended to protect consumers from unnecessarily high settlement charges due to abusive practices, such as illegal kickbacks and referral fees and excessive escrow payments.

The basic purpose of this law is to effect certain changes in the home financing settlement process by:

A. Establishing an effective and uniform system of disclosure which cover all costs associated with purchasing a home;

B. Eliminating illegal kickbacks and referral fees which can increase the costs of settlement services needlessly;

C. Reducing and/or limiting the amount home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and

D. Reforming and modernizing local recordkeeping of land title information.

It is through full and advanced disclosure that the consumer is informed of all costs associated with the settlement process. Thus, providing information to this extent protects the consumer, and should also limit the liability of the lender.

II. COVERAGE

A. Key Definition. It is important to understand the meaning of "federally related mortgage loan," as defined under 24 CFR 3500.2. "Federally Related Mortgage Loan" refers to any loan (except for temporary financing, such as a construction loan) that:

1. is secured by a first or subordinate lien on residential real property, including a refinancing of any secured loan on residential real property upon which there is located or will be constructed using the proceeds of the loan, a one to four family structure. This includes condominiums and manufactured housing units.
2. is made by a lender regulated by or whose deposits or accounts are insured by any federal government agency.

3. is made in whole or part, insured, guaranteed, supplemented, assisted or administered in any way by a federal government agency.

4. is intended to be sold by the originating lender to the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or a financial institution from which the loan is to be purchased by the Federal Home Loan Mortgage Corporation.

5. is made in whole or in part by a creditor that makes or invests in residential real estate loans totalling more than $1,000,000 annually.

6. is originated either by a dealer or, if the obligation is to be assigned to any maker of mortgage loans specified in 2 through 5 above, by a mortgage broker.

7. is the subject of a home equity conversion mortgage, also known as "reverse mortgages" issued by any maker of mortgage loans specified in 2 through 5 above. Any installment sales contract, land contract, or contract for deed on otherwise qualifying residential property is a federally related mortgage loan if the contract is funded in whole or in part by proceeds of a loan made by any maker of mortgage loans specified in 2 through 5 above.

B. Know the customer. One of the primary keys to understanding the scope of RESPA is to know who the borrower is and are they covered by the regulation. That is, is the borrower acting in his/her capacity as an individual? Furthermore, when is it necessary to apply the business-purpose test? If the borrower is acting as an individual, requesting a federally-related mortgage, chances are RESPA applies.

III. REFINANCINGS UNDER RESPA

Now that the coverage of RESPA extends to refinancing transactions, you should have an understanding of the definition of a refinancing. HUD provides a definition which is substantially similar to that found in Regulation Z. Thus, for purposes of RESPA a refinancing means:

A transaction in which an existing obligation that was subject to a secured lien on residential real property is satisfied and replaced by a new obligation undertaken by the same borrower and with the same or a new lender. The following shall not be treated as a refinancing, even when the existing obligation is satisfied and replaced by a new obligation with the same lender:
A. A renewal of a single payment obligation with no change in the original terms;

B. A reduction in the annual percentage rate as computed under the Truth in Lending Act with a corresponding change in the payment schedule;

C. An agreement involving a court proceeding;

D. A workout agreement, in which a change in the payment schedule or change in collateral requirements is agreed to as a result of the consumer’s default or delinquency, unless the rate is increased or the new amount financed exceeds the unpaid balance plus earned finance charges and premiums for continuation of allowable insurance; and,

E. The renewal of optional insurance purchased by the consumer that is added to an existing transaction, if disclosures relating to the initial purchase were provided.

(Note: Generally speaking, if a new note is required, the transaction will likely be subject to RESPA. Thus, new RESPA disclosures should be provided to the customer.)

IV. EXEMPTIONS

Another key aspect to understanding the scope and coverage of RESPA is to know and understand what types of loans are exempt. These include:

A. 25 acres or more. Whether the property is vacant, the property is used for agricultural purposes, or a one to four family residential structure is involved, this is an absolute exemption for property consisting of 25 or more acres in a single transaction.

B. Business purpose loans. Loans that are made primarily for a business, commercial, or agricultural purpose. The definition of such an extension of credit for purposes of this exemption generally parallels Regulation Z, 12 CFR 226.3(a)(1), and persons may rely on Regulation Z in determining whether the exemption applies. Notwithstanding the foregoing, the exemption in this section for business purpose loans does not include any loan to one or more persons acting in an individual capacity (natural persons) to acquire, refinance, improve, or maintain a 1- to 4- family residential property used, or to be used, to rent to other persons. An individual who voluntarily chooses to act as a sole proprietorship is not considered to be acting in an individual capacity for purposes of this part.

C. Temporary financing. A construction loan is a form of temporary financing. The exemption for temporary financing does not apply to a loan made to finance construction of a one to four family residential property if the loan is used as, or may be converted to permanent financing by the same lender or is used to finance the transfer of title to the first user.
Thus, if you issue a commitment to provide permanent financing, with or without conditions, the loan is covered by RESPA. Furthermore, bridge or swing loans are exempt from RESPA coverage.

D. Vacant land. Any loan secured by vacant or unimproved property, unless within two years from the date of the settlement of the loan, a structure or manufactured home will be constructed or placed on the real property with the proceeds of the loan.

E. Assumption without lender approval. Any assumption in which the lender does not have the right to expressly approve a subsequent person as the borrower on an existing federally related mortgage loan is not subject to RESPA. Any assumption in which the lender's permission is both required and obtained is covered by RESPA, whether or not the lender charges a fee for the assumption.

F. Loan conversions. Any conversion of a covered loan to different terms that are consistent with provisions of the original mortgage instrument, as long as a new note is not required, even if the lender charges an additional fee for the conversion.

G. Secondary market transactions. A bona fide transfer of a loan in the secondary market is not covered by RESPA, except as set forth in section 6 of RESPA and 24 CFR 3500.21.

V. REQUIRED DISCLOSURES

You have received a loan request and determined that RESPA applies -- What is your next move? Disclosure.

You must provide certain information disclosures to the customer at the time of application (or within three business days in some circumstances), while others must be made by the closing date. The following is a brief overview of the disclosures required for a RESPA covered transaction.

A. Special Information Booklet. (24 CFR 3500.6). Guide to Settlement Costs. You must provide a copy of the special information booklet to the applicant by delivering it or placing it in the mail not later than three business days after the application is received or prepared. However, if you deny the application before the end of the three business day period, then you need not provide the booklet to the borrower.

In the case of nonpurchase-money transactions (i.e. refinancings, subordinate-lien closed-end loans, and reverse mortgages) and equity lines, you are not required to provide the special information booklet. For open-end home equity lines of credit, you are deemed to be in compliance with the regulation by providing the Federal Reserve's brochure, "When Your Home Is on the Line: What You Should Know About Home Equity Lines of Credit."
B. **Good Faith Estimate (GFE).** (24 CFR 3500.7). You must provide all applicants with a good faith estimate of the amount of or range of charges for the specific settlement services the borrower is likely to incur in connection with the settlement. This must be provided at the time of application or within three business days after the application is received or prepared:

1. If the application is denied before the end of the three business day period, you are not required to provide the denied applicant with a good faith estimate.

2. For "no cost" or "no point" loans, the charges to be shown on the good faith estimate include any payments to be made to affiliated or independent settlement service providers. These payments should be shown as P.O.C. (Paid Outside of Closing) on the good faith estimate and the HUD-1 or HUD-1A.

3. In the case of dealer loans, you are responsible for provision of the good faith estimate, either directly or by the dealer.

4. If a mortgage broker is the exclusive agent of the lender, either the lender or the mortgage broker shall provide the good faith estimate within three business days after the mortgage broker receives or prepares the application.

A good faith estimate consists of an estimate, as a dollar amount or range, of each charge which will be listed in section L of the HUD-1 or HUD-1A and, the borrower will normally pay or incur at or before settlement based on common practice in the locality of the mortgaged property.

The suggested format of the good faith estimate is set forth in Appendix C of Regulation X. The good faith estimate may be provided together with disclosures required by the Truth in Lending Act so long as all required information for the good faith estimate is grouped together. You also can include additional relevant information, such as the name and signature of the applicant, loan officer, date and information identifying the loan application and property, so long as the form is clear and concise.

Note -> For open-end lines of credit (home-equity plans) covered under the Truth in Lending Act and Regulation Z, if you provide the borrower with the disclosures required by 12 CFR 226.5b of Regulation Z at the time of application, this action shall be deemed to satisfy the requirements of RESPA and this Section of Regulation X.

C. **Required Service Provider Disclosure.** (24 CFR 3500.7(e)). If your bank requires the use of a particular provider of a settlement service, other than the bank's own employees, and also requires the borrower to pay any portion of the cost of such, then the good faith estimate must:
1. Clearly state that the use of the particular provider is required on the GFE and that the estimate is based on the charges of the designated provider;

2. Give the name, address, and telephone number of each provider; and,

3. Describe the nature of any relationship between each such provider and the lender. That is, references to the relationship should be utilized, such as "X is a depositor of the lender," "Y is a borrower from the bank," "Z has performed 60% of the bank's settlements in the past year." If more than one relationship exists, each should be disclosed.

If a bank maintains a controlled list of required providers (five or more for each type of service) or relies on a list maintained by others, and at the time of application you have not yet decided which provider will be selected from the list, then you can satisfy this requirement by giving the applicant a written statement that the bank will require a particular provider from the controlled list; and provides the borrower in the good faith estimate the range of costs for the required provider(s), and provides the name of the specific provider and the actual cost on the HUD-1 or HUD-1A.

Note -> If a bank is in a controlled business relationship with a service provider, it cannot require the use of that provider, with exception to attorneys, credit reporting agencies, or appraisers.

D. Transfer of Mortgage Servicing Disclosure. (24 CFR 3500.21). On December 19, 1994, HUD published the final rule on transfer of mortgage servicing, replacing an interim rule that had been in place since April 26, 1991. This rule implements Section 6 of RESPA which sets forth procedures regarding the transfer of mortgage servicing for any federally related mortgage loan.

At the time a customer submits an application for a federally-related mortgage loan, you must disclose to each person who applies for the loan whether the servicing of the loan may be assigned, sold or transferred to any other person at any time while the loan is outstanding. If the person who makes the loan does not engage in the servicing of any federally-related mortgage loans, the disclosure may consist of a statement that the person making the loan currently intends to assign, sell or transfer servicing of the loan to another person. Additional disclosures come into play at the point of transfer, and must be made by both the transferor and transferee.

Although RESPA was extended by section 908 of the Housing and Community Development Act of 1992 to subordinate liens, in this rule HUD has exempted from coverage all federally related mortgage loans that are not secured by a first lien.
E. **Controlled Business Arrangement Disclosure (where applicable).** (24 CFR 3500.15). In general, a controlled business arrangement disclosure informs the applicant that a business relationship between the bank and a third party settlement service provider exist. This disclosure sets forth the estimated charge or range of charges of the service provider. If the lender is in a controlled business relationship with a provider, the lender may not require the use of that provider unless the provider is the lender's chosen attorney, credit reporting agency, or appraiser. By definition, a controlled business arrangement exist where:

1. A person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally-related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and

2. Such person directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider.

F. **HUD-1 or HUD-1A Settlement Statements.** (24 CFR 3500.8, 3500.9, 3500.10). The HUD-1 and HUD-1A settlement statements must be completed in connection with the final settlement of a federally-related mortgage loan. For transactions where there is a borrower and a seller, a HUD-1 statement applies. Alternatively, for transactions in which there is a borrower and no seller, such as a refinancing or subordinate lien, the HUD-1A shall be completed.

1. No fees. What if there are no fees in connection with a refinance or junior lien transaction, do you have to complete a HUD-1A? Yes. If the borrower is not responsible for paying any costs, and the fees are paid by the bank, these fees must be marked on the GFE and the HUD-1A as paid outside of closing or "POC."

2. One-day advance inspection. You are required to have the HUD-1 or HUD-1A statement ready for inspection one day prior to settlement upon the request of the borrower.

G. **Three-day Denial of Credit.** HUD incorporated a three business day denial-of-credit rule into Regulation X. This rule provides that if a credit is denied within three business days after receipt of the application, the creditor is not required to provide the Good Faith Estimate or Special Information Booklet to the applicant. HUD's position is that this rule has been in effect since the date of the Housing and Community Development Act, October 28, 1992.

VI. **OTHER MATTERS.**

A. **Prohibition Against Kickbacks and Unearned Fees.** 24 CFR 3500.14. Any violation of this section is a violation of section 8 of RESPA and is subject to enforcement as such under section 3500.19(b). Therefore, what must be considered where kickbacks and unearned fees are concerned?
1. No referral fees.
2. No split of charges except for actual services performed.
3. Thing of value - What constitutes?
4. Agreement or understanding.
5. Referral.
6. Fees, salaries, compensation, or other payments - What is permitted/prohibited?

B. Title Companies. (24 CFR 3500.16). No seller of property that will be purchased with the assistance of a federally-related mortgage loan shall require, directly or indirectly, as a condition of selling the property, that title insurance covering the property be purchased by the buyer from any particular title company.

C. Escrow Accounts. (24 CFR 3500.17). On October 26, 1994 HUD issued a final rule that limits the amounts lenders may require borrowers to deposit in escrow accounts under RESPA. It also established the aggregate accounting analysis method (as opposed to single-item accounting) as the standard for escrow accounts settled on or after the effective date of the rule. In addition, it allows up to three years for existing escrow accounts to be converted to the aggregate accounting method.

Section 10 of RESPA requires that an initial escrow account statement be provided at time of closing or within 45 days of opening the escrow account. This disclosure may appear with the uniform settlement statement as a rider or integrated into the statement.

The escrow statement must itemize the estimated taxes, insurance premiums and other charges reasonably anticipated during the first 12 months after the account has been established and the expected dates of the payments.

You should be aware that the bank can only collect enough at the time of settlement to cover insurance and taxes since the seller's last payment through the first mortgage installment plus one sixth of the estimated total amount to be paid during the next twelve month period. During the subsequent months, the bank may not collect more than one twelfth of the amount due annually for taxes and insurance and any amount necessary to maintain the one sixth cushion required by the law.

D. Validity of Contracts and Liens. (24 CFR 3500.18). Nothing in RESPA or Regulation X shall affect the validity or enforcement of any sale or contract for the sale of real property or any loan, loan agreement, mortgage or lien made or arising in connection with a federally-related mortgage loan.
E. Enforcement Provisions. (24 CFR 3500.19). Two major considerations:

1. Violations of Section 8 of RESPA. Any person(s) who violate Section 8 shall be fined not more than $10,000 or imprisoned for not more than one year, or both, for each violation. Furthermore, violators shall be jointly and severally liable to the person or persons charged for the settlement service involved in the violation in an amount equal to three times the amount of any charge paid for the service. Additional actions may be brought by state officials and the prevailing party can recover court costs and reasonable attorney’s fees.

2. Violations of Section 9 of RESPA. Any seller who violates the provisions of Section 9 of RESPA or 3500.16 is liable to the buyer in an amount equal to three times all charges made for the title insurance.

VII. Investigations; subpoena authority. (24 CFR 3500.20). See Section 3500.20 of regulation for details.
Good Faith Estimate

<table>
<thead>
<tr>
<th>Item</th>
<th>HUD-1/HUD-IA</th>
<th>Amount or Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan Origination Fee</td>
<td>801</td>
<td>$</td>
</tr>
<tr>
<td>Loan Discount Fee</td>
<td>802</td>
<td>$</td>
</tr>
<tr>
<td>Appraisal Fee</td>
<td>803</td>
<td>$</td>
</tr>
<tr>
<td>Credit Report</td>
<td>804</td>
<td>$</td>
</tr>
<tr>
<td>Inspection Fee</td>
<td>805</td>
<td>$</td>
</tr>
<tr>
<td>Mortgage Broker Fee</td>
<td></td>
<td>$</td>
</tr>
<tr>
<td>CLO Access Fee</td>
<td></td>
<td>$</td>
</tr>
<tr>
<td>Tax Related Service Fee</td>
<td></td>
<td>$</td>
</tr>
<tr>
<td>Interest for [X] days at $ per day</td>
<td>901</td>
<td>$</td>
</tr>
<tr>
<td>Mortgage Insurance Premium</td>
<td>902</td>
<td>$</td>
</tr>
<tr>
<td>Hazard Insurance Premium</td>
<td>903</td>
<td>$</td>
</tr>
<tr>
<td>Reserves</td>
<td>1000-1005</td>
<td>$</td>
</tr>
<tr>
<td>Settlement Fee</td>
<td>1101</td>
<td>$</td>
</tr>
<tr>
<td>Abstract or Title Search</td>
<td>1102</td>
<td>$</td>
</tr>
<tr>
<td>Title Examination</td>
<td>1103</td>
<td>$</td>
</tr>
<tr>
<td>Document Preparation Fee</td>
<td>1105</td>
<td>$</td>
</tr>
<tr>
<td>Attorney's Fee</td>
<td>1107</td>
<td>$</td>
</tr>
<tr>
<td>Title Insurance</td>
<td>1108</td>
<td>$</td>
</tr>
<tr>
<td>Recording Fees</td>
<td>1201</td>
<td>$</td>
</tr>
<tr>
<td>City/County Tax Stamps</td>
<td>1202</td>
<td>$</td>
</tr>
<tr>
<td>State Tax</td>
<td>1203</td>
<td>$</td>
</tr>
<tr>
<td>Survey</td>
<td>1301</td>
<td>$</td>
</tr>
<tr>
<td>Pest Inspection</td>
<td>1302</td>
<td>$</td>
</tr>
<tr>
<td>Other Fees -- List Here</td>
<td></td>
<td>$</td>
</tr>
</tbody>
</table>

This section to be completed by lender only if a particular provider of service is required. Listed below are any providers of services which we require you to use in addition to those listed on the disclosure of Required Service Providers. The charges or ranges indicated in the Good Faith Estimate above are based on the corresponding charge of the designated providers.

<table>
<thead>
<tr>
<th>Item No.</th>
<th>Name &amp; Address of Provider</th>
<th>Telephone #</th>
<th>Bus. Relationship</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

Applicant

Authorized Official

Date

These estimates are provided pursuant to the Real Estate Settlement Procedures Act of 1974, as amended (RESPA). Additional information can be found in the HUD Special Information Booklet, which is to be provided to you by your mortgage broker or lender.
Notice to Mortgage Loan Applicants: The Right to Collect Your Mortgage Loan Payments may be transferred. Federal Law Gives you Certain Related Rights. Read This Statement and Sign it Only if you Understand its Contents.

Because you are applying for a mortgage loan covered by the Real Estate Settlement procedures Act [RESPA] [12 USC 2601 et seq.] you have certain rights under that Federal law. This statement tells you about those rights. It also tells you what the chances are that the servicing for this loan may be transferred to a different loan servicer. "Servicing" refers to collecting your principal, interest and escrow account payments, if any. If your loan servicer changes, there are certain procedures that must be followed. This statement generally explains those procedures.

Transfer Practices and Requirements

If the servicing of your loan is assigned, sold, or transferred to a new servicer, you must be given written notice of that transfer. The present loan servicer must send you notice in writing of the assignment, sale or transfer of the servicing not less than 15 days before the effective date of the transfer. The new loan servicer must also send you notice within 15 days after the effective date of the transfer. The present servicer and the new servicer may combine this information in one notice, so long as the notice is sent you 15 days before the effective date of transfer. The 15 day period is not applicable if a notice of prospective transfer is provided to you at settlement. The law allows a delay in the time (not more than 30 days after a transfer for servicers to notify you under certain limited circumstances, when your servicer is changed abruptly. This exception applies only if your servicer is fired for cause, is in bankruptcy proceedings, or is involved in a conservatorship or receivership initiated by a Federal agency.

Notices must contain certain information. They must contain the effective date of the transfer of the servicing of your loan to the new servicer, the name, address, and toll-free or collect call telephone number of the new servicer; and toll-free or collect call telephone numbers of a person or department for both your present servicer and your new servicer to answer your questions about the transfer of servicing. During the 60-day period following the effective date of the transfer of the loan servicing, a loan payment received by your old servicer before its due date may not be treated by the new loan servicer as late, and a late fee may not be imposed on you.

Complaint Resolution

Section 6 of RESPA [12 USC 2605] gives you certain consumer rights, whether or not your loan servicing is transferred. If you send a "qualified written request" to your loan servicer concerning the servicing of your loan, your servicer must provide you with a written acknowledgment within 20 Business Days of receipt of your request. A "qualified written request" is a written correspondence, other than notice on payment coupon or other payment medium supplied by the servicer, which includes your name and account number, and your reasons for the request. Not later than 60 Business Days after receiving your request, your servicer must make any appropriate corrections to your account, or must provide you with a written clarification regarding any dispute. During this 60-Business Day period, your servicer may not provide information to a consumer reporting agency concerning any overdue payment related to such period or qualified written request.

A Business Day is any day, excluding public holidays (State or Federal), Saturday and Sunday.

Damages and Costs

Section 6 of RESPA also provides for damages and costs for individuals or classes of individuals in circumstances where servicers are shown to have violated the requirements of that Section.
Servicing Transfer Estimated by Lender

(1) The following is the best estimate of what will happen to the servicing of your mortgage loan:

We may assign, sell or transfer the servicing of your loan sometime while the loan is outstanding. [We are able to service your loan [.] and we [will][will not][haven't decided whether to] service your loan.]

[or]

We do not service mortgage loans, and we presently intend to assign, sell or transfer the servicing of your mortgage loan. You will be informed about your servicer.

(2) For all the mortgage loans that we make in the 12 month period after your mortgage loan is funded, we estimate that the percentage of mortgage loans for which we will transfer servicing is between:

- 0 to 25%
- 26 to 50%
- 51 to 75%
- 76 to 100%

[This estimate [does][does not] include assignments, sales or transfers to affiliates or subsidiaries.] This is only our best estimate and it is not binding. Business conditions or other circumstances may affect our future transferring decisions.

(3) This is our record of transferring the servicing of the mortgage loans we have made in the past:

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of loans transferred (rounded to nearest quartile--0%, 25%, 50%, 75% or 100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>19--</td>
<td>%</td>
</tr>
<tr>
<td>19--</td>
<td>%</td>
</tr>
<tr>
<td>19--</td>
<td>%</td>
</tr>
<tr>
<td>19--</td>
<td>%</td>
</tr>
</tbody>
</table>

[This information [does][does not] include assignments, sales or transfers to affiliates or subsidiaries.]

Lender [Signature Not Mandatory]

Date

Instructions to Preparer: For item 3, for applications received in calendar year 1991, the information will be for calendar year 1990 only; for applications received in 1992, this information will be for calendar years 1990 and 1991; and for applications received in 1993 and thereafter, this information will be for the previous three calendar years. If the percentage of servicing transferred is less than 12.5%, the word "nominal" or the actual percentage amount of servicing transfers may be used.

Acknowledgement of Mortgage Loan Applicant

I/we have read this disclosure form, and understand its contents, as evidenced by my/our signature(s) below.

Applicant's Signature

Co-Applicant's Signature

Date
Notice of Assignment, Sale or Transfer of Servicing Rights

You are hereby notified that the servicing of your mortgage loan, that is, the right to collect payments from you, is being assigned, sold or transferred from ______ to _______, effective _________.

The assignment, sale or transfer of the servicing of the mortgage loan does not affect any term or condition of the mortgage instruments, other than terms directly related to the servicing of your loan.

Except in limited circumstances, the law requires that your present servicer send you this notice at least 15 days before the effective date of transfer, or at closing. Your new servicer must also send you this notice no later than 15 days after this effective date or at closing. [In this case, all necessary information is combined in this one notice].

Your present servicer is ___________. If you have any questions relating to the transfer of servicing from your present servicer call ___________ [enter the name of an individual or department here] between _________ a.m. and _________ p.m. on the following days ___________. This is a [toll-free] or [collect call] number.

Instructions to Preparer: Delivery means placing the notice in the mail, first class postage prepaid, prior to 15 days before the effective date of transfer (transferor) or prior to 15 days after the effective date of transfer (transferee). However, this notice may be sent not more than 30 days after the effective date of the transfer of servicing rights if assignment, sale or transfer of the servicing of the mortgage loan is preceded by termination of the contract for servicing the loan for cause, commencement of proceedings for bankruptcy of the servicer, or commencement of proceedings by the Federal Deposit Insurance Corporation (FDIC) or the Resolution Trust Corporation (RTC) for conservatorship or receivership of the servicer, or an entity by which the servicer is owned or controlled.

"Lender" may be substituted for "present servicer" where appropriate.

Your new servicer will be ___________. The business address for your new servicer is: ___________. The [toll-free] [collect call] telephone number of your new servicer is ___________. If you have any questions relating to the transfer of servicing to your new servicer call ___________ [enter the name of an individual or department here] at ___________ [toll-free or collect call telephone number] between _________ a.m. and _________ p.m. on the following days ___________.

The date that your present servicer will stop accepting payments from you is _______________.
The date that your new servicer will start accepting payments from you is _______________.

[Use this paragraph if appropriate; otherwise omit] The transfer of servicing rights may affect the terms of or the continued availability of mortgage life or disability insurance or any other type of optional insurance in the following manner:

________________________________________________________

________________________________________________________

________________________________________________________

and you should take the following action to maintain coverage _______________.

F - 15
You should also be aware of the following information, which is set out in more detail in Section 6 of RESPA [12 USC 2605]:

During the 60-day period following the effective date of the transfer of the loan servicing, a loan payment received by your old servicer before its due date may not be treated by the new loan servicer as late, and a late fee may not be imposed on you.

Section 6 of RESPA [12 USC 2605] gives you certain consumer rights. If you send a "qualified written request" to your loan servicer concerning the servicing of your loan, your servicer must provide you with a written acknowledgement within 20 Business Days of receipt of your request. A "qualified written request" is a written correspondence, other than notice on a payment coupon or other payment medium supplied by the servicer, which includes your name and account number, and your reasons for the request. Not later than 60 Business Day after receiving your request, your servicer must make any appropriate corrections to your account, and must provide you with a written clarification regarding any dispute. During the 60-Business Day period, your servicer may not provide information to a consumer reporting agency concerning any overdue payment related to such period or qualified written request.

A Business Day is any day, excluding legal public holidays (State or Federal), Saturday and Sunday.

Section 6 of RESPA also provides for damages and costs for individuals or classes of individuals in circumstances where servicers are shown to have violated the requirements of that Section. You should seek legal advice if you believe your rights have been violated.
Notice

To: Buyer or Seller

Property:

From: [Entity Making Statement]

Date:

This is to give you notice that [referring party] has a business relationship with [provider]. [Describe the nature of the relationship between the referring party and the provider, including ownership and financial interests.]

Set forth below is the estimated charge or range of charges by [provider] for the following settlement services:

<table>
<thead>
<tr>
<th>HUD-1 Line No.</th>
<th>Service</th>
<th>Amount or Range</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>$</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$</td>
</tr>
</tbody>
</table>

Check one

☐ You are not required to use [provider] as a condition for [settlement of your loan on] [or] [purchase or sale of] the subject property. You may be able to get these services at a lower rate by shopping with the other settlement service providers.

☐ A lender is allowed to require the use of an attorney, credit reporting agency or real estate appraiser chosen to represent the lender's interest.

By signing below, the undersigned acknowledges receipt of a copy of this disclosure.

X ___________________________ Date: ___________________________
A. Settlement Statement

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan number</td>
<td>123</td>
</tr>
<tr>
<td>Borrower's address</td>
<td>456</td>
</tr>
<tr>
<td>Seller's address</td>
<td>789</td>
</tr>
</tbody>
</table>

B. Summary of Borrower's Transaction

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Amount Due From Borrower</td>
<td>1000</td>
</tr>
<tr>
<td>Contract Sales Price</td>
<td>500</td>
</tr>
<tr>
<td>Personal Property</td>
<td>200</td>
</tr>
<tr>
<td>Total Settlement Charges to Borrower (line 1400)</td>
<td>1500</td>
</tr>
<tr>
<td>Adjustments for Items Paid by Seller in Advance</td>
<td>300</td>
</tr>
</tbody>
</table>

C. Summary of Seller's Transaction

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Amount Due To Seller</td>
<td>2000</td>
</tr>
<tr>
<td>Adjustments for Items Paid by Seller in Advance</td>
<td>-300</td>
</tr>
</tbody>
</table>

D. Adjustments for Items unpaid by seller

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>City Town Taxes</td>
<td>400</td>
</tr>
<tr>
<td>County Taxes</td>
<td>500</td>
</tr>
<tr>
<td>Assessments</td>
<td>600</td>
</tr>
</tbody>
</table>

E. Adjustments for Items unpaid by seller

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>City Town Taxes</td>
<td>700</td>
</tr>
<tr>
<td>County Taxes</td>
<td>800</td>
</tr>
<tr>
<td>Assessments</td>
<td>900</td>
</tr>
<tr>
<td>Total Paid By Seller</td>
<td>1200</td>
</tr>
</tbody>
</table>

F. Cash at Settlement:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>From Borrower</td>
<td>100</td>
</tr>
<tr>
<td>To Buyer</td>
<td>200</td>
</tr>
<tr>
<td>To Seller</td>
<td>300</td>
</tr>
</tbody>
</table>

G. Notes:

- All amounts are in USD.
- Line 1400 represents the total settlement charges to the borrower.
- Line 1500 represents the total settlement amount to be paid by the seller.
- Line 200 represents the contract sales price.
- Line 300 represents adjustments for items paid by the seller in advance.

H. Additional Notes:

- Adjustments for city town taxes, county taxes, and assessments are included.
- The total paid by the seller includes cash and any other payments.

I. Signature:

[Signature]

[Date]
<table>
<thead>
<tr>
<th>Settlement Charges</th>
<th>Disbursement to Others</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>L.</strong></td>
<td><strong>M.</strong></td>
</tr>
<tr>
<td><strong>Settlement Charges</strong></td>
<td><strong>Disbursement to Others</strong></td>
</tr>
<tr>
<td>801. Loan origination fee</td>
<td>1501.</td>
</tr>
<tr>
<td>802. Loan discount</td>
<td>1502.</td>
</tr>
<tr>
<td>803. Appraisal fee</td>
<td>1503.</td>
</tr>
<tr>
<td>804. Credit report fee</td>
<td>1504.</td>
</tr>
<tr>
<td>805. Inspection fee</td>
<td>1505.</td>
</tr>
<tr>
<td>806. Loan mortgage loan fee</td>
<td>1506.</td>
</tr>
<tr>
<td>807. Mortgage loan fees</td>
<td>1507.</td>
</tr>
<tr>
<td>808. Insurance premiums</td>
<td>1508.</td>
</tr>
<tr>
<td>809. Hazard insurance premium for</td>
<td>1509.</td>
</tr>
<tr>
<td>810. Reserve Deposited with Lender</td>
<td>1610.</td>
</tr>
<tr>
<td>811. Hazard insurance</td>
<td>1611.</td>
</tr>
<tr>
<td>812. Mortgage insurance</td>
<td>1612.</td>
</tr>
<tr>
<td>813. City property taxes</td>
<td>1613.</td>
</tr>
<tr>
<td>814. County property taxes</td>
<td>1614.</td>
</tr>
<tr>
<td>815. Annual assessments</td>
<td>1615.</td>
</tr>
<tr>
<td>816. Mortgage loan fees</td>
<td>1616.</td>
</tr>
<tr>
<td>817. Interest on mortgage loan</td>
<td>1617.</td>
</tr>
<tr>
<td>818. Total Disbursed (enter on line 1630)</td>
<td><strong>NET Settlemens</strong></td>
</tr>
<tr>
<td>1100. Title Charges</td>
<td>1630.</td>
</tr>
<tr>
<td>1101. Settlement or closing fee</td>
<td>1631.</td>
</tr>
<tr>
<td>1102. Abstract or title search fee</td>
<td>1632.</td>
</tr>
<tr>
<td>1103. Title examination fee</td>
<td>1633.</td>
</tr>
<tr>
<td>1104. Title insurance binder fee</td>
<td>1634.</td>
</tr>
<tr>
<td>1106. Notary fees</td>
<td>1636.</td>
</tr>
<tr>
<td>1107. Attorney's fees</td>
<td>1637.</td>
</tr>
<tr>
<td>1108. Title insurance</td>
<td>1638.</td>
</tr>
<tr>
<td>1109. Lender's coverage</td>
<td>1639.</td>
</tr>
<tr>
<td>1110. Owner's coverage</td>
<td>1640.</td>
</tr>
<tr>
<td>1111.</td>
<td>1641.</td>
</tr>
<tr>
<td>1112.</td>
<td>1642.</td>
</tr>
<tr>
<td>1300. Government Recording and Transfer Charges</td>
<td><strong>NET Settleement</strong></td>
</tr>
<tr>
<td>1301. Recording fees</td>
<td>1650.</td>
</tr>
<tr>
<td>1302. County tax stamps</td>
<td>1651.</td>
</tr>
<tr>
<td>1303. State tax stamps</td>
<td>1652.</td>
</tr>
<tr>
<td>1304.</td>
<td>1653.</td>
</tr>
<tr>
<td>1305.</td>
<td>1654.</td>
</tr>
<tr>
<td>1306. Additional Settlement Charges</td>
<td><strong>NET Settleement</strong></td>
</tr>
<tr>
<td>1301. Survey</td>
<td>1655.</td>
</tr>
<tr>
<td>1302. Appraisal fee</td>
<td>1656.</td>
</tr>
<tr>
<td>1303. Architectural-engineering services</td>
<td>1657.</td>
</tr>
<tr>
<td>1304. Building permits</td>
<td>1658.</td>
</tr>
<tr>
<td>1305.</td>
<td>1659.</td>
</tr>
<tr>
<td>1306.</td>
<td>1660.</td>
</tr>
<tr>
<td>1307.</td>
<td>1661.</td>
</tr>
<tr>
<td>1400. Total Settlement Charges (enter on line 1602)</td>
<td><strong>NET Settleement</strong></td>
</tr>
<tr>
<td>Borrower(s) Signature(s):</td>
<td></td>
</tr>
</tbody>
</table>
INITIAL ESCROW ACCOUNT DISCLOSURE STATEMENT

YOUR MONTHLY MORTGAGE PAYMENT FOR THE COMING YEAR WILL BE $______ OF WHICH $______ WILL BE FOR PRINCIPAL AND INTEREST AND $______ WILL GO INTO YOUR ESCROW ACCOUNT.

THIS IS AN ESTIMATE OF ACTIVITY IN YOUR ESCROW ACCOUNT DURING THE COMING YEAR BASED ON PAYMENTS ANTICIPATED TO BE MADE FROM YOUR ACCOUNT.

<table>
<thead>
<tr>
<th>Month</th>
<th>Payments to Escrow Account</th>
<th>Payments from Escrow Account</th>
<th>Description</th>
<th>Escrow Account Balance</th>
</tr>
</thead>
</table>

Starting balance: ........................................................................................................ $______

[A filled-out format follows]

(PLEASE KEEP THIS STATEMENT FOR COMPARISON WITH THE ACTUAL ACTIVITY IN YOUR ACCOUNT AT THE END OF THE ESCROW ACCOUNTING COMPUTATION YEAR.)

Cushion selected by servicer: $________________.
Appendix E to Part 3500
CLO Fee Disclosure

Where the lender is requiring an attorney, credit reporting agency or real estate appraiser to represent its interest, this paragraph should be omitted.

Instructions: Whenever it is anticipated that a fee will be paid by the borrower for CLO access and related services, a disclosure form must be fully completed and delivered to the borrower itemizing the services provided and the specified fee to be charged as well as the other information set forth below. The form must provide a place for the purchaser to acknowledge its receipt. The disclosure format set forth below is satisfactory to the Secretary.

CLO FEE DISCLOSURE

To: [Potential Borrower] From: [Person Making Disclosure]

NOTICE: I am proposing to charge you a fee in the amount of $_______ for the following services:

[ ] Displaying a variety of mortgage loans and rates which may be available to you.

[ ] Counseling you regarding the different types of loans available and the relative rates in a fair and equitable manner.

[ ] Relating your personal housing needs with available loan programs; and assisting you in deciding which, if any, loan meets your needs.

[ ] Entering information regarding you into the Computer Loan Origination System (CLO).

[ ] Other ___________________________________________________________

____________________________________________________________________

THIS IS TO INFORM YOU THAT YOU ARE PAYING THIS FEE DIRECTLY TO [Person or Company Making Disclosure].

YOU ARE ADVISED THAT YOU MAY AVOID THIS FEE ENTIRELY IF YOU APPROACH A LENDER OR MORTGAGE BROKER DIRECTLY. ADDITIONALLY, LOWER MORTGAGE RATES OR OTHER LOWER FEES MAY BE AVAILABLE FROM OTHER MORTGAGE LENDERS WHO ARE NOT LISTED ON THIS COMPUTER SYSTEM.

I hereby pay [commit to pay] a CLO Fee in the amount of $________________________

____________________________________________________________________

Borrower

Received by: ____________________________

EXHIBIT F
**RESPA Changes Finalized**

by Thomas W. Grundy  
Kentucky Bankers Association

On February 10, 1994, the Department of Housing and Urban Development (HUD) issued its final rule amending Regulation X (24 CFR 3500) which implements the Real Estate Settlement Procedures Act (RESPA). This action set in motion the subordinate lien coverage mandated by the Housing and Community Development Act of 1992 (HCDA). In addition, it establishes certain exemptions from RESPA coverage. The final rule will take effect August 9, 1994, except for certain exemptions outlined in section 3500.5(b) of the regulation, which went into effect on March 14, 1994. The following information briefly highlights the key elements of the final rule.

**COVERAGE.** The final RESPA rules apply to all "federally related mortgage loans" which include loans secured by first and subordinate liens on residential real property. If no real property is taken as security in the transaction (i.e., a loan to finance the purchase of a mobile home with no real estate), RESPA rules do not apply.

**EXEMPTIONS**

**25 or More Acres** — HUD has reinstated the 25 or more acre exemption for all properties to include vacant land, property used for agricultural purposes, or one-to-four family residential real property.

**Business Purpose Loans** — HUD has created an exemption for business purpose loans in an attempt to parallel the business purpose test of Regulation Z (12 CFR 226). The business purpose test exemption applies to loans made to corporations, associations, partnerships, and trusts, as well as other entities not involving individuals. If an individual is named in the transaction, then it would not fall under the business purpose test and RESPA would apply. On March 30, HUD issued a clarification, stating that the business purpose exemption for Regulation X “extends to all business purpose transactions exempted under Regulation Z in determining whether the exemption applies. The one exception is loans to individuals to acquire, refinance, improve, or maintain one-to-four family residential properties, used or to be used, for rental purposes; these transactions have been determined by the Department to be covered by RESPA.” Therefore, the business purpose exemption applies to individuals in keeping with its application to corporations, partnerships and other organizations except in this instance. According to HUD, an individual acting as a sole proprietorship is not considered as an individual for purposes of RESPA.

**Temporary Financing** — HUD clarifies the existing exemption for temporary financing. The issuance of a commitment for permanent financing disqualifies temporary financing from this exemption. HUD further indicates that “any construction loan for new or rehabilitated one-to-four family residential property, other than a loan to a bona fide builder is subject to this part if its term is for two years or more.” Also a “bridge loan” or “swing loan” in which the lender takes a security interest in otherwise covered one-to-four family residential property is not covered by RESPA.

**Vacant Land** — HUD includes vacant land in its exemption list. This is an absolute exemption unless “within two years from the date of the settlement of the loan, a structure or manufactured home will be constructed or placed on the real property using loan proceeds.”

**Assumption Without Lender Approval** — This exemption applies to assumptions in which the lender does not have the right to approve a subsequent person as the borrower on an existing federally related mortgage loan. Conversely, any assumption in which the lender’s permission is both required and obtained is covered by RESPA, whether or not the lender charges a fee for the assumption.

**Loan Conversions** — This exemption extends to any conversion of a federally related mortgage loan to different terms that are consistent with provisions of the original mortgage instrument, as long as a new note is not required, even if the lender charges an additional fee for the conversion.

**Secondary Market Transactions** — Any bona fide transfer of a loan in the secondary market is not covered by RESPA, except as set forth in section six of RESPA/3500.21 of Regulation X which pertains to servicing of mortgage loans. In deciding what constitutes a bona fide transfer, you must consider the real source of funding and the real interest of the funding lender. Mortgage broker transactions that are table-funded are not secondary market transactions. Neither the creation of a dealer loan or dealer consumer credit contract, nor the first assignment of such loan or contract to a lender, is a secondary market transaction.

**OTHER KEY ISSUES**

**HUD-1 and HUD-1A** — HUD has created a new settlement statement, the HUD-1A. The HUD-1A may be used for transactions involving a borrower without a seller such as refinancing or subordinate lien loans. To reduce the forms requirement and expense on banks, HUD has indicated that the HUD-1 currently in use may be utilized for those types of transactions by using only the borrower’s side of the statement.

**Refinancing Defined** — HUD has provided a definition of refinancing, which provides some guidance on the type of transactions covered under RESPA. In exempting certain transactions from the definition of refinancing, HUD has followed the language of Regulation Z. For transactions included in the definition of refinancing for purposes of RESPA, borrowers should receive a good faith estimate, but not a copy of the special information booklet. At closing, banks can use either a HUD-1 or the new HUD-1A.

**Open-end Lines of Credit** — HUD has modified RESPA’s coverage to defer to Regulation Z in the treatment of home equity lines of credit. In effect, Truth-in-Lending disclosures can be provided in the place of the required RESPA disclosures. This takes in the good faith estimate and the special information booklet. Furthermore, HUD has clarified that the HUD-1 or HUD-1A need not be used provided that the transaction complies with the Truth-in-Lending Act and Regulation Z.

**Good Faith Estimate/Special Information Booklet** — In addition to the open-end credit situation discussed above, HUD has indicated that a special information booklet and good faith estimate need not be provided when the lender denies the credit before the end of the three business day period.

**Required Use Relationship Disclosure** — HUD modified the required use provider disclosure section of RESPA to clarify what is expected when identifying the relationship between the bank and the settlement service provider. In situations where the lender is not aware of the identity of the ultimate service provider at the time of the good faith estimate, HUD has modified the regulation to allow more flexibility. Lenders who maintain a controlled list of five or more potential required providers, or who rely on a list maintained by others, will provide the borrower with a written statement that the bank will require a provider from its list and a range of costs for the providers.
HUD Finalizes Escrow Accounting Rule

by Thomas W. Grundy
Director of Compliance, Kentucky Bankers Association

OVER THE YEARS, THE REAL ESTATE SETTLEMENT Procedures Act (RESPA) and the Department of Housing and Urban Development's (HUD) implementing regulations, Regulation X ("the reg"), have slowly evolved into a tremendous amount of work for lenders. From its introduction in 1974 until 1990, little change occurred in the reg, despite amendments to RESPA resulting from legislative actions at a couple points during the 1980s. However, since 1990, keeping up with changes in the reg have devoted disproportionate amounts of time for mortgage lenders, compliance officers and just about anyone involved in the mortgage documentation process.

Last December, HUD published a proposed rule on escrow accounting procedures and at the same time, other proposals greatly affecting the reg were in progress. Thus, it seems that the escrow accounting proposal may have received back burner treatment in light of other issues under consideration. Nonetheless, upon reviewing comments received from the public, HUD developed its final rule on escrow accounting which it purports is consistent with the consumer-oriented approach originally proposed. As released on October 26, 1994, the final rule is designed to:

Reduce the cost of home-ownership, by ensuring that funds are not held in escrow accounts in excess of the amount necessary to protect lenders' interests in preserving the collateral;

Establish reasonable, uniform practices for escrow accounting; and

Provide servicers with clear, specific guidance on the requirements of Section 10 of RESPA.

REVIEW OF THE BASICS. Over the years, Section 10 of RESPA has been the statutory authority setting the limits on the amounts that lenders may legally require borrowers to deposit in escrow accounts. However, due to the inherent complexity of its language, Section 10 has long been subject to debate and controversy. Section 10 at times uses the term "lender" while at other points utilizes the term "servicer." While a lender may usually act as the mortgage originator, it may not always service the loan beyond origination. One of the clarifying features of the final rule is that HUD now uses the term servicer to include the lender when the lender also acts in a servicing capacity.

Looking at one of the key elements of Section 10 — limits on escrow — a servicer may only charge the borrower an amount sufficient to pay the charges accruing to the mortgaged real estate, such as taxes and insurance, attributable to the period from the date such payments were last paid until the first full installment payment under the loan contract. In addition, the lender may charge the borrower a cushion to cover unanticipated expenses. But no more than one-sixth of the estimated total annual payments from the account. From this point forward, a servicer can only charge a borrower a monthly sum equal to one-twelfth of the total annual escrow payments that the servicer reasonably anticipates paying from the account. There again, the servicer may add an amount to maintain a cushion equal to one-sixth of the estimated total annual payments from the account.

In the interest of keeping the consumer informed, RESPA requires a servicer to provide the borrower with initial and annual escrow account statements, or face stated penalty provisions for failure to do so. Furthermore, if a servicer requires an escrow account, then the servicer shall make disbursement payments for the escrow account expenses in a timely manner as they come due.

AGGREGATE ACCOUNTING ANALYSIS. Perhaps the single most newsworthy element contained in the final rule is HUD's decision to require servicers to analyze all new escrow accounts on an "aggregate" accounting basis. This developed as a result of a prevalent practice often referred to as "single-item analysis," in which a lender accounts for each escrow item separately. Over the years, it has been determined that escrow accounts may collect more money under a single-item accounting basis than under aggregate accounting analysis. Through its own escrow account study, HUD found that too many escrow accounts were over-funded. Moreover, State Attorneys General throughout the country have determined that the single-item analysis results in substantial over-escrowing over time. Furthermore, the Attorneys General have interpreted Section 10 of RESPA as requiring use of aggregate accounting as the basis to determine the maximum allowable escrow account balances.

Under the aggregate accounting method, the sufficiency of the funds is determined by analyzing the escrow account as a whole. For new accounts, the final rule provides a 180-day phase-in and implementation period; for existing accounts, HUD is allowing up to three years as a phase-in period.
Regulatory Update

COMMUNITY REINVESTMENT ACT: Recent Developments

Jo Ann B. Heppermann
Liberty National Bank and Trust Company of Kentucky
Louisville, Kentucky

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SECTION G
COMMUNITY REINVESTMENT ACT: Recent Developments

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SECTION G
COMMUNITY REINVESTMENT ACT
Recent Developments

I. PROPOSED REFORMS OF COMMUNITY REINVESTMENT ACT ("CRA")

A. What is CRA?

1. CRA is an economic development statute designed to spur increased lending and investment in the low and moderate income neighborhoods within a bank's service area.

2. Eugene A. Ludwig, Comptroller of the Currency, said "The overarching purpose of CRA is to encourage banks to do what they can do consistent with safe and sound operations." "Banks can do business where they may not be doing business now. Banks can look for customers whom they may now overlook. Banks can make more of an effort to recognize that a person's net worth can be measured in purpose and ambition as well as in the dollars and cents of ready collateral." (Taken from a speech to the National Community Reinvestment Coalition on November 18, 1994).

3. CRA is not about fair lending. Fair lending is about discrimination; CRA is about making loans in the areas where a bank does business.

B. Why is Reform Needed?

1. Common complaints from the Banking industry are:

   (a) CRA places too much emphasis on documentation and not on performance.

   (b) There is no continuity among examiners within a particular banking regulatory agency or among the banking regulatory agencies themselves.

   (c) Banks need for CRA to provide more definiteness and clearer guidance.

2. Community groups complain that current CRA's enforcement provisions have no real "teeth."
C. Attempts at Reform.

1. The December, 1993, proposed regulation, (the "December Reg"), emphasized lending performance which was measurable (58 Fed. Reg. 67466, December 21, 1993). It was very definite and provided clear guidance regarding what banks needed to do in order to obtain a satisfactory or outstanding rating. It contained onerous and duplicative reporting requirements. It also contained very strict enforcement provisions. The overwhelming response by the banking industry to the December Reg was that it was too rigid and inflexible.

2. The September, 1994, proposed regulation, (the "September Reg"), contains many of the same provisions as December Reg, just with more "waffle words" (59 Fed. Reg. 51232, October 7, 1994). Some of the reporting requirements have been scaled back while other new data reporting requirements have been added.

II. BRIEF OVERVIEW OF SEPTEMBER REG.

The September Reg provides for different CRA testing methods depending on the size or type of bank.

A. Large Retail Banks (Assets in excess of $250 Million)

These banks will be judged based on a composite rating of three tests: Lending, Investment and Service. Each test will receive a separate score, but the Lending Test score will account for 50 percent of the composite score. A bank which does not score at least a "Low Satisfactory" in the Lending Test cannot receive a "Satisfactory" rating overall.

1. Each bank will be tested on a case-by-case basis within the agency-determined context of:

(a) demographic data on income levels, housing costs, etc. in the bank's delineated service area,

(b) credit needs of the bank's delineated service area,

(c) bank's products and business strategy as well as capacity and constraints,

(d) bank's past performance and the performance of similarly situated institutions,
(e) bank's CRA public file, and
(f) any other information deemed relevant (!)

2. Of the three tests, the Lending Test is the most important. A bank will be evaluated based on its performance in helping to meet the credit needs of its service area as measured by the number and amount of (i) home mortgages, (ii) small business and small farm loans outstanding and (iii) community development loans outstanding. Other consumer loans can be added to the mix, such as auto loans and credit card loans, but the bank must then compile the same data that is required for home mortgages such as geographic location, borrower incomes and year end outstanding balances on each such loan. Also, consumer loans made by a nonbank affiliate, such as a mortgage company, can be included, but only if the bank includes all consumer loans made by all of its other nonbank affiliates.

(a) Under the Lending Test, the examiners will look at (i) how much of the bank's lending is within its service area, (ii) how the loans in the service area are distributed between low and moderate income areas ("LMI") and middle and upper income areas ("UMI"), and (iii) how the loans are dispersed among income levels. A major criticism of the December Reg was that it required a bank to have a certain percentage of the market share of loans in a particular area in order to get a Satisfactory or better rating. The September Reg did away with the market share requirement. However, based on what the examiners are looking for, penetration of LMIs in bank's service area will still be very critical. Service areas must be fairly assessed (must include areas around bank branches where consumer and small businesses are made), must include whole census tracts and can't exclude LMIs arbitrarily.

(b) Loans to small businesses (gross revenues of less than $1 million a year) are part of the Lending Test mix—but under the September Reg, banks will have to collect data on all small business loans (any commercial or industrial loan of $1 million or less). (Note—the definitions don't match up.) Part of the data banks would be required to attempt to collect
is the race and gender of the owners of the entity receiving the small business loan. Why? (This is CRA not Fair Lending). Federal Reserve Board Governor Lawrence Lindsey said regarding the requirement to collect this data, "Citizens will rightly be puzzled as to our purpose." (Federal Banking Law Reporter, Report Letter--No. 6 dated 10/10/94).

(c) Examiners will also look at the number and dollar amount of the bank's community development loans and the complexity thereof as well as the bank's innovative or flexible lending practices used to address the credit needs of the bank's service areas. If the bank does an "adequate" level of lending but has limited innovative or flexible lending practices, then the bank will receive a "Low Satisfactory" lending rating.

3. The Investment Test will assess the bank's extent of investments in projects or organizations that (i) promote community development or affordable housing, or (ii) demonstrably benefit low and moderate income individuals or small businesses. The types of investments that will be included are investments in (i) community development banks, (ii) small business investment companies, (iii) housing bonds, and (iv) investments or grants to non-profit organizations serving low and moderate income housing needs or those that support, develop or provide facilities and services such as day care centers, home-ownership counseling, home maintenance counseling, credit counseling or other activities that enhance the ability of low and moderate income individuals to utilize credit or sustain economic development. Bank's can also include investments by bank's Community Development Corporation if such investments aren't included somewhere else.

4. The Service Test looks at:

(a) the bank's system for delivering its banking services by looking at the location of the bank's branches and ATMs as well as the availability of alternative banking systems (computer hookups, pay by phone, etc.) Examiners will look to see if the services available in the LMI areas are comparable to the services available in UMI areas.
(b) the extent and innovativeness of community
development services such as technical
expertise or lending staff to community
organizations, credit counseling, etc.
Caveat—the activity must be one that enhances
the ability of low and moderate income
individuals to utilize credit or sustain
economic development.

B. Streamlined Exam Option for Small Banks  (Independent
banks with less than $250 million in assets or banks
which are a part of a holding company with assets under
$250 million).

1. The exam process is streamlined in that examiners
base the bank’s rating on the following criteria:

(a) bank’s loan-to-deposit ratio (60 percent loan-
to-deposit ratio no longer required for a
satisfactory rating) and other lending related
activities,

(b) the percentage of the bank’s lending within
the bank’s service area and how those loans
are geographically distributed in the service
area,

(c) the distribution of loans over all income
groups, and

(d) the bank’s record in responding to written
complaints about its CRA performance.

2. Small banks will not be required to collect the
data the large banks are required to collect. But
note the emphasis is still on where loans are made—
so small banks are going to need to be able to
prove they are serving their entire market.

3. It’s difficult to understand how examiners will
determine the bank’s rating. September Reg says
that small banks will be rated using same matrix as
used for large banks—but small bank criteria does
not fit into matrix.

4. Why should small banks which are a part of a larger
holding company be treated any differently that a
independent small bank?

C. Strategic Plan Option.

1. Both large retail banks and small banks can opt to
prepare a CRA plan, with the help of informal suggestions solicited during the development stage, of up to five years in length which has measurable yearly goals. Once the plan is finalized, the bank would formally solicit public comment for 30 days. The plan, plus any comments and any revisions to the plan as a result, would be submitted to the bank's primary regulator for review at least 60 days prior to implementation. If the plan is implemented, the bank would be rated on how the bank has complied with its plan.

2. Large banks will still need to collect same data as other large banks.

3. Will plan have to disclose too much regarding a bank’s future plans?

D. Community Development Test.

Limited purpose banks (such as credit card banks with national or regional scope) and wholesale banks (banks which are not in the business of extending home mortgages, small businesses, small farms or consumer loans to retain customers) may, if they so request, be evaluated on the number and amount of qualified investments, community development lending and community development services provided in their service area (the local area or areas around its offices).

E. Enforcement Provisions.

1. The enforcement provisions in the September Reg (and December Reg) include not only taking CRA performance into account when acting on applications but also include the sanctions which are in place for the violation of other banking regulations such as:

   (a) $1 million per violation per day,

   (b) a ban on bank officers and directors that impeded CRA efforts,

   (c) cease and desist orders against the bank,

   (d) requiring the bank to compensate victims harmed by the lack of community investment efforts, and

   (e) withdrawal of FDIC insurance.
2. The Justice Department has determined that the banking agencies overstepped their bounds by including the above sanctions. The Justice Department said the agencies were limited to the enforcement powers in CRA itself; namely, (i) the denying of applications for expansion through such means as mergers, acquisitions or new branches and (ii) the encouraging of more vigorous efforts to meet the communities' borrowing needs. The Justice Department said that the imposing of sanctions went beyond "encouraging more vigorous efforts." (JO ANN--GET CITE!)

F. Evidence of Discrimination.

This is the Fair Lending Hook. The September Reg says that evidence of discriminatory or other illegal credit practices SHALL (emphasis added) adversely affect a bank's overall performance. Just how much performance will be affected depends on the extent of discrimination, the policies and procedures in place to prevent such discrimination, actions taken by the bank to discover and then correct such discrimination, etc. Voluntary corrective action taken as a result of self-testing or self-assessment will be viewed favorably.

G. Transition Period.

1. Data collection to begin six month after publication of final rule.

2. Assessments under the proposed lending, service and investment tests would be mandatory beginning July 1, 1996--but large banks could ask to be examined under the September Reg earlier.

3. Small banks could choose to be examined under the streamlined method anytime after July 1, 1995.

III. BANKING INDUSTRY'S RESPONSE TO SEPTEMBER REG.

A. Delight with Justice Department's opinion.

B. Loud booing by large retail banks regarding the new data collection requirements--particularly the tracking of race and gender of owners of businesses who receive small business loans.

C. Major concern about the exclusion of non-mortgage consumer loans from the Lending Test unless onerous reporting requirements are met.
D. Desire to increase minimum number of assets to $5 million in order to be included under definition of small bank.

E. Concern that September Reg will not provide any more certainty than the current rule. The staff members of the Federal Reserve Board share that view. They told the Reserve Board that examiner judgment would play as big a part in enforcing the September Reg as it did in enforcing the current regulation. Federal Banking Law Reporter, Report Letter--No. 6 dated 10/10/94.

F. "Some analysts have suggested that the biggest beneficiary of the CRA reforms may actually be the regulators themselves, because the increased workload will prevent anticipated staff cuts at the bank regulatory agencies and may require the hiring of additional examiners. The Federal Reserve, for example, has estimated that it will have to hire 50 new examiners plus additional researchers and statisticians to handle the more comprehensive exams and data analysis the revised CRA regs will require. CRA Bulletin, Warren Gorham Lamont, February, 1995, Volume 4/No. 5, pg. 3.

IV. STATUS OF REFORM

A. The effect of the November, 1994 elections is unknown. However, Rep. Marge Roukema, (N.J. Rep.), the head of the House Banking subcommittee, sent a letter to the four agencies urging the agencies not to make the proposed revisions final until Congress had adequate time to review the impact of the revisions, indicating that Congress intended to commence hearings in the very near future on the impact of CRA reform. (American Banker, Thursday, January 19, 1995, pg. 2). FDIC Chairman Ricki Tigert Helfter indicated that the FDIC would not issue any final ruling until those hearings were held. (Wall Street Journal, Monday, January 23, 1995). Meanwhile, Al Gore told the agencies that the Administration wanted the final rules by March 31, 1995.

B. Rep. Roukema accused the agencies of already using the September Reg in their CRA examinations. (American Banker, Thursday, January 19, pg. 2). Jo Ann Barefoot, president of Barefoot, Marrinan & Associates Inc., said, "Examiners are using the new rules. Move quickly to imagining life under the new reg." (American Banker, Thursday, January 26, 1995, pg. 10). "The measurement of volume is going to be the whole ball game. And you can’t get those loans on the books overnight." (Id.)

I think she is right--Forewarned is Forearmed!
### Current CRA Regulation

#### December 1993 Proposal
- **Twelve Assessment Factors**
- **Three Assessment Tests** - lending, service and investment - for all large and small retail institutions; wholesale and limited purpose institutions evaluated under a new community development test.
- Three assessment tests - lending, service and investment - for all large retail institutions.
- The streamlined assessment method for smaller institutions.
- Determination of overall rating.
- The presumption under streamlined procedures if the rating could then be increased or decreased based on extraordinarily weak or strong performance under the lending test.
- The presumption that a 60 percent loan-to-deposit ratio would be satisfactory.

#### September 1994 Proposal
- **Twelve Assessment Factors**
- **Three Assessment Tests** - lending, service and investment - for all large and small retail institutions; wholesale and limited purpose institutions evaluated under an approved strategic plan.
- The presumption under streamlined procedures if the rating could then be increased or decreased based on extraordinarily weak or strong performance under the lending test.
- The presumption that a 60 percent loan-to-deposit ratio would be satisfactory.

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**September 26, 1994**
### Performance under the Lending Test

- Performance when appropriate in evaluating
- Competitive comparisons that examiners would use
- Performance language has been reduced.

### Market Share

- No market share provisions.

### Market Share

- No alternative assessment

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<tr>
<th>September 26, 1994</th>
<th>December 1993 Proposal</th>
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<td><strong>Areas:</strong></td>
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<td>Loans in lower- and moderate-income areas compared to market share of loans in middle- and upper-income areas</td>
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<td><strong>Proposals:</strong></td>
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<td>Revised to provide greater clarification of plan development process, provisions for community input, and goal specifications.</td>
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<td>Maximum plan term lengthened to 5 years, and plan amendment procedures.</td>
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Institutions are required to prepare lengthy eRA over process. Emphasis is placed on performance, not lengthy eRA over process, and no longer required to "document the flies." In addition to taking eRA performance into account when acting on applications, regulators would enforce eRA compliance in the same manner as any other regulation, and could impose formal enforcement actions. Institutions would engage in marketing and outreach efforts.

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<tr>
<th>Small Farm Loans</th>
<th>Consumer Loans</th>
<th>Small Farm Loans</th>
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<tr>
<td>No Race or Gender data collected for</td>
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<td>Enforcement actions would be required.</td>
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<td>Large banks and thrifts would have to collect race, ethnicity, and gender data on small business or small farm loans.</td>
<td>Large banks and thrifts would have to collect race, ethnicity, and gender data on consumer loans.</td>
<td>Large banks and thrifts would have to collect race, ethnicity, and gender data on small business or small farm loans.</td>
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<td>Resources to &quot;documenting the files.&quot; would be required.</td>
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Current CRA Regulation

SEPTEMBER 1994 PROPOSAL

DECEMBER 1993 PROPOSAL
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Institutions' public file: Development loans would be included in large banks and thrifts reporting and small farm loans and community bank call reports. Annual revenues of more or less than $75 million, aggregate data on small business borrowers would include an indication of whether the business or farm had gross annual revenues of more or less than $75 million. Large banks and thrifts would be required to collect and report data on the geographic distribution of and the race, ethnicity and gender of housing, consumer, small business, and farm loans. They would also report data on the size of businesses to which loans were made. These new reporting requirements would be in addition to existing HMDA reporting requirements.

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Large banks and thrifts would collect and report certain data on the geographic distribution of small business and small farm loans. Some data would be reported by loan size, and would indicate whether the business or farm had gross annual revenues of more or less than $1 million. Aggregate data on small business and small farm loans would be included in an institution's public file. Large banks and thrifts would be required to report data on home mortgage loans made outside of MSAs, required to report data on home mortgage loans made under HMDA, and on loan origination and purchase data. They would also report data on the geographic distribution of small business, consumer, and community development loans. No data collected and reported on the geographic distribution of small business and community development loans.
Regulatory Flexibility Act

OCC: It is hereby certified that this proposed rule, if adopted as a final rule, will not have a significant economic impact on a substantial number of small banks. Accordingly, a regulatory flexibility analysis is not required. This proposal would enable most small banks to avoid the data collection requirements in 12 CFR Part 228 and will encourage greater small business lending by financial institutions of all sizes. Accordingly, a regulatory flexibility analysis is not required. The Board invites comment on this matter.

FDIC: It is hereby certified that this proposed rule, if adopted as a final rule, will not have a significant economic impact on a substantial number of small banks. This proposal would enable most small banks to avoid the data collection requirements in 12 CFR Part 345 and will encourage greater small business lending by financial institutions of all sizes. Accordingly, a regulatory flexibility analysis is not required.

OTS: It is hereby certified that this proposed rule, if adopted as a final rule, will not have a significant economic impact on a substantial number of small savings associations. This proposal provides an alternative means of evaluating a small savings association's CRA requirements that would enable most such savings associations to avoid the data collection requirements in 12 CFR Part 563e and will encourage greater small business lending by savings associations of all sizes.

Executive Order 12866

OCC: It has been determined that this document is a significant regulatory action. The proposal would clarify existing requirements and would exempt small banks from many of the requirements in 12 CFR Part 25. Further, the proposal will encourage greater small business lending by banks of all sizes.

OTS: It has been determined that this document is a significant regulatory action. The proposal sets forth a more focused and streamlined method of evaluating savings associations' compliance with existing statutory requirements; moreover it would exempt small savings associations from many of the requirements in 12 CFR Part 563e. Further, the proposal will encourage greater small business lending by savings associations of all sizes.

List of Subjects

12 CFR Part 228
Community development, Credit, Federal Reserve System, Investments, Reporting and recordkeeping requirements.

12 CFR Part 345
Banks, Banking, Community development, Credit, Investments, Reporting and recordkeeping requirements.

12 CFR Part 563e
Community development, Credit, Investments, Reporting and recordkeeping requirements, Savings associations.

Authority and Issuance

OFFICE OF THE COMPTROLLER OF THE CURRENCY

12 CFR CHAPTER I

For the reasons outlined in the joint preamble, the Office of the Comptroller of the Currency proposes to amend 12 CFR chapter I as set forth below:

PART 25—COMMUNITY REINVESTMENT ACT REGULATIONS

1. The authority citation for part 25 is revised to read as follows:

Authority: 12 U.S.C. 21, 22, 26, 27, 30, 36, 93a, 161, 215, 215a, 481, 1814, 1814a, 1815, 1826(c), and 2901 through 2907.

§ 25.101 [Redesignated as § 25.9]

2. Existing § 25.101 is redesignated as § 25.9 and transferred with its undesignated center heading immediately following § 25.8.

3. Part 25 is amended by adding Subparts A through E and Appendices A through C following § 25.9 to read as follows:

Subpart A—General
Sec.
25.11 Authority, community reinvestment obligation, purposes and scope.
25.12 Definitions.

Subpart B—Standards for Assessing Performance

25.21 Assessment tests and ratings, in general.
25.22 Lending test.
25.23 Investment test.
25.24 Service test.
25.25 Community development test for wholesale or limited purpose banks.
25.26 Small bank assessment standards.
25.27 Strategic plan assessment.
25.28 Assigned ratings.
25.29 Effect of ratings on applications.

Subpart C—Records, Reporting and Disclosure Requirements

25.41 Service area delineation.
25.42 Data collection and reporting.
25.43 Public file and disclosure by banks.
Subpart A—General
§ 25.11 Authority, community reinvestment obligation, purposes and scope.
(a) Authority and OMB control number—(1) Authority. The authority for this part is 12 U.S.C. 21, 22, 26, 27, 30, 36, 43a, 161, 215, 215a, 461, 1814, 1816, 1818, 1826(c), and 2901 through 2907.
(b) OMB control number. The information collection requirements contained in this part have been assigned OMB control number 1557-0160.
(c) Purposes. The purposes of this part are to implement the community reinvestment obligation of national banks; to explain how the Office of the Comptroller of the Currency (OCC) assesses the performance of national banks in satisfying the community reinvestment obligation; and to describe how that performance is taken into account in certain applications.
(d) Scope—(1) General. This part applies to all national banks that are in the business of extending credit to the public, including wholesale or limited purpose banks, as defined in §25.12 of this part.
(2) Certain special purpose banks. This part does not apply to a bankers bank that engages exclusively in providing services for other depository institutions and for their officers, directors and employees, or to other special purpose banks described in §25.101 of this part.
(3) Federal branches and agencies. This part applies to insured Federal branches. References in this part to "main office" mean, in the case of insured Federal branches of foreign banks, the principal branch within the United States. The "service area" of an insured Federal branch refers to the community or communities located within the United States served by the branch as described in §25.41 of this part. The term "branches" refers to insured branches located within the United States. As provided in §28.102 of this chapter, this part does not apply to Federal agencies, limited Federal branches, and uninsured Federal branches.
§ 25.12 Definitions.
For purposes of this part, the following definitions apply:
(a) Affiliate means any company that controls, is controlled by, or is under common control with another company.
(b) Area median income means the median family income for the MSA in which a person or geography is located or, in the case of a person or geography located outside an MSA, the higher of the county median family income or the statewide nonmetropolitan median family income.
(c) Automated teller machine (ATM) means an automated, unstaffed banking facility with a fixed site owned or operated by or operated exclusively for the bank at which deposits are received, cash dispersed, or money lent.
(d) Bank means a national bank.
(e) Branch means a staffed banking facility (shared or unshared) licensed as a branch with a fixed site at which deposits are received, checks paid, or money lent, including a mini-branch in a grocery store or a branch operated in conjunction with any other local business or nonprofit organization.
(f) Community development loan means a loan (including a line of credit, commitment, or letter of credit) that addresses affordable housing (including multifamily rental housing) or other community economic development needs not being met by the private market; provided the loan:
(1) Primarily benefits low- or moderate-income individuals, businesses or farms with gross annual revenues less than or equal to $1 million, or businesses or farms that qualify as businesses eligible under a Small Business Administration program;
(2) Has not been reported or collected by the bank or one of its affiliates as a home mortgage loan, small business loan, small farm loan, or a consumer loan pursuant to §25.42 of this part, unless it is a multifamily dwelling loan (as described in Appendix A to 12 CFR Part 203); and
(3) Except in the case of a wholesale or limited purpose bank, benefits the bank's service area(s) or a broader statewide or regional area that includes the bank's service area(s).
(g) Consumer loan means a loan extended to one or more individuals for household, family, or other personal expenditures; provided the loan is not secured by real estate and is not used for the purpose of purchasing or carrying securities.
(h) Geography means a census tract delineated by the United States Bureau of the Census in the most recent decennial census, or a block numbering area delineating a small statistical subdivision where a census tract has not been established.
(i) HMDA means the Home Mortgage Disclosure Act (12 U.S.C. 2801 et seq.).
(j) Home mortgage loan means a mortgage loan as defined in section 301(1) of HMDA (12 U.S.C. 2802(1)) and implementing regulations.
(k) Income level—(1) Low-income means, in the case of a person, an individual income, or in the case of a geography, a median family income, that is less than 50 percent of the adjusted area median income, with adjustments to take into account family size and the prevailing levels of residential housing construction costs or unusually high or low family incomes.
(2) Moderate-income means, in the case of a person, an individual income, or in the case of a geography, a median family income, that is between 50 percent and less than 80 percent of the adjusted area median income, with adjustments to take into account family size and the prevailing levels of residential housing construction costs or unusually high or low family incomes.
(3) Middle-income means, in the case of a person, an individual income, or in the case of a geography, a median family income, that is at least 80 percent and less than 120 percent of the adjusted area median income, with adjustments to take into account family size and the prevailing levels of residential housing construction costs or unusually high or low family incomes.
(4) Upper-income means, in the case of a person, an individual income or, in the case of a geography, a median family income, that is at least 120 percent or more of the adjusted area median income, with adjustments to take into account family size and the prevailing levels of residential housing construction costs or unusually high or low family incomes.
(l) Limited purpose bank means a bank that offers only a narrow product line (such as credit cards or automobile
loans) to a national or regional market and has, pursuant to a written request, been designated by the OCC as a limited purpose bank, as provided in § 25.25 of this part.

(iii) Loan location. A loan is located in a geography as follows:

(1) A consumer loan is located where the borrower resides;
(2) A home mortgage loan is located where the property to which the loan relates is located;
(3) A small business or small farm loan is located where the main business facility or farm is located or where the loan proceeds otherwise will be applied, as indicated by the borrower.

(iv) Loan production office means a staffed banking facility that is accessible to the public, and provides lending-related services such as loan information and applications, but is not a branch.

(v) MSA means metropolitan statistical area or primary metropolitan statistical area as defined by the Director of the Office of Management and Budget.

(vi) Minority means an individual who is an American Indian or Alaskan Native, an Asian or Pacific Islander, a Black, or of Hispanic origin as provided in the Office of Management and Budget’s Statistical Policy Directive No. 15, Race and Ethnic Standards for Federal Statistics and Administrative Reporting.

(vii) Minority-owned business means a business, including a farm, that is more than 50 percent owned by one or more minority individuals, and that has not issued any securities registered under Section 12(g) of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) and has 100 or fewer shareholders.

(viii) Loan location. A loan is located in a geography as follows:

(1) A consumer loan is located where the borrower resides;
(2) A home mortgage loan is located where the property to which the loan relates is located;
(3) A small business or small farm loan is located where the main business facility or farm is located or where the loan proceeds otherwise will be applied, as indicated by the borrower.

(n) Loan production office means a staffed banking facility that is accessible to the public, and provides lending-related services such as loan information and applications, but is not a branch.

(o) MSA means metropolitan statistical area or primary metropolitan statistical area as defined by the Director of the Office of Management and Budget.

(p) Minority means an individual who is an American Indian or Alaskan Native, an Asian or Pacific Islander, a Black, or of Hispanic origin as provided in the Office of Management and Budget’s Statistical Policy Directive No. 15, Race and Ethnic Standards for Federal Statistics and Administrative Reporting.

(q) Minority-owned business means a business, including a farm, that is more than 50 percent owned by one or more minority individuals, and that has not issued any securities registered under Section 12(g) of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) and has 100 or fewer shareholders.

(r) Service area means a geographical area delineated in accordance with § 25.41 of this part.

(s) Small bank means a bank with total assets of less than $250 million that is:

(1) Independent; or
(2) An affiliate of a holding company with total banking and thrift assets of less than $250 million.

(t) Small business loan means a loan with an original amount of $1 million or less that is either a commercial or industrial loan or a loan secured by nonfarm, nonresidential property.

(u) Small farm loan means a loan with an original amount of $500,000 or less that is a loan secured by farmland (including a loan to finance a farm residence or other improvements), a loan to finance agricultural production, or any other loan to a farmer.

(v) Women-owned business means a business, including a farm, that is more than 50 percent owned by one or more women, and that has not issued any securities registered under Section 12(g) of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) and has 100 or fewer shareholders.

(vi) Wholesale bank means a bank that is not in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers, and has, pursuant to a written request, been designated by the OCC as a wholesale bank, as provided in § 25.25 of this part.

Subpart B—Standards for Assessing Performance

§ 25.21 Assessment tests and standards, in general.

(a) Assessment tests and standards. In connection with an examination of a bank, the OCC shall assess the Community Reinvestment Act (CRA) performance of the bank as follows:

(1) Lending, investment, and services tests. The OCC shall apply these three tests, as described in §§ 25.22 through 25.24 of this part, in evaluating the performance of banks, except as provided in paragraphs (a)(2), (3) and (4) of this section.

(2) Community development test for wholesale or limited purpose banks. In evaluating the performance of wholesale or limited purpose banks (as defined in § 25.12 of this part), the OCC shall apply the community development test, as provided in § 25.25 of this part, except as provided in paragraph (a)(4) of this section.

(3) Assessment standards for small banks. In evaluating the performance of small banks (as defined in § 25.12 of this part), the OCC shall apply the assessment standards for small banks as provided in § 25.26 of this part.

However, a small bank may elect instead to be assessed as provided in paragraphs (a)(2) and (4) of this section, or it may elect to be evaluated under paragraph (a)(1) of this section if it has collected and reported the data required for other banks under § 25.42(a)(1) of this part.

(4) Strategic plan. Any bank may elect not to be assessed by any tests described in paragraphs (a)(1), (2) and (3) of this section by submitting to the OCC and receiving approval of a strategic plan as described in § 25.27 of this part.

(b) Assessment context. The OCC shall apply the tests and standards in paragraph (a) of this section in the context of the following information:

(1) Demographic data on median income levels, distribution of household income, nature of housing stock, household costs, and other relevant data pertaining to a bank’s service area(s);

(2) Examiner-developed information regarding the credit needs of the bank’s service area(s) obtained from community-based organizations, state and local governments, economic development agencies, and from any information the bank may choose to provide;

(3) The bank’s product offerings and business strategy as determined from data provided by the bank;

(4) Institutional capacity and constraints, including the size and financial condition of the institution, the economic climate (national, regional and local), safety and soundness limitations, and any other factors that significantly affect the bank’s ability to lend to the different parts of its service area(s);

(5) The bank’s past performance and the performance of similarly-situated lenders;

(6) The bank’s public file, as described in § 25.43 of this part, and any signed, written comments about the bank’s CRA performance submitted to the bank or the OCC; and

(7) Any other information deemed relevant by the OCC.

(c) Assigned ratings. The OCC shall assign to each bank one of the following four ratings as set out in § 25.28 of this part and Appendix A of this part: "outstanding"; "satisfactory"; "needs to improve"; or "substantial noncompliance" based on:

(1) The results of the applicable assessment test(s) or standards or performance under an approved strategic plan; and

(2) Any evidence of discriminatory or other illegal credit practices.

(d) Safe and sound operations. This part and the CRA do not require any bank to make loans or investments, or to provide services that are inconsistent with safe and sound operations. Banks are permitted and encouraged to develop and apply flexible underwriting standards, consistent with safe and sound operations. Banks are permitted and encouraged to develop and apply flexible underwriting standards, consistent with safe and sound operations.

(e) Compliance with community reinvestment obligation. The assigned ratings reflect the extent of compliance or noncompliance with the community reinvestment obligation described in § 25.11(b) of this part. A bank that receives an assigned rating of "substantial noncompliance" shall be subject to enforcement actions pursuant to 12 U.S.C. 1818.

§ 25.22 Lending test.

(a) Scope of test. (1) The lending test evaluates a bank’s performance in helping to meet the credit needs of its
service area(s) through its lending activities, as measured by home mortgage originations and purchases, small business and small farm loans outstanding, and community development loans outstanding. At the bank’s option, the lending test will also evaluate the bank’s consumer loans outstanding and any other loan distribution data the bank may choose to provide, such as data on extensions of lines of credit, commitments, and letters of credit.

(2) When evaluating a bank’s overall lending performance, the OCC shall weigh its assessments of the bank’s home mortgage lending, small business and small farm lending, and (at the bank’s option) consumer lending to reflect the relative importance of each category of lending to the bank’s overall business.

(3) The OCC shall weigh the bank’s community development lending according to the characteristics and needs of the bank’s service area(s), the capacity and constraints of the bank, and the opportunities available to the bank for this lending.

(b) Assessment criteria. The OCC shall evaluate a bank’s lending performance pursuant to the following criteria:

(1) Geographic distribution. The geographic distribution of the bank’s lending (based on the location of the loan as provided in § 25.12 of this part), including:

(i) The proportion of total lending in the bank’s service area(s);

(ii) The dispersion of lending throughout the bank’s service area(s); and

(iii) The number and amount of loans in low-, moderate-, middle-, and upper-income geographies in the bank’s service area(s);

(2) Borrower characteristics. The distribution, particularly in the bank’s service area, of the bank’s lending (based on borrower characteristics), including:

(i) The number and amount of home mortgage loans to low-, moderate-, middle-, and upper-income individuals;

(ii) The number and amount of small business and small farm loans to businesses and farms with gross annual revenues less than or equal to $1 million;

(iii) The number and amount of small business and small farm loans by size of loan; and

(iv) At the bank’s option, the number and amount of consumer loans to low-, moderate-, middle-, and upper-income individuals;

(3) Community development lending. The bank’s community development lending, including the number and amount of community development loans outstanding, their complexity and innovativeness, and the number and amount of lines of credit, commitments, and letters of credit.

(c) Innovative or flexible lending practices. The bank’s use of innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies.

(d) Affiliate lending. (1) The OCC shall, if the bank elects, consider in its assessment of a bank’s lending performance under this section lending by an affiliate of the bank, if the bank, or its affiliate, reports or collects the lending data pursuant to § 25.42 of this part.

(2) The OCC may consider in its assessment lending by a bank’s affiliate even if the bank has chosen not to have the affiliate’s lending considered if the OCC determines that this lending is integral to the business of the bank.

(3) Consideration of affiliate lending shall be subject to the following constraints:

(i) No affiliate may claim the same loan as another institution; and

(ii) If the OCC considers loans within a particular lending category (e.g., home mortgage, small business, small farm, consumer or community development lending) made by one or more of the bank’s affiliates in a particular service area, the OCC shall consider all the loans within that lending category made by all of the bank’s affiliates in that particular service area.

(e) Consortia and third-party lending. Community development loans made through consortia in which the bank participates or through third parties in which the bank has invested.

(f) Investment performance rating. The OCC shall evaluate the investment performance of a bank pursuant to the following criteria:

(1) The dollar amount of qualified investments that directly address credit needs;

(2) The use of innovative or complex qualified investments to support community development initiatives; and

(3) The degree of responsiveness to credit and community economic development needs.

§ 25.24 Service test.

(a) Scope of test. The service test evaluates a bank’s record of helping to meet the credit needs of the bank’s...
service area(s) by analyzing both the availability and responsiveness of a bank’s systems for delivering retail banking services and the extent and innovativeness of its community development services.

(b) Assessment criteria—retail banking services. The OCC shall evaluate the availability and responsiveness of a bank’s systems for delivering retail banking services, pursuant to the following criteria:

(1) The current distribution of the bank’s branches and ATMs among low-, moderate-, middle-, and upper-income geographies;

(2) In the context of its current distribution of the bank’s branches and ATMs, the bank’s record of opening and closing branches and ATMs, particularly branches and ATMs located in low- or moderate-income geographies or primarily serving low- or moderate-income individuals;

(3) The availability of alternative systems for delivering retail banking services, e.g., banking by telephone or computer, mobile branches and ATMs, ATMs not owned or operated by or operated exclusively for the bank, loan production offices, and bank-at-work or by-mail programs, in low- and moderate-income geographies and to low- and moderate-income individuals; and

(4) The range of services provided in low-, moderate-, middle-, and upper-income geographies and the degree to which the services are tailored to meet the needs of those geographies.

(c) Assessment criteria—community development services. (1) Community development services are services that:

(i) Primarily benefit low- or moderate-income individuals, businesses or farms with gross annual revenues less than or equal to $1 million, or businesses or farms that qualify as small businesses under a Small Business Administration program; and

(ii) Address affordable housing (including multifamily rental housing) or other community economic development needs that are not being met by the private market.

(2) The OCC shall evaluate community development services pursuant to the following criteria:

(i) The extent to which the bank provides community development services; and

(ii) The innovativeness and responsiveness of community development services.

(3) When evaluating a bank’s overall service performance, the OCC shall weigh the bank’s community development services according to the characteristics and needs of the bank’s service area(s), the capacity and constraints of the bank, and the opportunities available to the bank to provide community development services.

(4) At a bank’s option, the OCC shall consider in its assessment of a bank’s service performance a community development service provided by an affiliate of the bank, provided that the community development service is not claimed by any other institution.

(d) Service performance rating. The OCC shall rate a bank’s service performance as provided in Appendix A of this part.

§ 25.25 Community development test for wholesale or limited-purpose banks.

(a) Scope of test. (1) The OCC shall assess the degree to which a wholesale or limited purpose bank (as defined in § 25.12 of this part) is helping to meet the credit needs of its service area(s) under the community development test only if the bank’s written request to be designated as a wholesale or limited purpose bank has been approved by the OCC before the commencement of its CRA examination and the designation has not been revoked at the request of the bank or at the OCC’s own initiative.

(2) The community development test evaluates the record of a wholesale or limited purpose bank in helping to meet the credit needs of its service area(s) through qualified investments, community development lending, or community development services.

(b) Assessment criteria. The OCC shall evaluate the community development performance of a wholesale or limited purpose bank pursuant to the following criteria:

(1) The number and amount of community development loans outstanding, qualified investments (as defined in § 25.23 of this part), or community development services (as defined in § 25.24 of this part);

(2) The use of innovative or complex qualified investments, community development services outstanding, or community development services and their connection to credit needs; and

(3) The degree of responsiveness to credit and community economic development needs.

(c) Indirect activities. The OCC shall consider the qualified investments, community development loans outstanding, and community development services provided by a wholesale or limited purpose bank’s community development performance pursuant to the following criteria:

(1) The extent to which the bank is helping to meet the credit needs of its service area(s) under the assessment standards described in this section.

(2) Community development lending by affiliates, consortia and third parties, subject to the requirements and limitations in § 25.22(c)(3) and (d) of this part.

(d) Benefit to service area(s). The OCC shall consider the qualified investments, community development loans outstanding, and community development services provided by a wholesale or limited purpose bank that benefit areas outside the bank’s service area(s) only up to the amount equivalent to the amount of investments, loans, and services considered under paragraph (d)(1) of this section. If a bank demonstrates a limited need or opportunity for these investments, lending, and services, the OCC may exempt the bank from all or part of this limitation.

(e) Community development performance rating. The OCC shall rate a bank’s community development performance as provided in Appendix A of this part.

§ 25.25 Small bank assessment standards.

(a) Scope of assessment. The OCC shall assess the degree to which a small bank is helping to meet the credit needs of its service area(s) under the assessment standards described in this section.

(b) Assessment criteria. The OCC shall evaluate a small bank’s CRA performance pursuant to the following criteria:

(1) The bank’s loan-to-deposit ratio, adjusted for seasonal variation and, as appropriate, other lending-related activities, such as loan originations for sale to the secondary markets or community development lending or investment:
25.27 Strategic plan assessment.

(a) Alternative election. A bank may request to be rated under a strategic plan rather than under the lending, service, and investment tests (§§ 25.22 through 25.24 of this part), the community development test (§ 25.25 of this part), or the small bank assessment standards (§ 25.26 of this part), by submitting to the OCC a strategic plan as provided for in this section. A bank’s request to be rated under a strategic plan is not approved until the OCC approves the plan. The OCC’s approval of a strategic plan does not affect the bank’s obligation, if any, to report data as required by § 25.42 of this part.

(b) Strategic plans in general. (1) A plan may have a term of no more than five years, and any multi-year plan shall include annual interim measurable goals according to which the OCC shall evaluate the bank’s performance.

(2) A bank with more than one service area may prepare a single plan for all of its service areas or a plan for one or more but not all of its service areas.

(3) Affiliated institutions may prepare joint plans if the plans provide measurable goals for each institution.

(c) Public participation in strategic plan development. Before submitting a plan to the OCC for approval, the bank shall:

(1) Informally seek suggestions from the public in its service area(s) while developing the plan;

(2) Once the bank has developed a plan, formally solicit public comment on the plan for at least 30 days by publishing notice in a newspaper of general circulation in each of its service areas; and

(3) During the period of formal public comment, make copies of the plan available for review at all offices of the bank in any service area covered by the plan.

(d) Submission of plan. The bank shall submit its plan to the OCC at least three months prior to the proposed effective date of the plan. The bank shall also submit with its plan any public comments received, and if the plan was revised in light of the comments received, the initial plan as released for public comment.

(e) Plan content—(1) Measurable goals. (i) A bank shall specify in its plan measurable goals for helping to meet the credit needs of each of its service area(s) covered by the plan, particularly the needs of low- and moderate-income geographies and low- and moderate-income individuals, through lending, investment, and the provision of services, as appropriate.

(ii) A bank shall address all three performance categories, and, unless the bank has been designated as a wholesale or limited purpose bank, shall emphasize lending and lending-related activities. Nevertheless, a different emphasis, including a focus on one or more performance categories, may be appropriate if responsive to the characteristics and credit needs of its service area, considering public comment and the bank’s capacity and constraints, product offerings, and business strategy.

(2) Confidential information. The OCC shall submit additional information to the OCC on a confidential basis, but the goals stated in the plan shall be sufficiently specific to enable the public and the OCC to judge fairly the merits of the plan.

(3) Satisfactory and outstanding goals. A bank shall specify in its plan measurable goals that constitute “satisfactory” performance. A plan may specify measurable goals that constitute “outstanding” performance. In order to be considered for an “outstanding” performance rating, the bank shall submit both “satisfactory” and “outstanding” performance goals.

(f) Plan approval—(1) Timing. The OCC shall act upon a plan within 60 days after the complete plan and required accompanying material are submitted. If the OCC fails to act within this time period, the plan shall be deemed approved unless the OCC extends the review period for good cause.

(2) Public participation. In evaluating the plan’s goals, the OCC shall consider the public’s involvement in formulating the plan, public comment on the plan, and any response by the bank to public comment on the plan.

(3) Criteria for evaluating plan. The OCC shall evaluate a plan’s measurable goals using the following criteria, as appropriate:

(i) The extent and breadth of lending or lending-related activities, including, as appropriate, the distribution of loans among different geographies, businesses and farms of different sizes, and individuals of different income levels, the extent of community development lending, and the use of innovative or flexible lending practices to address credit needs;

(ii) The amount and innovativeness, complexity, and responsiveness of the bank’s qualified investments, as defined in § 25.23 of this part; and

(iii) The extent and availability of the bank’s services, including, as appropriate, the accessibility of retail delivery systems and the extent and innovativeness of community development services, as defined in § 25.24 of this part.

(g) Plan amendment. During the term of a plan, the bank may petition the OCC to approve an amendment to the plan on grounds that a material change in circumstances has made the plan no longer appropriate. Any amendment proposed shall be developed in accordance with the public participation requirements of paragraph (c) of this section.

(h) Strategic plan assessment. The OCC shall approve the goals and assess performance under a strategic plan as provided for in Appendix A of this part.

§ 25.28 Assigned ratings.

(a) Ratings in general. Subject to paragraphs (b), (c), and (d) of this section, the OCC shall assign to a bank a rating of “outstanding,” “satisfactory,” “needs to improve,” or “substantial noncompliance” based on the bank’s performance under the lending, investment and service tests, the community development test, the small bank assessment standards, or an approved strategic plan, as applicable.

(b) Lending, investment, and service tests. The OCC shall assign a rating for a bank assessed under the lending, investment, and service tests in accordance with the procedures provided in Appendix A of this part and the following principles:

(1) A bank’s rating on the lending test shall be weighed so as to count for at least 50 percent of its assigned rating.

(2) A bank that receives an “outstanding” rating on the lending test shall receive an assigned rating of at least “satisfactory”.

(3) A bank that receives an “outstanding” rating on the lending test and an “outstanding” rating on either the service test or the investment test
shall receive an assigned rating of “outstanding”;
(4) A bank that receives an “outstanding” rating on both the service test and the investment test and a rating of at least “high satisfactory” on the lending test shall receive an assigned rating of “outstanding”; and
(5) No bank may receive an assigned rating of “satisfactory” unless it receives a rating of at least “low satisfactory” on the lending test.

(c) Effect of evidence of discriminatory or other illegal credit practices. Evidence of discriminatory or other illegal credit practices shall adversely affect the OCC’s evaluation of a bank’s performance. In determining the effect on the bank’s assigned rating, the OCC shall consider the nature and extent of the evidence, the policies and procedures that the bank has in place to prevent discriminatory or other illegal credit practices, any corrective action that the bank has taken or has committed to take, particularly voluntary corrective action resulting from self-assessment, and other relevant information, such as the bank’s past fair lending performance.

(d) Effect of successive “needs to improve” ratings. A bank that would otherwise receive an assigned rating of “needs to improve” shall receive an assigned rating of “substantial noncompliance” if the bank received no better than a “needs to improve” rating on each of its two previous examinations.

§ 25.29 Effect of ratings on applications.

(a) CRA performance. Among other factors, the OCC shall take into account the record of performance under the CRA of each applicant bank in considering any application:
(1) By a bank for the establishment of a domestic branch or other facility that would be authorized to take deposits;
(2) By a bank for the relocation of the main office, a branch office or ATM;
(3) For the merger or consolidation with or the acquisition of assets or assumption of liabilities of a federally insured depository institution; and
(4) For the conversion of a federally insured depository institution to a national bank charter.

(b) Charter application. An applicant (other than a federally insured depository institution) for a national bank charter shall submit a description of how it will meet its CRA objectives when the application is made. In considering the application, the OCC shall take the description into account and may deny or condition approval on that basis.

(c) Interested parties. In considering CRA performance in an application described in paragraph (a) of this section, the OCC shall take into account any views expressed by interested parties which are submitted in accordance with the OCC’s procedures set forth in part 5 of this chapter.

(d) Denial of conditional approval of application. A bank’s record of performance may be the basis for denying or conditioned approval of an application described in paragraph (a) of this section.

Subpart C—Records, Reporting and Disclosure Requirements

§ 25.41 Service area delineation.

(a) In general. Subject to paragraphs (b) and (c) of this section, each bank may delineate its service area(s) using any method it chooses provided that the service area(s):
(1) Do(es) not reflect illegal discrimination;
(2) Do(es) not arbitrarily exclude low- and moderate-income geographies, taking into account the bank’s size and financial condition and the extent of its branching network, as appropriate; and
(3) Consist(s) only of whole census tracts or block numbering areas.

(b) Banks that are not wholesale or limited purpose banks. The service area(s) for a bank that is not a wholesale or limited purpose bank as defined in § 25.12 of this part:
(1) Shall include those geographies in the local areas around a bank’s branches and deposit-taking ATMs in which the bank has originated or held outstanding, during the previous calendar year, a significant number and amount of home mortgage, small business, and small farm, and community development loans;
(i) Home mortgage loans. If the bank is subject to reporting under HMDA, the location of each home mortgage loan located outside the MSAs in which the bank has a home or branch office (or outside any MSA) in accordance with Regulation C, Home Mortgage Disclosure (12 CFR Part 203);
(ii) Small business and small farm loan data. All small business and small farm loan data required to be collected and reported on the OCC’s Small Business and Small Farm Loan Register (CC—____), set forth in appendix C of this part, in accordance with the instructions in appendix C of this part; and
(iii) Community development loan data. All community development loan data required to be collected and reported on the OCC’s Community Development Report Form (CC—____), set forth in appendix C of this part, in accordance with the instructions in appendix C of this part.

(2) Service area data. Each bank shall collect and report to the OCC by April 1 of each year a list of the areas the bank considers to be its service area(s), a list of the geographies it considers to be within its service area(s), and a map of each service area showing the geographies contained therein.

(b) Optional data collection. (1) If a bank elects to have its consumer lending considered under the lending test (as described in § 25.22 of this part), the bank shall collect the consumer loan data requested on the OCC’s Consumer Loan Register (CC—____, set forth in appendix C of this part, in

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accordance with the instructions in appendix C of this part.

(2) At its option, a bank may:

(i) Provide information concerning outstanding small business, small farm, or consumer loans throughout the year to account for seasonal variations in lending for use in the evaluation of the bank under the lending test described in § 25.22 of this part; and

(ii) Provide any other information concerning its lending performance, including additional loan distribution data.

(c) Data on affiliate lending. A bank that wishes to have the OCC consider lending by its affiliates for purposes of the lending test shall be prepared to identify the particular home mortgage loans reported under HMDA which it wishes the OCC to consider, and shall collect or report, pursuant to the provisions of paragraphs (a) and (b) of this section, the requisite data concerning the small business, small farm, or consumer loans made by its affiliates that it wishes OCC to consider.

(d) Data on consortia and third party lending. A bank that wishes to have the OCC consider community development loans made through consortia in which the bank participates or through third parties in which the bank has invested shall report, pursuant to paragraph (a)(i)(ii) of this section, the requisite data concerning the community development loans made through consortia or third parties that it wishes the OCC to consider.

§ 25.43 Public file and disclosure by banks.

(a) Public availability. Each bank shall maintain a file that is readily available for public inspection containing the information required by this section.

(b) Current information. Each bank shall include in its public file the following information:

(1) All signed, written comments received from the public for the current year and each of the prior two calendar years that specifically relate to the bank's performance in helping to meet the credit needs of its community or communities, and any response to the comments by the bank; and

(2) A copy of the public section of the bank's most recent CRA Performance Evaluation prepared by the OCC. The bank shall place this copy in its public file within 30 business days after its receipt from the OCC;

(3) A list of the areas the bank considers to be its service area(s), a list of the geographies it considers to be within its service area(s), and a map of each service area showing the geographies contained therein;

(4) A list of the bank's branches and ATMs, their street addresses, and geographies;

(5) A list of branches and ATMs opened or closed by the bank during the current and each of the prior two calendar years, their street addresses, and geographies; and

(6) A list of services (including hours of operation, available loan and deposit products, and transaction fees) generally offered at the bank's branches and ATMs and descriptions of material deviations in the availability or cost of services at particular branches and ATMs, if any. At its option, a bank may include information regarding the availability of alternative systems for delivering retail banking services (e.g., banking by telephone or computer, mobile branches and ATMs, ATMs not owned or operated by or operated exclusively for the bank, loan production offices, and bank-at-work or by-mail programs).

(c) Information for prior years. Each bank that is not a small bank shall include in its public file the following information for each of the prior two calendar years derived from the data collected or reported pursuant to § 25.42 of this part:

(1) The number and amount of small business loans and small farm loans located in low-, moderate-, middle-, and upper-income geographies;

(2) A list of the geographies where the bank had outstanding at least one small business loan or small farm loan;

(3) The number and amount of small business and small farm loans located inside the bank's service area(s) and outside the bank's service area(s);

(4) The number and amount of small business and small farm loans to minority-owned businesses;

(5) The number and amount of small business and small farm loans to women-owned businesses;

(6) The number and amount of small business and small farm loans to businesses and farms with gross annual revenues less than or equal to $1 million;

(7) The number and amount of community development loans outstanding; and

(8) If the bank has elected to have its consumer loans considered under the lending test (as described in § 25.22 of this part), the number and amount of consumer loans to low-, moderate-, middle-, and upper-income individuals, the number and amount of consumer loans located in low-, moderate-, middle-, and upper-income geographies, and the number and amount of consumer loans located inside the bank's service area(s) and outside the bank's service area(s).

(d) Exception. A bank shall not place in its public file any information required under paragraph (c) of this section for a particular year if, given special circumstances such as a small number of loans made within a small number of designated income geographies or to a small number of designated borrowers, the information could reasonably be expected to disclose the identity of the borrower.

(e) HMDA statement. Each bank required to report home mortgage loan data pursuant to the HMDA shall include in its public file a copy of its HMDA Disclosure Statement provided by the Federal Financial Institutions Examination Council for each of the prior two calendar years. The statement shall be placed in the main office public file within three business days and in the branch office public files within 10 business days of the bank's receipt of the statement.

(f) Small bank file. (1) A small bank shall include in its public file the bank's loan-to-deposit ratio computed at the end of the most recent calendar year. A bank may include additional data on its loan-to-deposit ratio at its option.

(2) A small bank that elects to be evaluated under the lending, investment and service tests (as described in §§ 25.22 through 25.24 of this part) shall include in its public file the information specified in paragraph (c) of this section.

(g) Strategic plan. Each bank that has been approved to be assessed under a strategic plan as described in § 25.27 of this part shall include in its public file a copy of that plan. Information submitted to the OCC on a confidential basis in conjunction with the plan does not have to be included in the public file.

(h) Less than satisfactory rating. Each bank that received a less than satisfactory rating during its most recent examination shall include in its public file a description of its current efforts to improve its performance in helping to meet the credit needs of its entire community. This description shall be updated quarterly.

(i) Location of public file. Each bank shall maintain its public file as follows:

(1) The main office shall have a copy of the complete public file;

(2) At least one branch in each service area shall have a copy of the bank's HMDA Disclosure Statements and all materials in the public file relating to the service area in which the branch is located; and

(3) If a member of the public requests to review a bank's public file at a branch
that does not have a copy, the bank shall make a complete copy of the file for that service area available for review at the branch within 5 business days at no cost.

(j) Copies. Each bank shall provide copies of the information in its public file to members of the public upon request. A bank may charge a reasonable fee not to exceed the cost of reproduction and mailing (if applicable).

§ 25.44 Public notice by banks.

(a) CRA notice for banks. Each bank shall provide in the public lobby of its main office and each of its branches the public notice set forth in Appendix B of this part. Bracketed material shall be used only by banks having more than one service area.

(b) Additional notice for affiliate banks. The last two sentences shall be included only if the bank is an affiliate of a holding company and the last sentence only if the company is not prevented by statute from acquiring additional banks.

§ 25.45 Publication of planned examination schedule.

The OCC shall publish at least 30 days in advance of the beginning of each calendar quarter a list of the banks that are scheduled for CRA examinations in that quarter.

Subpart D—Transition Rules

§ 25.51 Transition rules.

(a) Effective date. Sections of this part 25 become effective over a period of time in accordance with the schedule set forth in paragraph (c) of this section. The provisions of part 25 become fully effective on July 1, 1996.

(b) Data collection and reporting.

(1) Data collection and reporting. On July 1, 1995, the data collection and reporting requirements set forth in § 25.42 of this part become effective.

(2) Strategic plan. Beginning July 1, 1995, a bank that elects to be evaluated under an approved strategic plan pursuant to § 25.27 of this part may submit its strategic plan to the OCC for approval.

(3) Small bank assessment standards. Beginning July 1, 1995, a bank that qualifies as a small bank pursuant to § 25.12 of this part may elect to be evaluated under the small bank assessment standards set forth in § 25.26 of this part. Beginning July 1, 1996, the OCC shall evaluate each small bank under the small bank assessment standards, unless the bank elects to be evaluated pursuant to the performance tests set forth in §§ 25.22 through 25.25 of this part or under an approved strategic plan.

(4) Performance tests. On July 1, 1996, the lending, investment, service, and community development tests set forth in §§ 25.22 through 25.25 of this part become effective. Thereafter, the OCC shall evaluate all banks pursuant to these test(s), except small banks evaluated under small bank assessment standards and banks that elect to be evaluated under an approved strategic plan.


Subpart E—Interpretations

§ 25.101 Applicability of the Community Reinvestment Act to certain special purpose banks.

In response to its July 1978 proposed regulation, 12 CFR Part 25, to implement the CRA, the OCC received several inquiries from institutions that, although they are chartered as national banks, do not perform commercial or retail banking services. These institutions serve solely as correspondent banks, or as trust companies, or as clearing agents, and they do not extend credit to the public for their own account. The OCC concludes that the CRA is not intended to cover these institutions. It is the purpose of the CRA to require the OCC to encourage banks to meet the credit needs of their local communities. To this end, the OCC must assess banks' records of performance and take those records into account in acting on certain applications affecting the banks. The OCC believes that these provisions were intended to cover all banks that are in the business of extending credit to the public, including both wholesale and retail banks. The lending activities of these banks affect the economic health of the communities in which they are chartered. However, the OCC believes it would be pointless to encourage or to assess the credit granting record of institutions that are not organized to grant credit to the public in the ordinary course of business, other than as an incident to their specialized operations. Accordingly, the term national bank as used in this part does not include banks that engage solely in correspondent banking business, trust company business, or acting as a clearing agent.

Appendix A to Part 25—Ratings

(a) Ratings in general. (1) In assigning a rating, the OCC shall evaluate a bank's performance under the applicable assessment criteria in this part, subject to § 25.28 of this part, which provides for adjustments on the basis of evidence of discriminatory or other illegal credit practices and prior "needs to improve" ratings.

(2) A bank's performance need not fit each aspect of a particular rating profile in order to receive that rating, and exceptionally strong performance with respect to some aspects may compensate for weak performance in others. The bank's overall performance, however, should generally be consistent with the appropriate profile stated below.

(b) Banks that are not wholesale or limited purpose banks or small banks.

(1) Lending performance rating. The OCC shall assign each bank's lending performance one of the five ratings described below.

(i) Outstanding. The OCC shall rate a bank's lending performance "outstanding" if, in general, it demonstrates: (A) Excellent responsiveness to credit needs in its service area(s); (B) A substantial majority of its loans are made in its service area(s); (C) An excellent geographic distribution of loans throughout its service area(s); (D) An excellent distribution, particularly in its service area(s), of loans among individuals of different income levels and businesses (including farms) of different size given the product lines offered by the bank; (E) An excellent record of serving the credit needs of the most economically disadvantaged areas of its service area(s), low-income individuals, or businesses (including farms) with gross annual revenues less than or equal to $1 million, consistent with safe and sound operations; (F) Extensive use of innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies; and (G) It is a leader in making community development loans.

(ii) High satisfactory. The OCC shall rate a bank's lending performance "high satisfactory" if, in general, it demonstrates: (A) Good responsiveness to credit needs in its service area(s); (B) A high percentage of its loans are made in its service area(s); (C) A good geographic distribution of loans throughout its service area(s); (D) A good distribution, particularly in its service area(s), of loans among individuals of different income levels and businesses (including farms) of different size given the product lines offered by the bank; (E) A good record of serving the credit needs of the most economically disadvantaged areas of its service area(s), low-income individuals, or businesses (including farms) with gross annual revenues less than or equal to $1 million, consistent with safe and sound operations;
(F) Use of innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It has made a relatively high level of community development loans.

(ii) Low satisfactory. The OCC shall rate a bank's lending performance "low satisfactory" if, in general, it demonstrates:

(A) Adequate responsiveness to credit needs in its service area(s);

(B) An adequate percentage of its loans are made in its service area(s);

(C) An adequate geographic distribution of loans throughout its service area(s);

(D) A very poor distribution, particularly in its service area(s), of loans among individuals of different income levels and businesses (including farms) of different size given the product lines offered by the bank;

(E) A very poor record of serving the credit needs of the most economically disadvantaged areas of its service area(s), low-income individuals, or businesses (including farms) with gross annual revenues less than or equal to $1 million, consistent with safe and sound operations;

(F) No use of innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It has made few, if any, community development loans.

(ii) Investment performance rating. The OCC shall assign each bank’s investment performance one of the five ratings described below.

(i) Outstanding. The OCC shall rate a bank’s investment performance "outstanding" if, in general, it demonstrates:

(A) Adequate responsiveness to credit needs in its service area(s), particularly low- or moderate-income individuals; and

(B) Adequate geographic distribution of loans, particularly in its service area(s), of loans among individuals of different income levels and businesses (including farms) of different size given the product lines offered by the bank;

(C) Outstanding. The OCC shall rate a bank’s investment performance "outstanding" if, in general, it demonstrates:

(A) Adequate responsiveness to credit needs in its service area(s), particularly low- or moderate-income individuals; and

(B) Adequate geographic distribution of loans, particularly in its service area(s), of loans among individuals of different income levels and businesses (including farms) of different size given the product lines offered by the bank;

(C) Excellent responsiveness to credit and community economic development needs.

(ii) High satisfactory. The OCC shall rate a bank’s investment performance "high satisfactory" if, in general, it demonstrates:

(A) A few, if any, qualified investments, particularly those that directly address credit needs;

(B) Occasional use of innovative or complex qualified investments to support community development initiatives; and

(C) Excellent responsiveness to credit and community economic development needs.

(iii) Low satisfactory. The OCC shall rate a bank’s investment performance "low satisfactory" if, in general, it demonstrates:

(A) A poor level of qualified investments, particularly those that directly address credit needs;

(B) Significant use of innovative or complex qualified investments to support community development initiatives; and

(C) Good responsiveness to credit and community economic development needs.

(iv) Needs to improve. The OCC shall rate a bank’s investment performance "needs to improve" if, in general, it demonstrates:

(A) A poor level of qualified investments, particularly those that directly address credit needs;

(B) Occasional use of innovative or complex qualified investments to support community development initiatives; and

(C) Adequate responsiveness to credit and community economic development needs.

(i) Outstanding. The OCC shall rate a bank’s investment performance "outstanding" if, in general, it demonstrates:

(A) Adequate responsiveness to credit needs in its service area(s), particularly low- or moderate-income individuals; and

(B) Adequate geographic distribution of loans, particularly in its service area(s), of loans among individuals of different income levels and businesses (including farms) of different size given the product lines offered by the bank;

(C) Outstanding. The OCC shall rate a bank’s investment performance "outstanding" if, in general, it demonstrates:

(A) Adequate responsiveness to credit needs in its service area(s), particularly low- or moderate-income individuals; and

(B) Adequate geographic distribution of loans, particularly in its service area(s), of loans among individuals of different income levels and businesses (including farms) of different size given the product lines offered by the bank;

(C) Excellent responsiveness to credit and community economic development needs.

(ii) High satisfactory. The OCC shall rate a bank’s investment performance "high satisfactory" if, in general, it demonstrates:

(A) A few, if any, qualified investments, particularly those that directly address credit needs;

(B) Occasional use of innovative or complex qualified investments to support community development initiatives; and

(C) Excellent responsiveness to credit and community economic development needs.

(iii) Low satisfactory. The OCC shall rate a bank’s investment performance "low satisfactory" if, in general, it demonstrates:

(A) A poor level of qualified investments, particularly those that directly address credit needs;

(B) Significant use of innovative or complex qualified investments to support community development initiatives; and

(C) Good responsiveness to credit and community economic development needs.

(iv) Needs to improve. The OCC shall rate a bank’s investment performance "needs to improve" if, in general, it demonstrates:

(A) A poor level of qualified investments, particularly those that directly address credit needs;

(B) Occasional use of innovative or complex qualified investments to support community development initiatives; and

(C) Adequate responsiveness to credit and community economic development needs.
(B) To the extent changes have been made, the bank’s record of opening and closing branches and ATMs has adversely affected the accessibility of its delivery systems, particularly in low- or moderate-income geographies or to low- or moderate-income individuals; (C) Services (including, where appropriate, business hours) vary in a way that inconveniences certain portions of its service area(s), particularly low- or moderate-income geographies or low- or moderate-income individuals; and
(D) It provides a limited level of community development services.

(v) Substantial noncompliance. The OCC shall rate a bank’s service performance as being in “substantial noncompliance” if, in general, the bank demonstrates:
(A) Its service delivery systems are inaccessible to significant portions of its service area(s), particularly low- and moderate-income geographies or low- and moderate-income individuals;
(B) To the extent changes have been made, the bank’s record of opening and closing branches and ATMs has significantly adversely affected the accessibility of its delivery systems, particularly in low- or moderate-income geographies or to low- or moderate-income individuals; or
(C) Services (including, where appropriate, business hours) vary in a way that significantly inconveniences many portions of its service area(s), particularly low- or moderate-income geographies or low- or moderate-income individuals; and
(D) It provides few, if any, community development services.

(4) Assigned rating. The OCC shall use the following procedures for assigning a rating:
(i) Assign points corresponding to the bank’s performance on each of the component tests as follows:

<table>
<thead>
<tr>
<th>Component test ratings</th>
<th>Lending</th>
<th>Service</th>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding</td>
<td>12 points</td>
<td>6 points</td>
<td>6 points</td>
</tr>
<tr>
<td>High Satisfactory</td>
<td>9 points</td>
<td>4 points</td>
<td>4 points</td>
</tr>
<tr>
<td>Low Satisfactory</td>
<td>6 points</td>
<td>3 points</td>
<td>3 points</td>
</tr>
<tr>
<td>Needs to Improve</td>
<td>3 points</td>
<td>1 point</td>
<td>1 points</td>
</tr>
<tr>
<td>Substantial Noncompliance</td>
<td>0 points</td>
<td>0 points</td>
<td>0 points</td>
</tr>
</tbody>
</table>

(ii) Total the points for the three tests, and use that total to determine the composite rating according to the chart below. However, if the total exceeds twice the number of points attributable to the bank’s lending test performance (as provided in paragraph (b)(4)(i) of this appendix), determine the composite rating using twice the number of points attributable to the bank’s lending test performance.

<table>
<thead>
<tr>
<th>Points</th>
<th>Composite rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>18 or over</td>
<td>Outstanding</td>
</tr>
<tr>
<td>9 through 17</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>6 through 8</td>
<td>Needs to Improve</td>
</tr>
<tr>
<td>0 through 4</td>
<td>Substantial Noncompliance</td>
</tr>
</tbody>
</table>

(c) Community development test for wholesale or limited purpose banks. The OCC shall assign each wholesale or limited purpose bank’s community development performance one of the four ratings described below.

(1) Outstanding. The OCC shall rate a wholesale or limited purpose bank’s community development performance “outstanding” if, in general, it demonstrates:
(i) A high level of qualified investments, community development loans outstanding, or community development services, particularly those that directly address credit needs;
(ii) Extensive use of innovative or complex qualified investments, community development loans, or community development services, to support community development initiatives; and
(iii) Excellent responsiveness to credit and community economic development needs in its service area(s).

(2) Satisfactory. The OCC shall rate a wholesale or limited purpose bank’s community development performance “satisfactory” if, in general, it demonstrates:
(i) An adequate level of qualified investments, community development loans outstanding, or community development services, particularly those that directly address credit needs;
(ii) Occasional use of innovative or complex qualified investments, community development loans, or community development services, to support community development initiatives; and
(iii) Adequate responsiveness to credit and community economic development needs in its service area(s).

(3) Needs to improve. The OCC shall rate a wholesale or limited purpose bank’s community development performance as “needs to improve” if, in general, it demonstrates:
(i) A poor level of qualified investments, community development loans outstanding, or community development services, particularly those that directly address credit needs;
(ii) Rare use of innovative or complex qualified investments, community development loans, or community development services, to support community development initiatives; and
(iii) Poor responsiveness to credit and community economic development needs in its service area(s).

(4) Substantial noncompliance. The OCC shall rate a wholesale or limited purpose bank’s community development performance in “substantial noncompliance” if, in general, it demonstrates:
(i) Few, if any, qualified investments, community development loans outstanding, or community development services, particularly those that directly address credit needs;
(ii) No use of innovative or complex qualified investments, community development loans, or community development services, to support community development initiatives; and
(iii) Very poor responsiveness to credit and community economic development needs in its service area(s).

(d) Assessment standards for small banks. The OCC shall rate each small bank’s performance as described below.

(1) Eligibility for a satisfactory rating. The OCC shall rate a bank’s performance “satisfactory” if, in general, the bank demonstrates:
(i) A reasonable loan-to-deposit ratio (considering seasonal variations) given the bank’s size, financial condition, the credit needs of its service area(s), and taking into account, as appropriate, lending-related activities such as loan origination for sale to the secondary markets and community development lending and investment;
(ii) A majority of its loans and, as appropriate, other lending-related activities are in its service area(s);
(iii) A distribution of loans to and, as appropriate, other lending-related activities for individuals of different income levels (including low- and moderate-income individuals) and businesses and farms of different sizes that is reasonable given the demographics of the bank’s service area(s);
(iv) A record of taking appropriate action, as warranted, in response to written complaints, if any, about the bank’s performance in meeting the credit needs of its service area(s).

(2) Eligibility for an outstanding rating. A small bank that meets each of the standards for a “satisfactory” rating under this paragraph and exceeds some or all of those standards may warrant consideration for an overall rating of “outstanding”. In assessing whether a small bank’s performance is “outstanding”, the OCC shall consider the extent to which the bank exceeds each of the assessment standards for a “satisfactory” rating and its performance in making qualified investments (as defined in § 25.23 of this part) and its performance in providing branches, ATMs or other services and delivery systems that enhance credit availability in its service area(s).

(3) Needs to improve or substantial noncompliance ratings. A small bank also may receive a rating of “needs to improve” or “substantial noncompliance” depending on the degree to which its performance has failed to meet the standards for a “satisfactory” rating.

(e) Strategic plan assessment and rating.

(1) Satisfactory goals. The OCC shall approve as “satisfactory” measurable goals that...
adequately help meet the credit needs of each of a bank’s service area(s).

(2) Outstanding goals. If the plan identifies a separate group of measurable goals that substantially exceed the levels approved as “satisfactory,” the OCC shall approve those goals as “outstanding.”

(3) Rating. The OCC shall assess the performance of a bank operating under an approved plan to determine if the bank has met its plan goals:

(i) If the bank substantially achieves its plan goals for a satisfactory rating, the OCC shall rate the bank’s performance under the plan as “satisfactory.”

(ii) If the bank exceeds its plan goals for a satisfactory rating, the OCC shall rate the bank’s performance under the plan as “outstanding.”

(iii) If the bank fails to substantially meet its plan goals for a satisfactory rating, it shall be rated as either “unsatisfactory” or “substantial noncompliance,” depending on the extent to which it falls short of its plan goals, or if the bank so elected at the time it first submitted its plan, it shall be rated under the loan investment and service tests (as described in §§ 25.22 through 25.24 of this part), the community development test (as described in § 25.25 of this part), or the small bank assessment standards (as described in § 25.26 of this part), as appropriate.

Appendix C to Part 25—CRA Loan Data Format

In the completion of the Loan Register for Small and Small Farm Loans, you may request from the Federal Comptroller of the Currency the CRA performance in helping to meet the credit needs of this community consistent with safe and sound operations. The Comptroller also takes our CRA performance into account when the Comptroller decides on certain applications submitted by us. Your involvement is encouraged. You should know that:

You may look at and obtain in this office information on our performance in this community. This information includes a file that includes: copies of all signed, written comments received by us, and any responses we have made to those comments; a map showing our service area; a list of our branches and ATMs in our service area; a list of services we provide at those locations; evaluations by the Comptroller of our CRA performance; and data on the loans we have made in this community during the last two years.

The CRA information on our performance in other communities served by us is available at our main office, located at

You may send signed, written comments about our CRA performance in helping to meet community credit needs to (title and address of State member bank official) and to Deputy Comptroller (address). Your letter, together with any response by us, will be considered by the Comptroller in evaluating our CRA performance and may be made public.

You may ask to look at any comments received by the Deputy Comptroller. You may also request from the Deputy Comptroller an announcement of our applications covered by the CRA filed with the Comptroller. We are an affiliate of (name of holding company), a bank holding company. You may request from the Federal Reserve Bank of (address) an announcement of applications covered by the CRA filed by bank holding companies.

Appendix C to Part 25—CRA Loan Data Format

Instructions for the Small Business and Small Farm Loan Register

This form contains the instructions for completion of the Loan Register for Small and Small Farm Loans. The register is used in conjunction with the reporting of this information as part of the CRA data collection process. The register and these instructions are to be used to provide the format in which the data should be reported. The actual data are to be submitted in machine-readable form in accordance with the instructions for submission of data pursuant to 12 CFR Part 203 (Regulation C).

I. Who Must File a Register

All independent insured banks and thrifts with $250 million or more in total assets and all insured banks and thrifts that are members of holding companies with $250 million or more in bank and thrift assets must report this information for small business and small farm loans outstanding beginning December 31, 1995. Banks and thrifts with fewer assets that wish to be included may report this information. This register is used in conjunction with the reporting of this information as part of the CRA data collection process. The register and these instructions are to be used to provide the format in which the data should be reported. The actual data are to be submitted in machine-readable form in accordance with the instructions for submission of data pursuant to 12 CFR Part 203 (Regulation C).

II. Types of Loans to be Reported

The loan register should contain individual loan data on each small business or small farm loan as defined in 12 CFR part 203 of the December 31 Report of Condition and Income. Include data on individual small business loans with original loan amounts of $500,000 or less that had an outstanding balance as of December 31.

III. Submission of Data

The data must be submitted in machine-readable form consistent with requirements for submission of data pursuant to 12 CFR Part 203 (Regulation C). The format must conform exactly to the form, including the order of columns, column headings, etc. Contact your federal supervisory agency for information regarding procedures and technical specifications for automated data submission.

Your institution should decide on the procedure it wants to follow for collection of the data consistent with the Supplemental Instructions For Collection Of Data In Connection with Small Business and Small Farm Loans. Keep in mind that data reported on the register are outstanding as of December 31 and not originations as are reported for some other regulatory purposes. Your institution may collect the data on separate registers at different branches or on separate registers for different loan types (small business or small farm), but make sure each loan number is unique. Entries need not be grouped on your registers by MSA, or chronologically, or by census tract, or in any other particular order.

IV. Instructions for Completion of Register Loan Information

1. Loan Number—Enter an identifying number that can be used to retrieve the loan file. It can be any number (not exceeding 25 characters). Use letters, numerals, or a combination of both. Make sure that all numbers are unique within the institution. If registers contain data for branch offices, for example, use a letter or a numerical code to identify the loans of different branches or assign a certain series of numbers to particular branches to avoid duplicate numbers. The use of the borrower’s tax-payer identification number or social security number is strongly discouraged for privacy reasons.

2. Outstanding Loan Amount—Enter the outstanding loan amount (balance) as of December 31. Show the amount in thousands rounding to the nearest thousand. Do not report loans with balances below $500. For example, a loan with a balance of $500 would be rounded to $1,000; a loan balance of $50,300 would be rounded to $50,000; and a balance of $15,700 would be rounded to $16,000.

Business or Farm Location

For each loan, identify the location of the business or farm. Location is determined by the following:

1. Small business loans are located in the census tract or block numbering area where the main business facilities or other property to which the loan proceeds will be applied (as indicated by borrower) is located.

2. Small farm loans are located in the census tract or block numbering area where the farm or other property to which the loan proceeds will be applied (as indicated by borrower) is located.

3. MSA—For each loan in a MSA, indicate the location of the loan by the four digit MSA number. Enter only the MSA number, not the MSA name. Use MSA boundaries that were in effect on January 1 of the calendar year for which you are reporting. A listing of MSAs is available from your regional supervisory agency. (In these instructions, the term MSA refers to metropolitan statistical area or primary metropolitan statistical area.) For loans outside MSAs, enter “N/A”.

4. State & County—Use the Federal Information Processing Standard (FIPS) two-digit numerical code for the state and the three-digit numerical code for the county. These codes are available from your regional supervisory agency. Do not use the letter abbreviations used by the United States Postal Service.

5. Census Tract/Block Numbering Area—Enter the census tract number or block numbering area from the U.S. Census
Bureau’s Census Tract/Street Index for the most recent census reporting period. For addresses not listed in the index, consult the Census Bureau’s census tract outline maps.

Borrower Information

1. Minority-Owned Code—Use the following codes to indicate small business or small farm loans with more than 50 percent ownership by one or more minority individuals (as indicated by borrower) pursuant to data collected as described in the Supplemental Instructions For Collection of Data In Connection With Small Business and Small Farm Loans.
   1—Yes
   2—No

2. Publicly traded business or farm (i.e., securities registered under Section 12(g) of the Securities Exchange Act of 1934 or has more than 100 shareholders)
   3—Publicly traded business or farm (i.e. has securities registered under Section 12(g) of the Securities Exchange Act of 1934 or has more than 100 shareholders)

3. Gross Annual Revenues ≤ $1MM
   2—No

4. Information not provided by borrower

Supplemental Instructions for Collection of Data In Connection With Small Business and Small Farm Loans

A. Format

Beginning July 1, 1995, financial institutions required to report small business and small farm loan registers are to collect information on the racial, ethnic, and gender make-up of applicants or borrowers in connection with small business and small farm loans. If you take a written application, you should list questions regarding the percent of minority and gender ownership on your loan application form or on a separate form completed by the applicant in conjunction with an application. If you do not take a written application, you should request the information at an appropriate time during the application or origination process; you must request the information for each loan you originate even if you did not take a written application. If you neither take a written application nor originate the loan, you do not have to request the information. See the sample form for recommended format and language. This information is to be maintained in the institution’s in-house loan files. This information is not to be reported to the agency, but is to be used to complete the small business and small farm loan register.

B. Procedures

1. You must ask for this information, but cannot require the applicant or borrower to provide it. You may not consider whether or not an applicant or borrower has provided this information in making your decision whether to extend credit or in setting the terms of credit.

2. If the applicant or borrower chooses not to provide the information, note this fact on the form.

3. Inform the applicant or borrower that the Federal government is requesting this information in order to monitor compliance with Federal statutes that prohibit lenders from discriminating on these bases.

BILLING CODES: OCC 4610-33-P (25%); Board 6210-01-P (25%); FDIC 8714-01-P (25%); OTS 6720-01-P (25%)
LENDING TO LIMITED LIABILITY COMPANIES
An Overview Of
The Kentucky Limited Liability Company
and
The Kentucky Registered Limited Liability Partnership

James C. Seiffert
Stites & Harbison
Louisville, Kentucky

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SECTION H
LENDING TO LIMITED LIABILITY COMPANIES
An Overview Of The Kentucky Limited Liability Company
and
The Kentucky Registered Limited Liability Partnership

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I. BACKGROUND

A. Senate Bill 184. The 1994 Kentucky General Assembly passed Senate Bill 184, signed into law April 11, 1994 with an effective date of July 15, 1994. Senate Bill 184 contained the Kentucky Limited Liability Act (KRS Chapter 275) and modified existing KRS Chapter 362 so as to provide for registered limited liability partnerships.

B. State-by-State Analysis. Kentucky became the 41st state to enact limited liability company legislation and the 10th state to pass registered limited liability partnership legislation. As of November 1, 1994, 46 states and the District of Columbia had adopted LLC legislation, while 20 states had enacted registered limited liability partnership legislation.

II. LIMITED LIABILITY COMPANY AND REGISTERED LIMITED LIABILITY PARTNERSHIP — DEFINITION

A. The Limited Liability Company. A limited liability company is an unincorporated association which combines the organizational and operational characteristics of both a closely-held corporation and a partnership. These characteristics include (i) insulation from personal liability; (ii) partnership tax treatment for both federal and state income tax purposes; and (iii) the "freedom to contract," which permits the business owners great latitude in tailoring the governance and financial arrangements to their needs.

B. The Registered Limited Liability Partnership. The registered limited liability partnership is a general partnership which elects limited liability status under
the Kentucky Uniform Partnership Act and thereby limits the joint and several liability of its general partners under certain circumstances.

C. Comparison of the Two. The principal difference between the limited liability company and the registered limited liability partnership is the degree of protection from personal liability. The limited liability company offers personal liability protection with respect to both contractual as well as business tort liabilities, while the registered limited liability partnership protection from personal liability extends only to business torts.

III. LIMITED LIABILITY COMPANY

A. Organization.


   a. Advantages.

   (1) Members of an LLC are insulated from personal liability much like a shareholder of a corporation;

   (2) An LLC possesses favorable federal and state income tax treatment as a "partnership" if organized and operated properly; it possesses important tax advantages over an S corporation and/or limited partnership.

   (3) Members of an LLC have the "freedom" to contract, which allows the business owners a great deal of flexibility and discretion in developing their business relations between and among each other and between the limited liability company and third parties.

   b. Disadvantages.

   (1) An LLC is unlikely to be used by a public company;
(2) A Kentucky LLC must have two or more people as members at all times; the Form cannot be utilized by one person;

(3) The LLC has not yet been recognized in all 50 states;

(4) The partnership tax treatment afforded an LLC is jeopardized if it is not structured properly.

2. Formalities — Limited Liability Company.

a. Powers/Purpose. An LLC may be formed for any lawful purpose, including the rendering of professional services (KRS 275.005) and is granted broad and all-inclusive powers. (KRS 275.010) Irrespective of the broad range of powers granted to limited liability companies, those organized to render professional services are not exempt from oversight by regulatory authorities charged with the obligation to regulate such profession. (KRS 275.010)

b. Articles of Organization.

(1) Contents (KRS 275.025): The Articles of Organization must contain the following information:

(a) The name of the LLC. The name must be distinguishable on the records of the Secretary of State from the name of any other business entity formed or registered to do business in Kentucky and must clearly place third parties on notice that they are dealing with an LLC. The name of any LLC must contain the words "Limited Liability Company" or "Limited Company" or the abbreviation "LLC," or "LC." (An LLC formed to render professional services must also include "Professional" in its name or the abbreviations "PLLC" or "PLC.");

(b) The street address of the initial registered office and the name of its registered agent at that office. (To make
the appointment of the registered agent
effective, the registered agent must execute
a document [which could include the Articles
of Organization] accepting the appointment.
This document must be delivered to the
Kentucky Secretary of State.);

(c) The mailing address of the initial
principal office of the LLC;

(d) A statement that the LLC has at
least two or more members;

(e) A statement as to whether the LLC
is to be managed by members or by managers;

(f) If the LLC is to have a specific
date of dissolution, the latest date on which
the LLC is to dissolve;

(g) If the LLC has been organized to
render professional services, the Articles of
Organization must state what professional
service or services will be practiced through
the professional LLC;

(h) The Articles of Organization may,
but are not required to, include any matters
permitted to be set forth in the Operating
Agreement. The Articles of Organization must
be accompanied by a statement of the
registered agent consenting to serve in such
capacity.

C. Additional Formalities Relating to
Organization

(1) Organizers (KRS 275.020): One or more
persons may form a limited liability company by
delivering articles of organization to the
Secretary of State for filing. It is not
necessary that such person or persons be members
of the limited liability company. The organizer
must execute the articles of organization on
behalf of the LLC.
(2) Filing (KRS 275.045): The Articles of Organization must be filed by the organizer with the Secretary of State and with the County Clerk in the county where the corporation has its principal place of business. The existence of a limited liability company begins once the Articles of Organization are filed with the Kentucky Secretary of State's office.

(3) The Operating Agreement (KRS 275.015(13)): The Operating Agreement is the principal document controlling the operations of the LLC. Often compared to the limited partnership agreement, the Operating Agreement sets out the rights, duties and responsibilities amongst the members. The Operating Agreement may set forth any provision that does not conflict with the Articles of Organization or the LLC Act. Unlike the Articles of Organization, the Operating Agreement is not recorded. An Operating Agreement may either be oral or written; however, certain amendments to any Operating Agreement must be in writing (see KRS 275.030). Additionally, any written Operating Agreement must be retained as a record at the limited liability company's principal office.

(4) Records and Information (KRS 275.185): Once formed, an LLC is required to maintain certain records relating to the structure, operation and finances of the LLC. The records and information required to be maintained at the limited liability company's principal office or other location as set forth in the written Operating Agreement are those set forth in KRS 275.185. Failure of the limited liability company to keep or maintain any of these records or information required will not be grounds for imposing liability on any member or manager for the debts and obligations of the limited liability company.

d. Consequences of Defective Formation. In the event the LLC has not been formed or has been formed in a defective manner, any persons who know of the formation problem but purport to act as or on behalf of the limited liability company will be jointly and
severally liable for all liabilities created while so acting. (KRS 275.095) In addition, it is unlawful for any person to execute a document the person knows is false in any material respect, with the intent that the document is to be delivered to the Secretary of State for filing. Anyone who violates this provision will be guilty of a Class B misdemeanor punishable by a fine not to exceed $100. (KRS 275.090)

B. **Members, Managers, and Authority.**

1. **Members.** (KRS 275.015(12))

   a. Owners of an LLC are defined as "Members." Membership in an LLC is open to individuals, corporations, general and limited partnerships, other LLCs, trusts, estates, associations and any other entities. A Kentucky LLC must have at least two members at all times.

   b. The statutory rights of all members include:

   (1) The right to vote on the adoption of and amendments to the Operating Agreement;

   (2) The right to directly manage the LLC or, in the alternative, to vote for managers of the LLC;

   (3) The right to approve or disapprove transfers of a member’s interest to a non-member;

   (4) The right to vote upon the continuation of the LLC after death, retirement, resignation, expulsion, bankruptcy or dissolution of a member; and

   (5) The right to receive allocation of profits and losses and to receive distribution from the LLC.

   c. Unless the members delegate the authority to manage to managers, each member will be an agent of the LLC for purposes of carrying on its business and affairs. (KRS 275.135(1)) The members will have the right and authority to manage the affairs of the
limited liability company and to make all decisions with respect thereto unless the Articles of Organization or Operating Agreement restrict or enlarge the management rights and duties of any person or groups or class of persons.

2. **Managers.** (KRS 275.015(11))

   a. The authority to manage an LLC may be vested in managers by its members. If management authority is vested in managers, each member ceases to be an agent of or able to bind the LLC. (KRS 275.135(2)) Managers are vested with exclusive agency power, and only their acts, when carried on in the usual course of business, will bind the LLC.

   b. The managers will be elected and removed by a vote of the majority of members, unless otherwise provided in the Articles of Organization or the Operating Agreement.

   c. Managers of an LLC will serve until their successors are duly elected and qualified, and they need not themselves be members of the LLC.

3. **Authority.** (KRS 275.135)

   a. If the LLC is managed by its members, then every member will be an agent of the limited liability company for purposes of its business and affairs, and the act of any member which is apparently carried on in the usual course of business of the LLC will bind the LLC unless the member in fact has no authority to act in that particular manner and the third party with whom the member is dealing with has knowledge or has received notification that the member has no authority.

   b. If the management of the LLC is vested in a manager or managers, then every manager will be an agent of the limited liability company, and any act of a manager which is apparently carried on in the usual course of business will bind the LLC unless the manager in fact has no authority and the third party with whom the manager is dealing has knowledge or has received notification that such manager has no authority. Those acts carried on by a manager or member that are not carried on in the usual course of business will not
bind the LLC unless, at the time the transaction or at any other time, the act is authorized in accordance with the Operating Agreement.

C. Contributions of Capital and Associated Liability.

1. Form of Consideration. (KRS 275.195) The transfer of an ownership interest directly from an LLC to a member requires a capital contribution. The capital contribution may take the form of cash, property, services performed, or a promissory note or obligation to contribute services, cash, or property in the future.

2. Liability. (KRS 275.200) A promise to make a contribution in the future is not enforceable unless set out in writing and signed by the member. Neither death or disability of the member will render the obligation unenforceable, unless otherwise set forth in the Operating Agreement. In the event a member fails to make a required contribution in the form of property or services, the LLC may demand, at its option, the contribution in the form of cash. To be effective, all members of an LLC must agree to compromise a member's delinquent contribution; however the compromise will not be effective against a creditor who has relied upon the obligation to contribute.

D. Management.

1. Voting. (KRS 275.175)

   a. As a general rule, the vote of more than one-half of the members or managers is necessary to pass any action relating to the LLC's business. This general rule may be altered by the Operating Agreement. In addition, unless otherwise provided in the Operating Agreement, the unanimous vote of all members is required to (1) amend a written Operating Agreement; (2) authorize a member or manager to carry out an act on behalf of the LLC that contravenes a written Operating Agreement; or (3) amend the Articles of Organization to change the management of an LLC from members to managers or from managers to members.

   b. Unless otherwise provided in the Operating Agreement the statute requires that voting rights be on a per capita (i.e., per person) basis. The Operating
Agreement may provide that voting be on a per capital rather than a per capita basis, which would mean that members would have a vote equal to the percentage of capital contributed to the LLC.

2. **Limitation on Liability to the LLC.**

   a. A member or manager is not personally liable to their LLC or their other members or managers for an action or failure to act unless the act or omission constitute wanton or reckless misconduct. However, a member or manager is obligated to account to and hold as trustee for the LLC any profit or benefit derived from the use of LLC property by that individual where the individual has used the property without the consent of at least one-half of the disinterested members or managers. (KRS 275.170)

   b. The Operating Agreement may eliminate or limit the personal liability of a member or manager for breaches of duty and/or provide for indemnification by members and managers arising in connection with the proceeding in which they are a party because of that status. (KRS 275.180)

   c. The LLC Act does not define the standard of care imposed on those vested with management authority. It merely defines the level of culpability required to hold a manager liable for monetary damages. (KRS 275.170)

3. **Limited Liability to Third Parties.** (KRS 275.150)

   a. No member, manager, employee, or agent of an LLC will be personally liable by reason of being a member, manager, employee or agent of the LLC ... for a debt, obligation or liability of the LLC whether arising in contract, tort or otherwise. The LLC affords its members the same level of protection associated with corporate shareholders and limited partners of a limited partnership. It is important to note that the liability shield will not protect a member, manager, employee, or agent from personal liability arising from his or her own acts. The liability shield protects only against vicarious liability for the acts of other members, managers, employees, or agents of the LLC.
b. Regardless of the limited liability afforded the members, managers, employees, and agents, the assets of the LLC always remain subject to the claims of creditors. Accordingly, the extent of a member's liability will be that equal to his or her contribution of capital and any distributions he or she may be entitled to receive.

E. Allocation of Profits and Losses. (KRS 175.205)

1. **Per Capita.** Unless otherwise set forth in the Articles of Organization or the Operating Agreement, the allocation of all LLC profits and losses between members will be on a per capita basis. The use of a per capita allocation of profits and losses avoids the problem of valuing services, property, and other intangibles often utilized in the formation of LLCs.

2. **Alternative Methods.** In the alternative, an LLC is free to provide for different allocations of profits and losses, such as on a per capita basis, as long as it is addressed in a written operating agreement.

F. Distributions.

1. **Distributions of Profits.** (KRS 275.210) The distribution of cash or other assets of an LLC will be based on a per capita method unless otherwise set forth in the Operating Agreement.

2. **Distributions on an Event of Disassociation.** (KRS 275.215) A member may at any time and for any reason withdraw from the LLC and demand payment for the fair value of the member's interest, unless otherwise set forth in the Operating Agreement. In addition, the withdrawing member will be entitled to receive any distributions to which he or she was entitled to receive prior to the disassociation. The application of these two rules presumes that the disassociation will not cause the dissolution of the LLC.

3. **Distribution in Kind.** (KRS 275.220) Unless otherwise set forth in the Operating Agreement, a member does not have a right to demand that any distribution be made in a form other than in cash. Furthermore, a member will not be required to accept an in kind distribution from an LLC, the value of which is disproportionate to the cash distribution made to other members.

   a. An LLC is prohibited from making distributions which would render it insolvent (i.e., balance sheet approach – liabilities exceed assets) or otherwise prevent the LLC from being able to pay its debts as they become due in the usual course of business. The effect of a distribution upon the capital of an LLC is measured as of the date the distribution is authorized provided payment is to occur within 120 days after the date of authorization of payment or the actual date of distribution if such occurs more than 120 days after the date of authorization.

   b. In the event a member votes for a distribution which violates these provisions, the members are liable to the LLC for the excess over the permissible distribution. A member or manager found liable to the LLC for the excess is entitled to contribution from every other member who voted for such a distribution as well as from each member who received an impermissible distribution. Any action to hold a member or manager liable for an improper distribution must be brought within two years after the affect of the distribution is measured.

G. **Assignment of LLC Interests. (KRS 275.255 and KRS 275.265)**

1. **In General.** An LLC member may unilaterally transfer the prospective economic rights associated with his or her membership interests but may not unilaterally transfer the management and/or participatory rights (i.e., voting) incident to such membership right.

2. **Personal Property.** An LLC membership interest is personal property and is assignable in whole or in part, unless otherwise provided in the Operating Agreement. It is also possible to have the LLC interest evidenced by a certificate much like a stock certificate issued by a corporation.

3. **Limited Assignment.** A member who assigns the economic rights of his or her membership interest remains a
member, exercising only the management rights of membership until such time as the assignee becomes a member or the assignor member is removed. The assignment of an LLC interest does not dissolve the LLC.

4. Assignment of Management Rights. The transfer of the management rights of the membership interest as contrasted with merely the economic rights, requires the consent of all other members unless otherwise provided in the Operating Agreement or the Articles of Organization. The Operating Agreement may specify the manner in which consent will be evidenced upon becoming a member. A transferee has the rights and powers of a member and is similarly subjected to the restrictions and liabilities of a member as determined by the Articles of Organization, any Operating Agreement or the LLC Act itself.

H. Dissolution. (KRS 275.285)

1. In General. An LLC will dissolve upon the occurrence of the following events: (1) at the time or upon the events specified in the Articles of Organization or the Operating Agreement, (2) by the written consent of all of its members, (3) upon certain events of "disassociation" of members, and (4) pursuant to judicial dissolution by a court or administrative dissolution by the Secretary of State.

2. Events of Disassociation. An event of disassociation includes the death, withdrawal, expulsion, bankruptcy (including an assignment for the benefit of creditors, filing of a bankruptcy petition and other actions relating to bankruptcy proceedings), or dissolution of a member. (KRS 275.280)

   a. All of the events of disassociation are subject to contrary written provisions in the Operating Agreement.

   b. An LLC will dissolve and its affairs will be wound up upon the disassociation of a member unless within 90 days following the event of disassociation all of the remaining members agree to continue the LLC. The Operating Agreement may provide that the approval for the continuation of the LLC after the disassociation of a member may be with the consent of less than all of the remaining members.
3. **Winding-Up Phase.** The winding up of the affairs of an LLC is carried out by either the members or managers, depending on which mode of management is utilized by the LLC. (KRS 274.300)

   a. During the winding up phase, an LLC is limited to actions relating to collecting its assets, providing for the satisfaction of its liabilities and distributing to its members such assets as are not necessary to satisfy the outstanding liabilities. Every member or manager must hold for the benefit of the LLC any gain derived from a transaction relating to the conduct or winding up of the affairs of the LLC.

   b. During the winding up phase of the dissolution of an LLC, a member or manager of the LLC may bind the entity in any course of action appropriate to the winding up of its affairs. A member or manager may bind the LLC with respect to matters outside the winding up of the LLC's affairs if such action deals with a third party who has no knowledge of the dissolution. (KRS 275.305)

   c. During the winding up phase the assets of the LLC are distributed first for payment to creditors and then to the satisfaction of any pre-dissolution declared distributions to members and former members of the LLC. Any remaining assets are then distributed to the members and former members as a return of contributions and then in proportion to their rights to share in distribution of assets prior to dissolution. (KRS 275.310)

4. **Articles of Dissolution.** After dissolution, the LLC is required to file Articles of Dissolution with the Kentucky Secretary of State setting forth (a) the name of the LLC; (b) the statutory authority pursuant to which it was dissolved; (c) the effective date of its dissolution; and (d) whatever additional information the members or managers filing the Articles of Dissolution deem appropriate. (KRS 275.315)

5. **Disposition of Known and Unknown Claims.** The LLC Act provides a procedure for allowing the LLC to give notice of dissolution to both creditors with no claims as well as notice of the LLC dissolution to unknown creditors. (KRS 275.320 and KRS 275.325)
6. **Judicial and Administrative Dissolutions.** An LLC may also be dissolved judicially as well as administratively by the Kentucky Secretary of State. (KRS 275.290 and KRS 275.295, respectively)

I. **Foreign Limited Liability Companies.**

1. **Definitions.** A foreign LLC is an unincorporated association, organized under the law of a jurisdiction other than Kentucky, which provides limited liability for each of its members for the liabilities of the entity. (KRS 275.015(6))

2. Subject to the Kentucky Constitution, the internal operation and liability of the members of a foreign LLC is governed by the laws of its jurisdiction of organization. However, no foreign LLC will have greater rights or powers than would an LLC organized under Kentucky law. A foreign LLC will not be denied registration in Kentucky simply because of the differences that exist between the laws of its organizational jurisdiction and those of Kentucky. (KRS 275.380)

3. **Certificate of Authority.** A foreign LLC intending to transact business in Kentucky is required to first obtain a Certificate of Authorization from the Secretary of State. The LLC Act identifies a number of activities which will not be deemed to constitute transacting business. (KRS 275.285)

4. **Failure to Register.** A foreign LLC that has not qualified to transact business in the state of Kentucky is prohibited from bringing or maintaining any action to enforce its rights in Kentucky. However, the failure to qualify to do business in Kentucky will not impair any contract or act of an LLC or prevent it from defending a proceeding in Kentucky. A foreign LLC that transacts business in Kentucky without a Certificate of Authority is subject to a fine of $2.00 per day not to exceed $500 per year. (KRS 275.390)

5. **Application for Certificate of Authority.** An application to transact business in Kentucky is filed with the Secretary of State. In addition to the application a statement of valid organization must be filed by a member or manager of the LLC but need not be an official document from the jurisdiction or organization. A Certificate of
Authority authorizes a foreign LLC to transact business in Kentucky granting to the foreign LLC the same but no greater rights and privileges afforded a Kentucky organized LLC. (KRS 275.395)

6. **Name of Foreign LLC.** The name of a foreign LLC must meet the requirements for domestically formed LLCs and as a result must be distinguishable upon the records of the Kentucky Secretary of State from the names of other organized or registered entities. A foreign LLC may also use a fictitious name. (KRS 275.410)

7. **Registered Office and Agent of Foreign LLC.** A foreign LLC must at all times maintain a registered office and a registered agent in Kentucky. A registered agent of a foreign LLC acts as its agent for service of process. (KRS 275.415)

8. **Certificate of Withdrawal.** Foreign LLCs qualified to do business in the state may withdraw from Kentucky by applying for and obtaining a Certificate of Withdrawal from the Kentucky Secretary of State. (KRS 275.435)

J. **Professional Limited Liability Company.**

1. **Definition.** A professional LLC may be organized under the Kentucky LLC Act or the laws of a foreign jurisdiction for purposes that include the rendering of one or more professional services. (KRS 275.015(18)) "Professional Services" are defined to include those personal services rendered by physicians, osteopaths, optometrists, podiatrists, chiropractors, dentists, nurses, pharmacists, psychologists, occupational therapists, veterinarians, engineers, architects, landscape architects, certified public accountants, public accountants, physical therapists, and attorneys. (KRS 275.015(19)) The LLC Act allows for the possibility that more than one profession may be conducted through a single LLC or that professional or non-professional activities may be conducted in a single LLC.

2. **Defer to Regulatory Board.** The Kentucky LLC Act specifically states that it will not restrict, limit, or expand in any manner the authority and duty of any regulating board to regulate persons providing professional services, including the establishment of regulations concerning the provisions of one or more professional services through a professional limited liability company.
3. **Name of Professional LLC.** The name of a professional LLC must contain the words "Professional Limited Liability Company" or "Professional Limited Company" or the abbreviations "PLLC" or "PLC."

IV. **REGISTERED LIMITED LIABILITY PARTNERSHIP**

A. **Definition.**

A "registered limited liability partnership" is simply a new form of an existing general partnership which elects to be treated as a registered limited liability partnership. (KRS 362.155(7)) The registered limited liability partnership was created by various amendments to the existing Kentucky Uniform Partnership Act which permit a general partnership to elect registered limited liability partnership status and thereby limit the joint and several liability of its general partners under certain specified circumstances.

B. **Historical Background.**

The first registered limited liability partnership legislation was enacted in Texas in 1991, with subsequent similar legislation in Louisiana in 1992 and in Delaware, District of Columbia and North Carolina in 1993. At the time the Kentucky LLP legislation passed, Kentucky was the sixth state to enact such legislation. The purpose behind such legislation was to create a mechanism to limit the traditional joint and several liability of one partner in a partnership for the wrongful acts and omissions of his or her other partners.

C. **Limited Liability Protection.**

As a registered limited liability partnership, a partner is not liable, directly or indirectly, for the debts, obligations and liabilities of the partnership arising out of the negligence, wrongful acts, or misconduct committed by another partner or by an employee, agent or representative of the partnership. Protection is also extended to negligence claims arising under contract law theories (i.e., implied warranty). (KRS 362.220(2)) A non-negligent partner of a registered limited liability partnership is also not subject to the general indemnification or contribution obligations for partnership obligations paid
by other partners under the Kentucky Uniform Partnership Act. (KRS 362.235)

D. Extent of Limited Liability Protection.

The assets of the registered limited liability partnership continue to be at risk for the actions of any partner. A partner remains liable for his or her own negligence, wrongful acts or misconduct. Moreover, the negligent supervision of those under a partner’s control would most likely subject the partner to personal liability. (KRS 362.220(3)) Liabilities which arose prior to the election of the partnership to be treated as a registered limited liability partnership are excluded from this protection. (KRS 362.220)(2) Finally, contractual liabilities, other than contractual claims which are in essence negligence claims (e.g., breach of an implied warranty) also remain outside the protective shield of a registered limited liability partnership. Consequently, partners of a registered limited liability partnership remain liable for partnership obligations under leases, bank financing, and with respect to trade creditors absent a non-recourse or release arrangement.

E. Registered Limited Liability Partnership Name.

The name of the registered limited liability partnership must contain the words "Registered Limited Liability Partnership" or the abbreviation "LLP" as the last words or letters of its name. In addition, the name must not be the same as and must be distinguishable from the names of all other entities organized, reserved or registered in Kentucky. (KRS 362.656)

F. Formation of a Registered Limited Liability Partnership. (KRS 362.555)

Only partnerships formed under the Kentucky Uniform Partnership Act may become registered limited liability partnerships. To elect registered limited liability partnership status, a partnership must file a "statement" with the Kentucky Secretary of State containing the following information: (1) name; (2) address of the principal office if not located in the state; (3) the numbers of partners; and (4) a brief statement of the business in which the partnership engages. Registration is effective for one year. During the sixty day period prior
to the expiration of the one year period a "renewal statement" must be filed to continue the partnership's registered limited liability partnership status.

Registration pursuant to a renewal statement will expire one year after the registration would have expired if the last renewal had not occurred. A renewal statement requires the same type of information as the original statement. If the registered limited liability partnership fails to renew, the protection from liability is not available in a proceeding by any person who did business with the partnership during the period it failed to qualify, if the person did not at the time have actual knowledge that the partnership was a registered limited liability partnership. A filing fee of $200 must accompany each statement or renewal statement filed with the Kentucky Secretary of State. (KRS 362.585)

G. Foreign Registered Limited Liability Partnerships.

Before transacting business in the Commonwealth, a foreign registered limited liability partnership must register and renew annually with the Kentucky Secretary of State in the same manner as domestic registered limited liability partnerships.
LENDING TO LIMITED LIABILITY COMPANIES
Loan Documentation For
Limited Liability Companies
And Related Issues

William H. Haden, Jr.
Stites & Harbison
Louisville, Kentucky


SECTION I
LENDING TO LIMITED LIABILITY COMPANIES
Loan Documentation For Limited Liability Companies
And Related Issues

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SECTION I
INTRODUCTORY NOTE

With the enactment of the "Kentucky Limited Liability Company Act", codified as Chapter 275 of the Kentucky Revised Statutes, effective July 15, 1994, lenders and their counsel have been presented with the need to focus on the distinguishing characteristics between limited liability companies ("LLC's"), partnerships (both general and limited) and S corporations.

Lenders will likely see a dramatic increase in loan applications for LLC's as the business population in Kentucky is counselled by tax advisors and attorneys to take advantage of this newly available vehicle. Properly structured, an LLC is treated as a corporation for liability purposes, but as a partnership for income tax purposes. The intricacies and subtleties of the mechanics of creating the entity and assuring qualification for partnership tax treatment are addressed elsewhere in materials presented by other speakers. It is the intent of this article, to present to the reader an introductory format, with answers to the questions dealing with issues financial institutions and their counsel should recognize when lending to LLC's.

Documentation required for consummating loans to LLC's will not differ dramatically from such documentation for corporate or partnership transactions. There are, however, a multitude of issues which must be addressed by lenders, if not substantively, at least from a different perspective.

At the heart of most lending transactions will be (i) the opinion of counsel to the borrowing entity, (ii) certifications or representations made by the borrower upon which the lender will and must rely, (iii) issues related to personal guarantees of corporate entities or quasi-non-recourse obligations, and (iv) authorizing resolutions of the borrowing entity.

Accordingly, on the pages which follow will be found suggested formats of "Opinion of Counsel to LLC" and "Borrower's Certificate". Each contain several numbered footnotes pertaining to provisions which are intended to address substantive areas of concern to lenders and counsel to lenders. Following such Opinion and Borrower's Certificate are "Notes to Opinion of Counsel" and "Notes to Borrower's Certificate", with discussion contained in numerical paragraphs matched to the numbered footnotes in such Opinion and Certificate.

The ride along the learning curve associated with any recently created statutory entity can be both frustrating and costly. Hopefully, focusing on some of the issues treated in this brief discussion will at least make curves along that ride easier to handle.
March 10, 1995

ABC Bank & Trust Company
3000 West Jefferson Street
Louisville, Kentucky 40202

Re: ABC Bank and Trust Company ("Lender") loan to Give Me More Enterprises, LLC, \(^1\) a Kentucky limited liability company ("Borrower")

Ladies and Gentlemen:

We have acted as counsel to the Borrower and to Joseph C. Blow and Mon E. Bags (the "Guarantors") \(^2\) in connection with a $1,000,000 loan (the "Loan") by you to Borrower pursuant to a certain commitment letter dated February 1, 1995. In connection with such representation, we have examined and are familiar with the following documents:

1. A Loan Agreement dated March 10, 1995, by and between the Lender and Borrower.

2. Promissory Note (the "Note") dated March 10, 1995, in the original principal amount of $1,000,000, executed by Borrower, \(^3\) and payable to the order of Lender.

3. A Mortgage, Security Agreement and Fixture Financing Statement (the "Mortgage") dated March 10, 1995, between Borrower and Lender covering property (the "Property") known as 123 West Girard Street in Louisville, Jefferson County, Kentucky. \(^4\)

4. An Assignment of Rents and Leases (the "Assignment") dated March 10, 1995, from Borrower to the Lender covering the Property.

5. UCC-1 Financing Statement dated March 10, 1995, between Borrower and the Lender. \(^5\)

6. Respective Guaranty Agreements dated March 10, 1995, in favor of Lender from the Guarantors. \(^6\)


(The documents listed in items 1 through 9 above are hereinafter collectively referred to as the "Loan Documents.")

We have also examined and relied on such public records as we have deemed necessary or appropriate in rendering this opinion, and upon the originals or copies, certified or otherwise, identified to our satisfaction, of such other documents, certificates and instruments as in our judgment are necessary or appropriate to enable us to render the opinions expressed below.

Based upon the foregoing, and subject to the qualifications hereinafter set forth, it is our opinion that:

A. Borrower is a limited liability company validly existing under the laws of the Commonwealth of Kentucky, having Joseph C. Blow as its sole Manager (the "Manager") [the individuals listed in the "Operating Agreement" attached hereto and incorporated herein as Exhibit "A", as all Members (the "Member Managers") of the Borrower].

A copy of the Borrower’s Certificate of Existence issued by the office of the Secretary of State of the Commonwealth of Kentucky, is attached hereto and incorporated herein as Exhibit "B".

B. The Borrower has the requisite power and authority to carry on its business, to enter into and assume the obligations of the Loan Documents, and to carry out the transactions contemplated thereby.

C. The Loan Documents have been executed and delivered by Borrower and Guarantors, respectively, and, with respect to Borrower, have been executed and delivered on behalf of Borrower by it duly authorized Manager [Member Managers], and constitute Borrower’s and Guarantors’ valid and binding obligations enforceable in accordance with their respective terms.

D. The execution and delivery of the Loan Documents and the consummation of the transactions contemplated thereby, do not and will not violate, conflict with, or result in any breach of or constitute a default under any of the provisions of Borrower’s Articles of Organization or Operating Agreement, or, to the best of our knowledge, after discussions with Members of the Borrower and with the Guarantors, but without any independent investigation, any agreement to which Borrower or Guarantors are parties, or any license, permit, judgment, decree, order, statute, rule or regulation to which Borrower of Guarantors are subject.
E. The loan is not subject to the defense of usury in the Commonwealth of Kentucky.¹⁰

F. A search of the records of the Jefferson County, Kentucky Circuit Court, and the U.S. District Court for the Western District of Kentucky, discloses no suits having been filed against the Borrower or either of the Guarantors, nor, to the best of our knowledge, are any suits threatened wherein the potential liability may exceed $25,000.00.¹¹

G. [Based upon the provisions of its Articles of Organization and its Operating Agreement, the Borrower is eligible under the United States Internal Revenue Code of 1986, as amended, to be taxed as a general partnership].¹²

H. Since the issuance of the Certificate of Existence by the Kentucky Secretary of State [or any predecessor partnership in the event of a conversion to a registered limited liability partnership from a general partnership], the principal place of business of the Borrower has been in Jefferson County, Kentucky.¹³

Our opinions are limited by and subject to the following:

a. In rendering the opinions expressed herein, we have assumed that the Guarantors are under no disability (and we have no reason to believe such assumption is not accurate), that all documents or instruments submitted to us as originals are complete, that all instruments submitted to us as copies are true and correct copies of the originals thereof, that the Borrower has good and valid title to the properties (real and personal) which are subject to the Loan Documents, and we have no reason to believe such assumptions to be incorrect. We understand you will be relying on title insurance policies with respect to the title of the Property.

b. The enforceability of the obligations of the Borrower and Guarantors under the Loan Documents and the availability of certain rights and remedial provisions provided for therein, may be limited by applicable bankruptcy, insolvency, liquidation, conservatorship, reorganization, moratorium or other federal or state laws (including, but not limited to, the Constitution of the United States and the Kentucky Constitution) affecting the enforceability of rights of creditors generally and by equitable principles which may limit the availability of certain equitable remedies (such as specific performance) in certain instances.

c. We are licensed to practice law only in the Commonwealth of Kentucky and we express no opinion with respect to laws other than the laws of the Commonwealth of Kentucky and
the United States of America upon the validity and binding effect of the Loan Documents or any other documents referred to herein.

d. This opinion has been made solely for your benefit and no other person or entity shall be entitled to rely hereon without the express written consent of this firm.

Sincerely,
NOTES TO OPINION OF COUNSEL TO LLC

1. The name of each limited liability company shall contain the words "limited liability company", or "limited company" or the abbreviations of "LLC" or "LC". KRS 275.100(1).

2. Except as specifically set forth in Chapter 275 of the Kentucky Revised Statutes, no member, manager, employee or agent of a limited liability company, shall be personally liable for a debt, obligation or liability of such limited liability company. KRS 275.150. Accordingly, lenders dealing in other than non-recourse loans, may choose to require personal guaranties of the members of its borrower limited liability company, much as it would with a corporate entity. Lenders who have grown accustomed to joint and several personal liability attaching to each general partner of a general partnership (even though some lenders historically have required guaranty agreements in that format also), must avoid the trap of such confusion, which could result, from a practical standpoint, in a non-recourse loan.

3. Unlike corporate entities which designate authority in its officers by way of by-laws and specific authorizing resolutions, limited liability companies are bound pursuant to the provisions of its articles of organization. KRS 275.165. Unless stipulated in such articles of organization as being managed by a "manager" or "managers", all management functions of a limited liability company shall vest in any member. However, a member, solely by being a member, shall not have authority to transfer property of the limited liability company. KRS 275.245(5)(b). (See also Note 1 to Notes To Borrower’s Certificate).

4. Property acquired by the limited liability company shall be the property of such limited liability company and shall not be vested in its members. KRS 275.240. There is no need for title examiners in certifying title to collateral, to concern themselves with checking grantor or lien indexes regarding the names of members. Similarly, there is no need to require spouses of such members to join in mortgage documentation to convey statutory dower or curtesy interests. KRS 275.245(1).

5. Although a limited liability company has power pursuant to the provisions of KRS 275.240 to acquire and hold title to property, there is no specific provision in Chapter 275 creating the power to grant a security interest in personal property. However, the power to "convey" implicitly affords the limited liability company the power to grant a security interest in its property. Unfortunately, KRS 355.9-401(5) has not been amended to specifically provide for the place of filing in order to perfect a security in-
terest. Accordingly, filing should take place pursuant to KRS 355.9-401(5)(k) concerning filings for "any other organization", as defined in KRS 355.1-201(28). The definition of "organization" in such section "includes a corporation...or any other legal or commercial entity". Such filing should therefore take place in the county where the principal place of business of the limited liability company is located. (For further discussion, see note 16 to the Borrower's Certificate, infra).

6. As stated in note 2 above, lenders should avoid thinking of obligations from a limited liability company as passing through joint and several liability of the members, as the case would be in dealing with a note obligation of a general partnership. See KRS 362.215(1). Lending officers should consider covenants from respective guarantors concerning (i) standby agreements which would have the practical effect of subordinating amounts due members as a result of debt instruments existing between LLC's and their members, (ii) prohibition of assignment of a member's interest in the limited liability company, (iii) prohibition of transfer of assets to the spouse of such member/guarantor, and (iv) requirement of providing yearly financial statements and tax returns.

7. Since many times the borrowing entity is a single asset venture, and such asset consists of the real estate and improvements being pledged to the lender, the lender might wish to consider requiring a separate indemnity from the member/guarantor/indemnitor dealing with the obligation for environmental compliance and clean-up costs. (see Appendix "A" attached).

8. Lending officers must concern themselves with more than receipt and perfunctory review of a borrowing resolution, as might be the case in a standard loan to an S corporation or C corporation or general partnership. Although KRS 275.135(1) vests in every member the authority to act as an agent for a limited liability company for the purpose of binding the limited liability company in its business affairs, KRS 275.135(2) provides that the articles of organization may vest business authority in "manager(s)". Accordingly, lender's counsel must carefully review not merely the resolution submitted, but also the articles of organization and operating agreement to assure the resolution has been signed by the appropriate member(s)/manager(s).

9. Lender's counsel should always require the certificate of existence issued by the Kentucky Secretary of State pursuant to KRS 275.085, to be delivered as part of the due diligence process. Exercise of this aspect of due diligence by
lender's counsel enables the lender to rely upon such certificate as "conclusive evidence that the limited liability company...is in existence and is authorized to transact business in the Commonwealth of Kentucky."

10. Pursuant to the provisions of KRS 360.010(1)(b), any interest rate may be charged upon any obligation in writing where the original principal amount is in excess of $15,000. However, in those written obligations involving less than $15,000 do the provisions of KRS 360.025, which prohibit a "corporation" from pleading the defense of usury, apply to limited liability companies. Chapter 275 does not specifically address the issue. (See also, Note 5 to Notes To Borrower's Certificate).

11. Litigation by or against a limited liability company shall not require that a member of such limited liability company be named as a party plaintiff or defendant to such proceeding solely by reason of being such member. (See KRS 275.155). Accordingly, unlike general partnerships, a search of the plaintiff and defendant indexes need only include the name of the limited liability company.

12. To the extent favorable credit approval afforded the limited liability company applying for a loan is dependent upon tax treatment as a partnership, lender's counsel should consider requiring as part of the opinion of counsel to the limited liability company/borrower, such certification. If the articles of organization or operating agreement have been drafted by the scrivener through utilization of all "default" provisions in Chapter 275, the requirement may be tempered. However, the better practice might be to require such certification to avoid the post-closing surprise of the realization that the limited liability company is to be burdened with significant tax liability, penalties and interest as a result of faulty drafting, resulting in financial projections which are substantially off the mark.

13. As a result of the recent decision of In re Green River Coal Company, 165 BR 425 (Bankr., W.D. Ky. 1994), which recognized the continued perfection of a bank's security interest even though the Debtor had moved its registered office several years prior to the time that a subsequent creditor would have looked to determine if the Debtor's assets were free of perfected security interests, it is now advisable for lender's counsel to require certification from its borrower and/or borrower's counsel regarding any changes in the "residence" (principal office) of such entity, since the creation of such entity. Otherwise, a chattel lien search in other than all such counties, may be insufficient to assure no prior lien filings. In other
words, the Court in Green River Coal held that in that circumstance where a borrowing entity moved its principal office after the initial filing of the UCC-1, but before the initial five (5) year period of the security interest had lapsed, the filing of Continuation Statements in the former county of the principal office, and where the initial UCC-1 had been filed, would be sufficient to put subsequent creditors on notice, notwithstanding the subsequent change of county of principal office (where creditors would understandably search the public record for prior chattel lien filings). (See also note 5 hereinabove)
BORROWER'S CERTIFICATE

The undersigned, GIVE ME MORE ENTERPRISES, LLC, a Kentucky limited liability company (hereinafter referred to as the "Borrower"), by and through Joseph C. Blow, its sole "Manager", as an inducement to ABC Bank and Trust Company (hereinafter referred to as the "Lender") to make a loan to Borrower evidenced by that certain Note of even date herewith in the principal sum of ONE MILLION DOLLARS ($1,000,000) (hereinafter referred to as the "Note"), which Note is secured by that certain Mortgage, Security Agreement, and Fixture Financing Statement of even date herewith (hereinafter referred to as the "Mortgage") to be recorded in the Office of the County Court Clerk of Jefferson County, Kentucky, which Mortgage encumbers certain real property located in Jefferson County, Kentucky, more particularly described on Exhibit "A" attached hereto and by this reference made a part hereof (hereinafter referred to as the "Property"). Borrower hereby certifies, warrants, and represents to Lender that as of this date:

1. Borrower is a duly organized, validly existing limited liability company existing under the laws of the Commonwealth of Kentucky. Borrower is not in violation of any Federal or State laws relating to its structure, including, but not limited to, Federal securities laws, blue sky laws, and other laws, or the rules or regulations of the Securities and Exchange Commission. Borrower has all requisite power and authority to enter into all documents required in connection with the above described transaction (hereinafter together referred to as the "Loan Documents") and to carry out the obligations of Borrower contemplated by the Loan Documents and to own all of the Property;

2. That by the execution hereof, the undersigned sole Manager certifies that, as the sole Manager of Borrower, he has all necessary power and authority to execute and deliver the Loan Documents for, on behalf of, and in the name of Borrower;

3. As of the date hereof, there are no setoffs, defenses or counterclaims to the payment of the indebtedness evidenced by the Note, and Borrower hereby agrees that if any such defense to the payment of such indebtedness should hereafter exist against Lender, except to the extent such defense is permitted or provided by the usury laws of the Commonwealth of Kentucky, the same will not be raised against Lender;

4. Borrower owns fee simple title to all of the Property; the Mortgage creates the lien and security it purports to create and is a valid and binding obligation of Borrower enforceable against Borrower and the Property in accordance with its terms; and the Note represents a valid and binding obligation of Borrower enforceable in accordance with its terms;
5. There is not pending against Borrower any petition in bankruptcy, whether voluntary or otherwise, any assignment for the benefit of creditors, any petition seeking reorganization, liquidation or arrangement under the bankruptcy laws of the United States or of any State thereof, or any other action brought under the aforesaid bankruptcy laws; there are no law suits or legal proceedings pending or threatened in any court or before any governmental agency involving Borrower, its Members or the Property; and the financial condition of Borrower as of the date hereof has not adversely changed from the financial condition as indicated by the financial statements furnished to Lender dated ______________, 19__, and said financial statements are substantially true and accurate as of the date hereof;

6. Borrower is acting in this loan for its own account and will receive and apply the loan proceeds for its own account and not as agent or trustee for others;

7. Borrower has complied with each and every term, covenant, and condition of the Application/Contract for Mortgage Loan between Lender and Borrower dated ______________, 19__, and any subsequent amendments thereto, if any (hereinafter referred to as the "Commitment"); and

8. No part of the Property or the improvements located thereon have been damaged and not repaired to Lender’s satisfaction, nor taken in any condemnation or other similar proceeding, nor is any such proceeding pending or to the best of Borrower’s knowledge, threatened;

9. The improvements located on the Property have been completed in accordance with the plans and specifications and direct connection has been made from the Property to abutting public water, sewer, gas, electric, telephone and all other facilities necessary to serve the Property for its intended use as a (Insert Type of Security); that the improvements are ready for occupancy as a (Insert Type of Security); and that the original building permit, unconditional certificates of occupancy and all other consents and approvals of all governmental authorities having jurisdiction over the Property have been issued, evidencing compliance with all zoning, building and other laws and regulations applicable to the Property and the improvements located thereon;

10. This Certificate is given by Borrower to induce Lender to make the loan evidenced by the Note and secured by the Mortgage and other Loan Documents, with the knowledge that Lender will rely upon the truth of the statements made herein;

11. The Property is not in violation of any federal, state or local law, ordinance or regulation relating to industrial hygiene or to the environmental conditions on, under or about the
Property including but not limited to soil and groundwater condition. Neither Borrower nor, to the best of Borrower’s knowledge, any third party has used, generated, manufactured, stored or disposed of on, under or about the Property or transported to or from the Property any “Hazardous Substances,” as that term is defined in the Environmental Certificate and Indemnity Agreement of even date herewith from the Borrower, except for such substances which have been used in the normal course of operations of Borrower’s business on the Property.6

12. The Articles of Organization of Borrower, dated __________, 19__, and the Operating Agreement of Borrower dated ________, 19__, have not been amended or altered and are in full force and effect as of the date hereof. Notwithstanding the provisions of the Operating Agreement of Borrower regarding transfer of Member’s interests, Borrower acknowledges that the terms, conditions and restrictions on such transfer contained in the Mortgage executed in connection herewith shall govern.7

13. There are no lawsuits pending, or to the best of the Borrower’s knowledge, threatened against the Borrower or the Property, which pertain to the Property, or if adversely determined would materially, adversely affect the Borrower’s financial position, nor are there any judgments outstanding against the Borrower. Borrower also represents and warrants to Lender that Borrower is not engaged, and has not at any time since Borrower’s acquisition of the Property engaged in a "pattern of racketeering activity" within the meaning of 18 U.S.C. § 1961, as amended, or within the meaning of any similar state or federal law, nor has Borrower committed any other act or engaged in any other pattern of actions, the potential results of which might include forfeiture of Borrower’s interest in the Property.8

14. The Property is accessible to and usable by persons with disabilities and complies with the accessibility requirements of the Americans With Disabilities Act, 42 U.S.C.A. § 12101 et. seq. (hereinafter called the "ADA"), and the regulations thereunder promulgated by the U.S. Architectural and Transportation Barriers Compliance Board (36 C.F.R. § 1191 et. seq.) and by the U.S. Department of Justice (28 C.F.R. Part 36), including without limitation the ADA Accessibility Guidelines for Buildings and Facilities attached as an Appendix to said regulations.9

15. The Borrower is not doing business under any assumed name, and represents itself to the public only as Give Me More Enterprises, LLC, a Kentucky limited liability company.10

16. All voting by members of the Borrower shall be on a [per capita] [percentage of capital participation] basis.11
17. The Operating Agreement of the Borrower cannot be amended in the absence of (%) affirmative vote of all members of the Borrower.  

18. The Borrower is not the result of a conversion from a general partnership, and therefore, has no attendant liabilities for such predecessor partnership.  

19. Respective interests of the members of Borrower [may] [may not] be assigned.  

20. The principal place of business of the Borrower is located at , Louisville, Jefferson County, Kentucky 40202.  

IN WITNESS WHEREOF, the undersigned has hereunto caused these presents to be executed in its name and behalf this day of , 1995.  

GIVE ME MORE ENTERPRISES, a Kentucky limited liability company  

_________________________________________________________  
WITNESS  

By: ____________________________, Sole Manager
NOTES TO BORROWER'S CERTIFICATE

1. If the articles of organization vest management of the limited liability company in one or more managers, unless otherwise stipulated in such articles or in the operating agreement, such managers shall have exclusive power to manage the business affairs of the limited liability company. See KRS 275.165(2) (See also, Note 3 to Notes To Opinion of Counsel).

2. KRS 275.240 (2) vests in limited liability companies the power to acquire, hold and convey property in the name of such limited liability company. The power to grant mortgage liens is implicit. (See also, Note 5 To Opinion of Counsel and Appendix "B" regarding forms of Resolutions).

3. Property acquired by a limited liability company is vested in the limited liability company and not its members. See KRS 275.240. (See also, Note 4 to Notes To Opinion of Counsel and Note 14, infra).

4. As a result of the various management options available for limited liability companies pursuant to KRS 275.165, the completion of appropriate due diligence by lender's counsel is paramount. Review of the borrowing resolution is not sufficient without the accompanying review of the articles of organization and operating agreement, especially in those instances where sole reliance upon the opinion of counsel to the limited liability company does not satisfy the lender's comfort level. (See also, Note 3 to Notes to Opinion of Counsel).

5. There is some question as to the exemption of limited liability companies from protection under KRS 360.010. KRS 360.025 prohibits a "corporation" from pleading the defense of usury. Nothing in Chapter 275 addresses the issue. (See also, Note 10 to Notes To Opinion of Counsel).

6. Since KRS 275.150 exempts all members, employees and agents of limited liability companies from personal liability for debt, obligations or liability of a limited liability company, lenders may wish to require separate indemnity from members of limited liability companies for potential liability for environmental compliance or compliance with the Americans With Disabilities Act. (See also, Note 2 to Notes To Opinion of Counsel and Note 9, infra).

7. Since it is possible, with the consent of all members of a limited liability company, for an assignee of an interest of a member to actually become a member, thereby entitling such assignee not only to distributions due members, but also to voting rights (KRS 275.265(1)), lenders who are interested in key members being involved throughout the term of the
loan in the management of the LLC, should consider negative
covenants in loan documentation, prohibiting such
assignments in the absence of prior written consent such lender.

8. See also, Note 11 to Notes To Opinion of Counsel.

9. The same rationale for requiring indemnity from members of
limited liability companies with reference to environmental
law compliance, applies to potential liability for
compliance with ADA. (See also, Note 6, supra, and Note 2 to
Notes To Opinion of Counsel).

10. KRS 365.015 was not amended to provide for the filing of
assumed names of limited liability companies. Accordingly,
until and unless the statute is amended, the office of the
Kentucky Secretary of State will not accept such filings.

11. There is a presumption of per capita voting for limited
liability companies, in the absence of provisions in the
articles of organization or operating agreement providing
for voting by a percentage of capital. KRS 275.175(1).

12. KRS 275.175(2) requires 100% of all members voting, to
change the management of the company from members to
managers or from managers to members. The requirement calls
for 100% of all members voting to amend the operating
agreement or to amend the articles of organization to change
such management.

13. All existing or pending liabilities of a general or limited
partnership which converts to a limited liability company
shall follow the limited liability company. KRS
275.375(2)(b)(c). Accordingly, lenders should advise their
title examiners and counsel to be cognizant of the need to
review the public record not only in the real estate grantor
index, but in the general lien filing indexes, regarding the
name of the predecessor general or limited partnership.
Such liens will also constitute liens against the newly
created limited liability company.

14. Since the success of some ventures is, in the mind of the
lending officer or loan committee involved in a credit
review and approval process, dependent in some part on the
continuing management mix of the members of a borrower, the
assignability of member interests becomes important. KRS
275.255(1) permits such assignability unless the operating
agreement provides otherwise. However, mere assignment of a
member interest, without unanimous consent of all members
(unless the operating agreement provides otherwise), only
vests in the assignee the right to receive distributions of
the assignor (i.e., no voting rights). KRS 275.255(1)(b).
If the lender is concerned with management continuity, it should require negative or affirmative covenants from the borrower to attain such continuity.

15. Any change of mailing address of the principal office of a limited liability company must be filed with the Secretary of State of the Commonwealth of Kentucky on a form supplied by the office of the Secretary of State. KRS 275.040. Reviewing this filing becomes especially important in determining in which county a chattel lien search or searches must be conducted. The recent holding in the case of In re Green River Coal Company, 165 BR 425 (Bankr., W.D. Ky 1994), dealing with the issue of lien priorities of security interests and continuing perfection in the circumstance where the principal office of an entity changes, serves to emphasize the importance of complete information regarding the history of the principal office of legal entities in the Commonwealth of Kentucky. (See also, Note 13 to Notes To Opinion of Counsel).
ENVIRONMENTAL CERTIFICATE AND INDEMNITY AGREEMENT

THIS ENVIRONMENTAL CERTIFICATE AND INDEMNITY AGREEMENT is made this 10th day of March, 1995, by and among GIVE ME MORE ENTERPRISES, LLC, a Kentucky limited liability company, having its principal office at 123 Girard Street, Louisville, Jefferson County, Kentucky ("Borrower") and MON E. BAGS and JOSEPH C. BLOW, c/o 1200 Ft. Knox Blvd., Louisville, Kentucky 40202 (hereinafter, the "Members") in favor of ABC BANK & TRUST COMPANY, its successors and assigns, having its principal office at 3000 West Jefferson Street, Louisville, Kentucky 40202 ("Lender").

Recitals:

A. Borrower is the owner or lessee of real property (the "Property"); and

B. Lender is prepared to make and Borrower will accept a loan in the maximum amount of ONE MILLION DOLLARS ($1,000,000.00) (the "Loan") evidenced by a promissory note of even date herewith (the "Note") and governed or secured by certain documents, such documents together with the Note being hereafter referred to as the "Loan Documents"; and

C. As consideration for making the Loan, Lender requires Borrower to provide certain certifications and indemnities concerning environmental matters.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, and to induce Lender to make the Loan, Borrower hereby agrees as follows:

1. Environmental Laws and Hazardous Substances. For purposes herein, the term "Environmental Law(s)" shall mean any federal, state or local statute, law, ordinance, code, rule, regulation, order or decree regulating, relating to, or imposing liability or standards of conduct concerning any Hazardous Substance, as now or at any time hereafter in effect. For purposes herein, the term "Hazardous Substance(s)" shall have the meaning ascribed in and shall include those substances listed under the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. 9601 et seq. and the regulations promulgated thereunder (as amended from time to time) and the Clean Air Act, 42 U.S.C. 7401, et seq. and the regulations promulgated thereunder (as amended from time to time) and includes oil, waste oil, and used oil as those terms are defined in the Clean Water Act, 33 U.S.C. 1251 et seq. and regulations promulgated thereunder (as amended from time to time) and the Resource, Conservation and Recovery Act, 42 U.S.C. 6901 et seq.
and regulations promulgated thereunder (as amended from time to
time) and the Oil Pollution Act of 1990, 33 U.S.C. 2701 et seq.
and regulations promulgated thereunder (as amended from time to
time) and shall include any other pollutant or contaminant
designated as such by Congress or the United States Environmental
Protection Agency (EPA) or defined by any other federal, state or
local statute, law, ordinance, code, rule, regulation, order or
decree regulating, relating to, or imposing liability or
standards of conduct concerning any hazardous, toxic or dangerous
waste, substance or material, as now or at any time hereafter in
effect.

2. Compliance with Environmental Laws. Borrower certifies
that Borrower will not violate any Environmental Law, in
connection with the use, ownership, lease, maintenance or
operation of the Property.

3. Absence of Hazardous Substances. Borrower certifies,
based upon reasonable investigation, that, except for such
substances which have been used in the normal course of operation
of Borrower’s business, neither Borrower nor any other person
within Borrower’s knowledge or control, including any lessee of
the Property, has ever caused or permitted any Hazardous
Substance to be released, spilled or disposed of on, under or at
the Property or any part thereof and neither the Property nor any
part thereof has ever been used by Borrower or any other person
as a dump site or storage site, whether permanent or temporary,
for any Hazardous Substance.

4. Absence of Litigation. Borrower certifies that it is
not a party to any litigation or administrative proceeding, nor
so far as is known by Borrower is any litigation or
administrative proceeding threatened against it, which in either
case asserts or alleges that (i) Borrower violated any
Environmental Law, (ii) Borrower is required to clean up or take
other response action due to the release or threatened release or
transportation of any Hazardous Substance, or (iii) Borrower is
required to pay all or a portion of the cost of any past, present
or future cleanup or other response action which arises out of or
is related to the release or threatened release or transportation
of any Hazardous Substance.

5. Tanks. There are not now, nor to Borrower’s knowledge
after reasonable investigation have there ever been, tanks or
other facilities on, under or at the Property which contained
materials which, if known to be present in soils or groundwater,
would require cleanup or other corrective action. If there are
such tanks or other facilities, Borrower represents after
reasonable investigation that nothing contained therein has ever
been spilled, leaked or released into the environment, soil or
groundwater and that such tanks or other facilities are in
compliance with all Environmental Laws.
6. Notices of Other Information. If Borrower acquires any knowledge of or receives any notice or other information of (i) the happening of any event involving any Hazardous Substance with respect to the Property or to any activity of the Borrower or (ii) any noncompliance with regard to any environmental, health or safety matter with respect to the Property or to any activity of the Borrower, then Borrower shall immediately notify Lender orally and in writing and provide Lender with copies of any written notice or information.

7. Right of Mitigation. Lender shall have the right but not the obligation, and without limitation of Lender’s rights under the Loan Documents, to enter onto the Property and take such other actions as it deems necessary or advisable to clean up or otherwise deal with any Hazardous Substance or following receipt of any notice or other information which, in the sole opinion of Lender, could result in action against Borrower or Lender or could adversely affect the value of Lender’s collateral. All reasonable costs and expenses incurred by Lender in the exercise of any such rights shall be added to the outstanding balance of the Note and be payable by Borrower upon demand by Lender.

8. Indemnification. Borrower and Members hereby agree, and do hereby, jointly and severally, indemnify Lender and hold Lender harmless from and against any and all losses, liabilities, including strict liability, damages, injuries, expenses, including reasonable attorneys’ fees (which fees shall include the reasonable estimate of the allocated cost of in-house counsel and staff), claims for damage to the environment, claims for fines or civil penalties, costs of any settlement or judgment and claims of any and every kind whatsoever paid, incurred or suffered by or asserted against Lender by any person, entity or governmental agency for, with respect to or as a direct or indirect result of Borrower’s noncompliance or alleged noncompliance with any Environmental Law or the presence on, under or at the Property of, or the release or threatened release or transportation of, any Hazardous Substance, regardless of whether or not caused by or within the control of Borrower. The covenants, representations, warranties, and indemnities under this section shall be deemed continuing covenants, representations, warranties and indemnities for the benefit of Lender and any successors or assigns of the Lender, including any purchaser of Lender’s collateral at a mortgage foreclosure sale, any transferee of the title of the Lender and any subsequent owner of the Property claiming through or under the title of Lender, and shall survive any enforcement of Lender’s rights against collateral securing payment of the Note or the satisfaction of the obligations evidenced by the Note; provided, however, such continuing covenants, representations, warranties and indemnities shall pertain to activities or conditions on the Property only during the time period Borrower owned the Property.
The burden of establishing that activities or conditions which are the subject of this indemnity first arose subsequent to such period when Borrower owned the Property must be borne by Borrower.

9. Default. If any representation or warranty or certification made herein by Borrower shall prove untrue or Borrower shall violate or fail to comply with any of the provisions hereof, an Event of Default under the Loan Documents shall have occurred and Lender shall be entitled to exercise its remedies for default under the Loan Documents.

10. Borrower’s Obligations Not Impaired. The liability of Borrower and Members under this Certificate shall in no way be limited or impaired by, and Borrower hereby consents to and agrees to be bound by, any amendment to or modification of the provisions of the Loan Documents by Borrower. In addition, the liability of Borrower and Members under this Certificate shall in no way be limited by (i) any extensions of time for performance required by any of the Loan Documents, (ii) any sale or assignment of any of the Loan Documents or any sale or transfer of all or part of the Property after the enforcement of Lender’s rights under the Loan Documents or Lender’s, or its assignees, acquisition of all or part of the Property by a deed-in-lieu of foreclosure, (iii) the accuracy or inaccuracy of the representations and warranties made by Borrower under any of the Loan Documents, (iv) the release of Borrower or any other person from performance or observance of any of the agreements, covenants, terms or conditions contained in any of the Loan Documents by operation of law, Lender’s voluntary act or omission, or otherwise, (v) the release or substitution in whole or in part of any security for the Note or (vi) Lender’s failure to record any of the Loan Documents or file any UCC financing statements (or Lender’s improper recording or filing of any thereof) or to otherwise perfect, protect, secure or insure any security interest or lien given as security for the Note.

11. Waivers. Borrower and Members hereby waive any right or claim of right to cause a marshalling of Borrower’s or Members’ assets or to cause Lender to proceed against any of the security for the Loan before proceeding under this Certificate against Borrower and/or Members; Borrower and Members agree that any payments required to be made hereunder shall become due on demand; and Borrower and Members expressly waive and relinquish all rights and remedies (including any rights of subrogation) accorded by applicable law to indemnitors, sureties or guarantors.

12. Members. Members, in consideration for the economic benefit passing to them, jointly and severally, in their individual capacities through consummation of the Loan, and acknowledging that Lender would not consummate such Loan in the
absence of Members’ execution of this Certificate and Agreement, join herein for the sole purpose of, and do hereby agree to cause Borrower to perform in accordance with the terms of this Certificate and Agreement, and in the absence of such performance by Borrower in accordance with the terms hereof, and upon receipt by Members of written demand by Lender, Members shall perform in accordance with the terms hereof and shall bear all cost related thereto.

GIVE ME MORE ENTERPRISES, LLC., a Kentucky limited liability company

BY: ____________________________
    Joseph C. Blow

TITLE: __________________________
    Member - Sole Manager

MON E. BAGS, individually

JOSEPH C. BLOW, individually
CERTIFICATE OF MEMBERS
OF
[INSERT NAME OF LLC]
A [INSERT STATE] LIMITED LIABILITY COMPANY

The undersigned representing all of the members of
[insert name of LLC], a limited liability company, certify
to [insert name of financial institution] (the "Bank") that:

1. Membership. The undersigned are all of the members of
[insert name of LLC], a limited liability company organized under
the laws of [insert name of state] the ("Company"). In
accordance with its Articles of Organization, the Company is
managed by Members [in the alternative, insert Managers].

2. Resolutions. The resolutions attached to and
incorporated in this Certificate as Exhibit A (the "Resolutions")
(i) were duly approved and adopted by all of the members of the
Company in accordance with the Company’s Articles of Organization
and/or its Operating Agreement and the laws of the State of the
Company’s formation; (ii) are not inconsistent with the Company’s
Articles of Organization or Operating Agreement; and (iii) as of
this date have not been amended or rescinded and are in full
force and effect.

3. Incumbency. The signatures appearing below are the
signatures of the individuals authorized to act on behalf of the
Company and only in the manner set forth in the Resolutions:

<table>
<thead>
<tr>
<th>Authorized Persons (Type Name)</th>
<th>Title (if any)</th>
<th>Signatures</th>
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4. Representations and Warranties as to Formation and Good
Standing. The Company is formed, validly existing and in good
standing under the laws of the [insert name of state]. A true
and complete copy of the Company’s (i) Articles of Organization,
and all amendments and (ii) the Operating Agreement with all
amendments are also attached hereto as Exhibit B-1 and B-2. The
Company has, and at the time of adoption of the Resolutions had,
full power and lawful authority to adopt the Resolutions and to
confer the powers granted in them to the persons named in them as
Authorized Persons; and those persons have full power and lawful
authority to exercise those powers. No other action or consent of any other person or entity is necessary in order for this Certificate or the Resolutions to be effective.

5. Change or Revocation. This Certificate shall remain in full force and effect, and the Bank shall be fully protected in relying on it until such time as the Bank has received written notice of a change or revocation from the Company and all of its members and has had due opportunity to act on the notice.

IN WITNESS WHEREOF, the undersigned have hereunto subscribed their names on [insert date], 199__.

WITNESS:

__________________________________
Type Name:__________________________

__________________________________
Type Name:__________________________

__________________________________
Type Name:__________________________

__________________________________
Type Name:__________________________

ALL OF THE MEMBERS OF THE LIMITED LIABILITY COMPANY MUST SIGN ON THE LINES ABOVE AND THEIR SIGNATURES MUST BE WITNESSED.
[Insert Name of Limited Liability Company]

LIMITED LIABILITY COMPANY'S RESOLUTIONS
AUTHORIZING FINANCIAL BORROWING

RESOLVED: that [NAME OF LLC] (the "Company")
borrow from [INSERT NAME OF BANK] (the "Bank")
the sum of ___________________ ($__________) (the
"Loan"); and it is

FURTHER RESOLVED: that _____________________ and
_____________________, or [either one of them]
(each such person being hereinafter referred
to as an "Authorized Person") is hereby
authorized and empowered at any time and from
time to time in the name of and on behalf of
the Company, and as security and collateral
for the Loan, and all future advances to be
made by the Bank to the Company, to mortgage,
pledge, assign, hypothecate, or grant a
security interest to the Bank in any and all
of the assets or properties of the Company,
both now owned or hereafter acquired (the
"Collateral"), together with all proceeds of
the Collateral, upon such terms and
conditions as may be agreed upon between the
Bank and such Authorized Person; and it is

FURTHER RESOLVED: that each Authorized Person
is hereby authorized and empowered in the
name of and on behalf of the Company to
eexecute and deliver to the Bank such loan and
security agreements, promissory notes, letter
of credit applications, letter of credit
agreements, requisitions, and other
documents, instruments and certificates (the
"Loan Documents") as may be necessary for the
Company to obtain the Loan; provided,
however, that each Authorized Person is
authorized in such person's discretion to
approve such changes in the substance, form,
and content of the Loan Documents as may be
determined by such Authorized Person to be
appropriate, necessary, or desirable for the
Company to obtain the Loan; such Authorized
Person's execution and delivery of the Loan
Documents to be conclusive evidence of the
Company's and its members' approval; and it is
FURTHER RESOLVED: that each Authorized Person is hereby authorized to specify to the Bank, orally or in writing, the amount or amounts of advances to be made under the Loan Documents and to do such other and further acts and things as may be necessary or advisable, in such person’s judgment, to carry out the terms of the Loan Documents and the purposes of these Resolutions; and it is

FURTHER RESOLVED: that each Authorized Person is hereby authorized and empowered at any time and from time to time in the name of and on behalf of the Company to enter into such amendments or modifications of the Loan Documents and any instruments, documents, or agreements executed and delivered pursuant to or in connection with the Loan Documents and to enter into such other loan, credit, or banking arrangements with the Bank as may be now or hereafter deemed necessary or advisable by such Authorized Person; and it is

FURTHER RESOLVED: that any indebtedness heretofore contracted, and any contracts, agreements, or notes heretofore made with the Bank on behalf of the Company and all acts of the members or agents of the Company in connection with such indebtedness or such contracts, agreements, or notes are hereby approved, ratified, and confirmed; and it is

FURTHER RESOLVED: that to induce the Bank to rely on these Resolutions in making the Loan to the Company, the Bank may consider these Resolutions to remain in full force and effect until written notice to the contrary is received by the Bank from the Company and all of its members.
EXHIBIT B-1

ARTICLES OF ORGANIZATION (and Amendments thereto)
LENDER LIABILITY UPDATE

John T. McGarvey
Morgan & Pottinger, P.S.C.
Louisville, Kentucky

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LENDER LIABILITY UPDATE

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SECTION J
LENDER LIABILITY UPDATE

John T. McGarvey
Morgan & Pottinger, P.S.C.

I. The significant lender liability cases lost by banks during 1994 and 1995 can be divided into three primary subject areas.

A. Breach of Fiduciary Duty.

1. Capital Bank v. MVB, Inc., 644 So. 2d 515 (Fla. Dist. Ct. App. 1994). Capital Bank was found by a jury to have owed MVB, Inc. a fiduciary duty, and to have breached that duty. A bank officer engineered the purchase by MVB, an existing customer of the bank, of the assets of another bank customer, Tellason. MVB sued the bank, claiming that the bank knew of problems with the business and its equipment, that it did not disclose, and arranged the purchase in order to keep the bank from suffering a loss on Tellason’s loans. The jury found in favor of MVB and awarded $571,137.00 in compensatory damages on the breach of fiduciary duty claim.

The Florida court recognized that a mere bank/borrower relationship does not create a fiduciary duty but found a fiduciary duty in this case because the bank’s officer had "... expressly invited (MVB’s) reliance by urging (MVB) to trust him and by reassuring (MVB) that he was part of the Capital Bank family." The court further found that the bank officer "... fostered (MVB’s) perception that the bank was his financial adviser, by repeating that the bank’s plans would benefit his business."

A separate jury verdict on fraud was the subject of a JNOV because the principal of MVB had signed a renewal note after having actual knowledge of the problems with the business he purchased.

of appellants having sought and received appellees financial advice in the past, appellants adequately demonstrated the existence of genuine issues of material fact regarding the parties purported confidential relationship and whether the duty to speak arose."

B. Breach of Covenant or Duty of Good Faith.

1. **Duffield v. First Interstate Bank of Denver, N.A., 13 F.3d 1403 (10th Cir. 1993), cert. denied, 114 S.Ct. 2674 (1994).** This one of the most troubling of all recent lender liability decisions. The conduct of the bank was entirely within the express written provisions of its contract. However, the court found that the obligation of good faith contained in the Uniform Commercial Code (KRS 355.1-203) does not permit unreasonable conduct "... even though the express terms of a contractual provision appeared to permit unreasonable actions." The Tenth Circuit affirmed an award of $6 million in compensatory damages.

2. **Wells Fargo Realty Advisors Funding, Inc. v. UIOLI, Inc., 872 P.2d 1359 (Colo. Ct. App. 1994).** The trial court awarded $12,929,486.00 against Wells Fargo on the basis that Wells Fargo breached its duty of good faith by refusing to accept a deed in lieu on defaulted properties. Instead, Wells Fargo foreclosed on all of the borrower's properties. The judgment amount was based on the court's findings as to the value of the properties owned by the borrower in addition to those properties on which the borrower had offered Wells Fargo a deed in lieu. The Colorado Court of Appeals affirmed, finding that a covenant of good faith exists in a credit agreement and, on the basis of specific facts, Wells Fargo had breached that covenant. This was another case where internal bank memos played a substantial role in the plaintiff's proof.

C. Breach of Loan Commitment.

1. **Upton Heights Associates Limited Partnership v. Seafirst Corp., 873 P.2d 438 (Or. App. 1994).** The Oregon Court of Appeals allowed Seafirst to proceed under the remedies permitted by its contract with the borrower despite the borrower's argument that the bank was required to act in good faith in its use of discretion as to the range of available remedies. The court found that "Seafirst had the contractual right to do what it did and breached no
contractual duty by doing so." See Breach of Loan Commitment One Anuhco, Inc. v. Westinghouse Credit Corp., 883 S.W.2d 910 (Mo. Ct. App. 1994). A $70 million jury verdict against Westinghouse was affirmed by the Missouri Court of Appeals in what Lender Liability Law Report terms "the largest lender liability verdict ever affirmed by an appellant court." Anuhco had paid Westinghouse a $200,000.00 commitment fee for a $65 million credit. A condition of the Westinghouse commitment was that operating results of the company "be in line with projected operating results." When the operating results from the preceding month were reported they were 12% below the level forecast by the borrower's officers. The jury found the variation and operating results insufficient for Westinghouse to withdraw its commitment.

2. Pelletech, Inc. v. Norwest Bank, 523 N.W.2d 207 (Wis. Ct. App. 1994). The Wisconsin Court of Appeals affirmed a jury verdict of $2 million based on Norwest Bank's failure to provide long term financing. Norwest had offered a financing package including short term and long term loans. Following a commitment from Norwest, the borrower did not pursue other opportunities for financing. After a change in account officers, the new officer informed the borrower that long term financing would not be available. Although Norwest obtained a JNOV on the breach of contract claim, the court of appeals reversed and directed the trial court to reinstate the jury's award of $1.7 million.

II. The results of lender liability prevention measures are mixed.

A. Jury Waiver Clauses.

1. Bench trials have not resulted in a better outcome for bank defendants. See Wells Fargo Realty Advisors Funding, Inc., supra. Edward F. Mannino reported similar findings in his survey of lender liability judgments presented to the Uniform Commercial Code Institute in October 1994.

2. Bank South, N.A. v. Howard, 444 S.E.2d 799 (Ga. 1994). The Georgia Supreme Court has found that a pre-litigation waiver of a right to a jury trial is unenforceable. The Georgia Supreme Court cited Article 1 of that state's constitution which provides in part: "The right to trial by jury shall remain inviolate, . . . " A similar provision is found in the Constitution of Kentucky at Section 7:
"The ancient mode of trial by jury shall be held sacred . . ."

B. Arbitration.

1. Although state courts in California and Alabama found binding arbitration clauses in bank lending contracts to be unenforceable, the decision of the U.S. Supreme Court in Allied-Bruce Terminix Companies v. Dobson, ___ U.S. ___, 130 L.Ed. 2d 876 (1995) should cause bankers to take another look at arbitration clauses. This decision will be discussed in depth later in this seminar.

C. The Attack on Punitive Damages.

1. Honda Motor Co. v. Oberg, ___ U.S. ___, 114 S.Ct. 2331, 129 L.Ed.2d 336 (1994). This decision overturned the Oregon system for imposition of punitive damages on the basis that judicial review was insufficient to afford a defendant the procedural due process required by the Fourteenth Amendment. "A decision to punish a tortfeaser by means of an extraction of exemplary damages is an exercise of state power and must comply with the due process clause of the Fourteenth Amendment." 114 S.Ct. at 2342. The Oregon system constitutionally prohibited judicial interference in awards of punitive damages unless there was no evidence to support the verdict. A close analysis of the decision reveals that the Oregon standards for judicial review are very near the standards currently used in Kentucky.

2. BMW of North America v. Gore, Cert granted, 63 U.S.L.W. 27. Whereas Honda v. Oberg addresses the procedural component of due process, the BMW case, now before the Supreme Court, again raises the substantive due process question in the imposition of punitive damages. The case before the court involves a jury verdict of $4 million, remitted to $2 million by the Alabama courts, wherein the underlying compensatory award was only $4,000.00. With its decision in this case, the U.S. Supreme Court will have addressed the issue of punitive damages and due process in four of its last five terms.
ENVIRONMENTAL LIABILITY ISSUES IN LENDING TRANSACTIONS

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Lexington, Kentucky

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# ENVIRONMENTAL LIABILITY ISSUES IN LENDING TRANSACTIONS

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ENVIRONMENTAL LIABILITY ISSUES
IN LENDING TRANSACTIONS

Marcus P. McGraw
GREENEBAUM, DOLL & MCDONALD

I. INTRODUCTION

This outline will cover in abbreviated fashion the major aspects of environmental liability facing lending institutions, including liability under CERCLA or Superfund, Trustee liability and various practical considerations, including checklists for lenders. This outline is not intended as an exhaustive treatment of the subject, but rather an overview designed to inform the audience generally about the various issues about which lenders should be aware.

II. SOURCES OF ENVIRONMENTAL LIABILITY FOR LENDERS

A. CERCLA OR Superfund Liability for Lenders

1. Among the many sources of environmental liability in connection with real estate transactions, the most notable and possibly the most important from a liability standpoint is the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA" or "Superfund"), 42 U.S.C. 9601, et seq.

2. CERCLA makes present and past "owners" and "operators" of contaminated real property (as well as generators and transporters of hazardous substances) strictly liable for the costs of
cleaning up the contaminated property. Current owners may be held strictly liable solely by virtue of their ownership status, and past owners may be held liable if they owned the property during any time when a "release" of hazardous substances occurred at the site.

3. However, CERCLA exempts "owners" or "operators" from this strict liability if they are "secured creditors" that hold "indicia of ownership" of a facility or property primarily to protect a security interest. Secured creditors that "participate in the management" of a facility are not exempt. See 42 U.S.C. Sec. 9601(20)(A).

B. Development of Lender Liability Concept Under CERCLA

1. Initial cases dealing with the CERCLA "secured creditor exemption" dealt primarily with interpreting the phrase "participating in the management" of a facility.

a. U.S. v. Mirabile, 15 Envtl. L. Rep. 20992 (E.D. Pa, 1985). A lender who owned property for four months and who took steps to remove contamination may be exempt under CERCLA depending on factual questions about whether the bank participated in day-to-day operations of the facility.
b.  

c.  

2. Later Cases Approached the Issue Differently

a.  
U.S. v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990). Lender holding a security interest in equipment, inventory and fixtures no longer exempt because it participated in the management of the facility after foreclosure to a degree indicating a capacity to influence environmental decisions.

b.  
In re Bergsoe Metal Corp., 910 F.2d 668 (9th Cir. 1990). Issuer of bond to finance business who held title to guarantee bond indebtedness and had rights to participate in management, but did not exercise that right, was nevertheless exempt since it did not participate in management.
3. Lender Liability Rule


b. Sets forth two-part test to determine whether lender's activities prior to foreclosure amount to "participating in the management" of the borrower's operations: (i) does the lender actually exercise control over the borrower's environmental compliance efforts; (ii) does the lender's level of participation in "operational aspects" (not financial) of the borrower's enterprise. See 40 C.F.R. 300.1100(c)(1). The rule also prescribes certain approved activities that lenders may follow after foreclosure of contaminated property to avoid becoming an "owner" under CERCLA.

4. Early Cases (Prior to Rule Invalidation)

a. In re Cuyahoga Equip. Corp., 980 F.2d 110 (2d Cir. 1992). Court noted that under the EPA rule, a bank's assumption of control of a facility pursuant to court order, and contracting for the salvage and sale of
equipment and materials with court approval did not constitute "management participation" triggering CERCLA liability.

b. *Grantors to the Silresim Site Trust v. State Street Bank & Trust Co.*, 1992 U.S. Dist. LEXIS 20612 (D.Mass. Nov. 24, 1992). In declining to determine whether the EPA rule applied, the court found that the bank did not participate in management and that therefore under CERCLA statutory language, legislative history, and legal precedent, it fell within the secured creditor exemption.

c. *United States v. McLamb*, 5 F.3d 69 (4th Cir. 1993). The court declined to apply the EPA rule and held that the lender fell within the secured creditor exemption, noting that the lender placed the property on the market immediately following the foreclosure sale and took no steps to manage or use the property during its ownership, and sold the land promptly.

d. *Ashland Oil, Inc. v. Sonford Prods. Corp.*, 810 F.Supp. 1057 (D.Minn. 1993). The lender was ruled exempt since it neither participated in management nor exercised any control over environmental compliance decisions. Periodic
reviews of the debtor’s finances were insufficient to constitute "participation in management" triggering CERCLA liability.

e. Waterville Indus. v. Finance Auth. of Maine, 984 F.2d 549 (1st Cir. 1993). The court declined to apply to the rule because of the timing of the case, and held that the exemption applies where a loan guarantor "promptly" divests itself of ownership. The placing of property on the market six months after receiving a title, and sale of the property within one year, was a "prompt" action, according to the Court.

f. Kelley v. Tiscornia, 810 F.Supp. 901 (W.D.Mich. 1993). The lender did not "participate in management," did not exercise control over the borrower’s environmental compliance, or assume responsibility for day-to-day management as a whole. Participation in semiannual board of director’s meetings, dissemination of information about the company’s financial condition, tracking the activities of the company, insisting on outside management, making bonus agreements, and holding meetings about financial matters,
were not deemed enough to trigger CERCLA liability.

g. United States v. Fleet Factors Corp., 819 F.Supp. 1079 (S.D.Ga. 1993). The federal lender liability rule was applied and was found to be consistent with the Eleventh Circuit’s earlier Fleet Factors decision.

h. United States v. Fleet Factors Corp., 821 F.Supp. 707 (S.D.Ga. 1993). Following the rule, the court held the lender to be liable under CERCLA because it maintained a presence at the facility for over eighteen months after a liquidation auction and handled hazardous wastes in an impermissible manner.

i. McGuire v. Sigma Coatings, Inc., 1993 U.S. Dist. LEXIS 11934 (E.D.La. Aug. 19, 1993). Since the lender’s actions were taken to protect a security interest, and because it had no capacity to exert control, it was protected by the secured creditor exemption.

j. The Reading Co. v. City of Philadelphia, 155 Bankr. 890 (E.D.Pa. Mar. 10, 1993). Applying the new rule, the court held that summary judgment was inappropriate since there were questions concerning the city’s degree of participation in management, namely it did not
appear that the city owned railcars "primarily to protect its security interest" because it had purchased the cars to attract riders to the downtown area.

k. *Northeast Doran, Inc. v. Key Bank of Maine*, 1994 U.S. App. LEXIS 1379 (1st Cir. Jan. 28, 1994). Although a lender failed to disclose information about site contamination, this does not create liability. Additionally, if the holder of a secured interest makes a "reasonably prompt" effort to divest itself from unwanted ownership, it is entitled to the exemption.

l. The EPA lender liability rule was **invalidated** by the D.C. Circuit on February 4, 1994, in *Kelley v. U.S. Environmental Protection Agency*, Nos. 92-1312 and 92-1314, 1994. The D.C. Circuit found the rule not to be a valid legislative or interpretative rule and, therefore, it may not be given judicial deference in any context. Hence, while EPA may follow its rule in its own enforcement decisionmaking, it may not impose its rule on private party cost recovery and contribution actions under CERCLA, and courts need not
follow the rule in either government-led or private party actions.

m. The D.C. Circuit's ruling leaves lenders with the potential for liability as owners and operators under CERCLA, and several courts recently have approved the general principles established in the rule for determining whether a lender is exempt.

5. Current Legislative Efforts

a. The Clinton Administration has proposed legislation that will amend CERCLA's definition of "owner or operator" to exclude persons who hold title to a facility solely as a fiduciary, provided that the person does not participate in the management of the facility and provided the person complies with all EPA regulations.

b. Other legislation has been introduced which tracks EPA's lender liability rule, except that it is wider in scope than the EPA lender liability rule because it extends the secured creditor exemption to fiduciaries (such as trustees) and expands and clarifies the secured creditor exemption under RCRA Subtitle I, which deals with underground storage tanks.
C. Defenses Under CERCLA

1. "Innocent Purchaser" Defense:
   a. If an entity has "undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability," but is nevertheless unaware of the contamination, there is no CERCLA liability. See 42 U.S.C. § 9601(35)(B).
   b. To qualify, a lender must perform environmental due diligence prior to obtaining title to property. This due diligence may be conducted prior to the origination of the loan in order to assess the lender's risk of future foreclosure on contaminated property, and/or immediately before foreclosure.

D. FDIC Environmental Risk Program

1. A lending institution should have in place "appropriate safeguards and controls to limit exposure to potential environmental liability associated with real property held as collateral." Feb. 25, 1993 FDIC memorandum.
2. FDIC encourages the inclusion of the following measures:

   a. Training of employees regarding environmental risk management, and consultation of outside experts when appropriate to assist in the assessment of risks.

   b. Designation of a person in management to be responsible for environmental risk management decisions.

   c. Environmental risk assessment during the loan application process, including more structured analysis when there is a concern.

   d. Loan documentation measures, including language requiring borrower to comply with environmental laws and disclose environmental status.

   e. Environmental risk assessment safeguards during loan workouts and foreclosures.

   f. Divest property in a reasonably expeditious manner at foreclosure.

E. Summary of Environmentally-Related Risks Facing Lenders

1. Property of a borrower used as collateral and other property of the borrower may be contaminated or become contaminated, causing the expenditure of large sums for remediation, resulting in cessation of loan payments.
2. The lender may become an "owner" or "operator" under CERCLA if it fails to meet the criteria for the secured creditor exemption. In such a case, the lender could become liable for the entire amount of cleanup costs associated with the property.

3. The risks of foreclosure may outweigh the amount of the loan. If the lender forecloses, property may have little or no value due to contamination of the property.

4. Loans involving industrial property raise the risk of severe contamination from hazardous substances, underground storage tanks, polychlorinated biphenyls (PCBs), lead paint, and asbestos. Residential property may involve risk associated with lead paint, asbestos, and hazardous substance contamination from adjacent properties. Agricultural property may involve risks due to farm-related dumping, pesticides, underground storage tanks, or even wetlands-related regulatory problems. Undeveloped property may involve risks from adjacent or historic uses, wetlands, endangered species, or archaeological claims.

F. How To Minimize Lender's Environmental Liability Pitfalls

1. Develop and follow written policies using the FDIC guidelines as an aid.
a. Determine business risks associated with providing loans secured by contaminated or potentially contaminated property or secured by assets that may be attached to pay for cleanup of other contaminated property.

2. Training of Key Personnel

3. Subject property to an environmental assessment (or require borrower to do so using a pre-approved consultant).
   a. Develop a standard contract or procedure for consultants to define the scope of work expected by the lender in an environmental assessment project.
   b. Conduct an inquiry to review all available information relating to the company/property/facility.
   c. If not done so by a consultant, perform an informal check with various regulatory agencies to learn of potential or actual problems.

4. Require documentation and other concessions both before and during the loan term, such as:
   a. Notification of violations of any permits or regulations;
   b. Indemnification for environmentally related liability;
c. Right to audit the facility and see all permits.

d. Right to terminate the loan

e. Representations and warranties that the owner/operator of the facility is, and at all times may remain, in compliance with all laws, and that he owner/operator bears the responsibility for responding to environmental conditions at the property; and

f. Right to inspect property at any time;

5. Monitor the property or facility to ensure that the owner/operator is in compliance with all laws.

III. Trustee Liability

A. Under CERCLA

1. Although there is no reference to trustee liability in the statute, trustees have been held as liable "owners" under CERCLA.

   a. Trustees have been considered "owners" when they hold legal title in real property.

   b. Even acting as a lessee-sublessor was deemed sufficient to confer "ownership" status under CERCLA, where the lender had the right to sublet the property, evict tenants, determine use of the property by tenants, collect rents, and enforce tenant obligations. See U.S. v. A

c. Obtaining equitable title was held sufficient to impose owner liability under CERCLA, where the purchaser entered into a contract but had paid only a small fraction of the purchase price and had not yet received a deed. See U.S. v. Wedzeb Enters., Inc., 809 F.Supp. 646 (S.D.Ind. 1992).

2. Prior to the Phoenix line of cases the courts usually concluded that holding mere title and exercising common fiduciary obligations were not sufficient to render an institutional trustee liable as an "owner."

B. Phoenix Line of Cases

1. In the first of the Phoenix Cases, Phoenix v. Garbage Services Co., 33 Env't Rep. Cas (BNA) 1655 (D.Ariz. 1991), the court ruled that institutional trustees could not be held liable under CERCLA without evidence of ownership in addition to a warranty deed of conveyance.

2. In Phoenix v. Garbage Services Co., 816 F.Supp. 564 (D.Ariz. 1993), a trustee may be held liable as an "owner" under CERCLA where it holds bare legal title, even if it never accepted the position of trustee contemplated in a will, but instead acted
only in its fiduciary capacity as the executor of the estate.

3. In *Phoenix v. Garbage Services Co.*, 827 F.Supp. 600 (D.Ariz. 1993), the court added that, under certain circumstances, liability can be personal, regardless of the ability of the trust to indemnify it, and that, as a past owner, the bank was personally liable, thus distinguishing between current and past owner liability.

C. Exemptions Or Defenses Under CERCLA

1. "Innocent Purchaser" Defense:

   If a party has "undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability," and still did not know of the contamination, the party is not held liable. See 42 U.S.C. § 9601(35)(B).

2. "Inheritance or Bequest" Defense:

   If the trust in which contaminated property is held came into being as a testamentary trust at the death of the settlor, the trustee may be able to assert the acquisition of the trust property by inheritance or bequest as a defense. See 42 U.S.C. § 9601(35)(A)(iii); *U.S. v. Pacific Hide & Fur Depot, Inc.*, 716 F.Supp. 1341, 1348 (D.Idaho 1989).
D. Avoiding Trustee Liability

1. Decline potentially contaminated properties where trust agreements give the trustee power to control the trust property.

2. Arrange for an environmental assessment prior to becoming trustee.

3. Options for Existing Trustees
   a. Evaluate the extent of control exercised and the properties covered under the trust agreement.
   b. Arrange for an environmental assessment of the property. However, be aware that reporting and cleanup obligations may be triggered.
   c. For leased property, insist in the lease that the lessee comply with all laws and that the lessee bear the responsibility for responding to environmental conditions at the property and obtain indemnification from the lessee.
LOAN AGREEMENTS
AND
DOCUMENTS

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I. INTRODUCTION.

A lender's ability to recover loans, to conduct a workout of a troubled loan, and to survive the challenges of a trustee and competing creditors in a bankruptcy proceeding may hinge on the loan documents which are executed and delivered by the borrower at the time the loan is made by the lender to the borrower. Seemingly inconsequential failures and oversights in the loan documentation may result in irreparable harm to the lender in many instances.

The necessity to have loan documentation which protects the lender in every conceivable circumstance must be weighed against a number of competing interests: (a) will the borrower be alienated by onerous or opaque loan provisions; (b) are the loan documents more complex than warranted under the specific situations; and (c) are the legal fees necessitated by extensive loan documentation warranted by the specific circumstances. When weighing these competing interests, the lender should keep in mind that, first and foremost, loose loan documentation can make an otherwise salvageable situation a disaster. In addition, precise and well drawn loan documentation will always prove less expensive and more effective than subsequent measures taken to salvage a deteriorating loan.
There are a variety of different types of commercial loans. Each type of loan will require unique provisions in the loan documentation evidencing same. An unsecured demand loan or line of credit will require simple and concise loan documentation, while, a secured line of credit and a construction loan require unique and specialized loan documentation.

Many lenders and lawyers have reviewed loan documents with such frequency so as to take for granted the uses and limitations of provisions contained in the loan documents. The lender and the lawyer must avoid the trap of viewing any provision contained in the loan documents as being "boilerplate." The lender and the lawyer should always remind themselves that there is no such thing as "boilerplate." Each and every term and provision contained in a loan document serves a specific and unique purpose. Each term and provision contained in the loan documents should be reviewed carefully to ensure that it is applicable and that it serves its intended purpose.

II. THE LOAN AGREEMENT.

The loan agreement is a written contract between the lender and the borrower which governs all aspects of the lending relationship. The loan agreement is the central file which may be referenced to ascertain any element of a commercial loan transaction.

The determination of whether to utilize a loan agreement is not an exact science. Normally, in a commercial loan transaction, it is beneficial to express in a single document all aspects of the
lending relationship between the borrower and the lender. While the basic agreements of the lender and the borrower may be expressed in other loan documents, the loan agreement provides a convenient reference for the overall terms of the transaction. It is accepted banking and legal practice that various types of agreements are to be expressed in separate documents. The functional separation of loan documents has promoted the standardization of certain of the less controversial loan documents (such as pledge agreements, mortgages and promissory notes) and made the loan agreement the receptacle for most special provisions and the focus of attention in loan negotiations.

In deciding whether a loan agreement is necessary for a particular transaction, the lender and the lawyer should keep in mind that certain loan provisions are susceptible of being expressed in any of several loan documents. For example, the long form promissory note, rather than a loan agreement, may be used to describe events of default, the mechanics of payment and remedies upon default. In addition, covenants concerning collateral may be expressed in the collateral documents rather than a loan agreement.

In those instances where a loan agreement is utilized, it is common practice for the parties to vigorously negotiate the loan agreement, but ignore the very restrictive and burdensome representations, warranties, covenants and events of default contained in standard form collateral documents. Irregardless of whether a loan agreement is utilized, all loan documentation should
be examined carefully to ensure that the terms and provisions of the documents do not overlap or conflict.

If a determination is made to utilize a loan agreement, the loan agreement format must conform to the particular type of facility being established. A few of the various loan agreement formats include the following:

Revolving Credit Agreement. A revolving credit agreement is a loan agreement under which the lender has an obligation, whether absolute or contingent, to make advances to the borrower and pursuant to which the borrower may repay and reborrow at any time without premium or penalty. The revolving credit agreement permits the borrower to borrow on an as needed basis and is therefore advantageous for borrowers who have seasonal borrowing needs.

Line of Credit Agreement. While a revolving credit facility is oftentimes referred to as a line of credit, the term "line of credit" references a facility under which the lender does not have an absolute obligation to lend funds.

Term Loan Agreement. The term loan agreement establishes a facility which is disbursed in a single advance or multiple advances over a particular availability period. The term loan agreement does not contemplate that the borrower will repay and reborrow on a revolving basis. The term loan agreement which permits multiple advances
normally requires that funds be drawn only for a specific purpose (e.g., the interim construction loan agreement).

**Combined Revolving Credit and Term Loan Agreement.** The revolving credit and term loan agreement either establishes a separate revolving credit and a separate term loan or establishes a revolving credit which converts to a term loan at the end of the revolving.

Normal and customary elements of the loan agreement include:

(a) the commitment of the lender to advance funds, (b) the obligation of the borrower to repay the loan with interest, (c) the collateral security to be pledged by the borrower or other parties for the loan, (d) any limitations on the lender's obligation to make additional or future advances; (e) representations and warranties by the borrower and the guarantors, (f) negative and affirmative covenants of the borrower and any guarantors, (g) specific events which constitute defaults by the borrower and the guarantors under the loan, (h) the rights and remedies of the lender upon the occurrence of any such events of default under the loan agreement, and various other unique and specific provisions required by the specific type of loan. Set forth below is a discussion of each of these components of the loan agreement. There is no magic or legal significance to the order in which the components of the loan agreement are presented below.

**A. Commitment to Lend.** This section of the loan agreement establishes the structure, amount and duration of the lender's obligation to advance funds, including circumstances or
events upon which the commitment may be increased or decreased. This section of the loan agreement also establishes the procedures for the manner of borrowing and the right of the borrower to terminate or reduce the lender's commitment. Oftentimes, this section includes provisions relating to minimum advance amounts, required borrowing notices and specificity of use of the proceeds. In multi-bank credit agreements, this section should also specify the procedure for the borrower to notify the agent of a request for borrowing, and, in turn, a procedure for the agent to notify the members of the bank group of such request. Also in multi-bank loan agreements, this section should also address (i) the procedure by which the members of the bank group are to make funds available to the agent for disbursement to the borrower, (ii) the pro rata nature of the members of the bank group's obligations to fund requests for borrowing, and (iii) that the obligation of each member of the bank group to fund is a separate and distinct obligation from the other members of the bank group. The commitment section will also include provisions governing the amount and other aspects of commitment fees paid or payable by the borrower in connection with the commitment established by the lender.

If the loan agreement contemplates future advances, the commitment section of the loan agreement should establish whether the obligation of the lender is absolute or discretionary.

From the lender's prospective, the loan agreement should be drafted so as to expressly provide that the lender will advance
funds only at its option or in its sole discretion. If the parties intend that the lender will be required to lend funds, the loan agreement should contain mandatory language creating a binding commitment to lend. Even in situations where the lender has an absolute commitment to lend, the amount that may be outstanding may be subject to borrowing base limitations such as 80% of the borrower's "eligible receivables" from time to time outstanding. The lender's absolute commitment to lend may be further qualified by permitting the lender to determine the eligible assets which may be included in the computation of the borrowing base, as determined by the lender in its sole discretion. Note that discretionary borrowing bases are still subject to good faith limitations and may be affected by course of dealing considerations.

B. Repayment and Note Terms. This section of the loan agreement will describe the repayment obligations of the borrower and normally refers to a form of promissory note which is attached to the loan agreement. Oftentimes when a loan agreement is utilized, the repayment terms and interest provisions will be contained solely in the loan agreement with specific reference in the note to those provisions of the loan agreement.

The structure of the repayment section of the loan agreement will depend entirely upon the type of credit facility. The amortization may be based on a fixed schedule, a percentage of cash flow or revenues, or some combination thereof.

This section of the loan agreement will also describe the interest, both pre-default and post-default, which will be charged
on the outstanding principal balance of the loan. A loan may bear interest, at any time or from time to time, by reference to one or more indices and the interest rate may be fixed for different periods based upon different indices. For example, a loan may bear interest by reference to an adjusted CD rate, LIBOR and/or a treasury note rate. This section of the loan agreement should specify the periods for which the interest rate(s) may be fixed, how often interest is due, whether the borrower may prepay the loan during a fixed interest period, and what increments prepayments may be made, and the prepayment premium due upon prepayment of all or any portion of the loan during a fixed interest period. If the loan is either match funded or contains a matched fund option, this section of the loan agreement should include a provision permitting the lender to pass through reserve requirements and FDIC assessment rates.

This section of the loan agreement should also specify the manner and application of prepayments (pro rata or inverse order of maturity). If the loan agreement covers more than one promissory note, the prepayment provisions in this section should specify the manner for determining which of the notes will be reduced by a prepayment. If prepayment premiums are required by the lender, such prepayment premiums and the method for the computation thereof should be included in this section. Any mandatory prepayments required in connection with the loan (e.g., excess cash flow) should also be included in this section.
C. Collateral Security. The collateral security section of the loan agreement normally references the collateral documents required in connection with the loan. While the collateral security section of a loan agreement is normally not used for the creation of the required liens and security interest, it is becoming more prevalent to include the granting language necessary for the creation of the liens and security interest in and to personal property in this section. If the loan agreement does include lien granting language, the loan agreement should incorporate all of the provisions of a security agreement. (See Section IV below). If the collateral security section contains special representations, warranties or covenants with respect to the collateral, the lender and the lawyer should be sure that there are no harmful inconsistencies between any special collateral provisions in the loan agreement and the provisions contained in the collateral documents.

D. Conditions Precedent. The conditions precedent section of the loan agreement will provide that the lender’s obligation to make the loan and/or to make future advances is conditioned upon the borrower’s delivery of specified documents, instruments and other items and the continuing accuracy, as of the date of any future advance, of certain lending assumptions. The required conditions precedent should be communicated to the borrower early in loan negotiations.

Typical conditions precedent include: (a) a requirement that all loan documents must be executed and delivered to the lender,
(b) a requirement that all collateral documents be recorded and/or filed, as necessary, (c) a requirement that title insurance, in the case of a real estate loan, be delivered to lender, (d) delivery of certificates of casualty and hazard insurance to the lender, (e) the delivery to lender of Uniform Commercial Code and tax lien searches in the name of the borrower and other parties pledging collateral for the loans, and (f) the delivery of a legal opinion of counsel for the borrower. If the borrower is an entity (a corporation, partnership, limited liability company, or a trust), then the conditions precedent should require the delivery of all pertinent organizational documents together with certified resolutions authorizing the borrower to consummate the transaction.

The contractual conditions precedent are not necessary when the funding obligations are satisfied simultaneously with the execution of the loan agreement. Nevertheless, while the conditions precedent might not be specifically set forth in the loan agreement, all of the items which would otherwise be included in the conditions precedent section must be delivered to the lender before (or at the time that) the lender signs and delivers the loan agreement.

A lender should not waive conditions precedent without careful thought. If, at a later date, the lender attempts to obtain documents covered by a waived condition, there may no longer be an amicable relationship. In addition, once the funds are out the door, the borrower will feel little pressure to comply with a waived condition precedent. If the lender waives any of the
conditions precedent, then the parties should execute a compliance agreement at closing to cover the subject of waived conditions.

E. **Representations and Warranties.** The representations and warranties section requires that the borrower make statements of pertinent facts to induce the lender to establish the loan or to lend the funds to the borrower. In addition to standard representations which are relevant in all loans (representations as to the borrower’s valid existence and authority to borrow money), the representation and warranty section should include representations as to any facts which are important to the lender’s decision to establish the loan or to lend funds (both initially and continually).

The representation and warranty section is often a battleground for the lender and borrower since the lender’s proposed, expansive representations will smoke out problems which will require specific exceptions from the borrower. The lender’s counsel should draft the representations broadly in order to force the borrower to provide a complete picture of its business and financial condition. The lender should resist attempts by the borrower to make the representations based on borrower’s best knowledge or to permit the representations to be qualified by a materiality standard. By making the borrower focus specifically on the truth and accuracy of various factual representations and warranties, the borrower itself comes to know its business in a more focused way. In many ways, this self audit can have a healthy effect upon the operations of the borrower and upon the credit.
It is important to note that representations and warranties are static statements in that they speak as of a particular date. Normally this date is the closing date or the funding date under the loan agreement. Representations and warranties are not only important for initially determining the extension of the credit and the closing of the loan but for the continuing viability of the credit and for providing a framework for continuing the existence of an event of default. The prudent lender should therefore require that all representations and warranties be repeated and delivered periodically. In all events, where there is multiple advances, the representations and warranties should be reaffirmed as a condition precedent to each and every loan advance.

Set forth below are some of the more common types of representations and warranties required by a corporate borrower in the loan agreement.

(a) That the corporation is duly organized and existing under the laws of its state of incorporation;

(b) That the corporation is qualified to do business in all jurisdictions in which it must be qualified to do business;

(c) That the corporation has authority to conduct its business and has all requisite power and authority to own its property;
(d) The corporation has all requisite corporate power and authority to execute, delivery and perform the loan documents;

(e) The corporation is duly authorized and has taken all corporate action necessary to authorize the corporation to execute, deliver and perform the loan documents;

(f) The execution, delivery and performance of the loan documents and the consummation of the transactions thereunder do not conflict with the terms and provisions of any law, statute or regulation or any applicable judgment, license, order or permit or any instrument to which the corporation is a party or is bound or violates any provision of the articles of incorporation or bylaws of the corporation;

(g) The loan documents are legal, valid and binding obligations of the corporation, enforceable in accordance with their respective terms;

(h) All of the properties and assets of the corporation are free and clear of all mortgages, liens, encumbrances and other adverse claims;

(i) The financial statements of the corporation as of ______ , 199__ are true and correct, fairly present the financial condition of the
corporation and have been prepared in accordance with generally accepted accounting principles applied on a basis consistent with that of prior periods; and

(j) There has been no material adverse change in the assets, liabilities, condition (financial or otherwise) or business of the corporation since the date of the financial statements referred to above.

Typically, the representations and warranties are amplified by exhibits supplied by the borrower. It is important that all such exhibits be submitted in proper form and that they be submitted in ample time so as to permit a meaningful examination prior to the closing. Any fact disclosed in the exhibit at the time of the closing of the loan will bar any future objections to the existence of such fact.

F. Covenants. In their simplest form, covenants contained in the loan agreement require certain acts of the borrower and prohibit others. Covenants will either be drafted in the form of a negative covenant (the borrower will not guarantee the debt of others) or an affirmative covenant (the borrower will pay its taxes as they become due).

The following is a list of the standard categories of covenants found in a loan agreement:

(a) **Covenants requiring the borrower to take actions which are generally deemed to be good**
and prudent business practices. Covenants of this nature would include the borrower’s covenant to preserve its existence, to properly maintain and operate its properties, to properly insure its properties, to pay its debts as they become due, to pay taxes as they become due, to maintain business and accounting records in accordance with generally accepted accounting principles and to comply with all applicable laws, licenses and approvals.

(b) Covenants requiring the borrower to provide a current source of financial information to the lender. Covenants of this nature include the borrower’s agreement to deliver to the lender audited annual financial statements, quarterly financial statements, monthly financial information or reports, borrowing base reports, statements and reports sent to the Security and Exchange Commission, periodic compliance certificates, notices of the occurrences of an event of default, notice of the institution of litigation, notice of the occurrence of a material adverse change in the business or financial condition of the borrower, notice of
reportable events under ERISA and notice of adverse events affecting the collateral.

(c) **Covenants which prohibit the borrower from making fundamental changes in the business, structure and management of the borrower's business.** Covenants of this category include a prohibition against liquidation, merger, consolidation, a prohibition against liquidation or sale of all or substantially all the assets, a prohibition against entering into new lines of business or discontinuing existing lines of business, prohibitions against material management changes, prohibitions against amendment to articles of incorporation or bylaws and prohibitions against acquiring all or substantially all of the assets of a third party.

(d) **Covenants restricting indebtedness of the borrower.** These types of covenants include restrictions on amount of indebtedness owed by borrower, restrictions on indebtedness owed by the borrower's subsidiaries, restrictions on guarantees of third party indebtedness by the borrower, restrictions on lease obligations of the borrower, a requirement for minimum net worth, a requirement of a minimum ratio of
tangible net worth to indebtedness, a requirement of a minimum ratio of net income or cash flow for a defined period to interest expense on indebtedness.

(e) Covenants regarding the liquidity of the borrower. Liquidity covenants are often expressed in one or more of the following ways: (i) maintenance of minimum working capital; (ii) maintenance of a minimum ratio of current assets to current liabilities; (iii) restriction on maximum current liabilities; (iv) a maximum ratio of current liabilities to other financial attributes (tangible net worth or tangible net assets); and (v) a minimum ratio of current assets to funded debt.

(f) Covenants requiring the borrower to maintain its assets. Asset maintenance covenants may include a required minimum amount of tangible assets, a prohibition against selling certain assets except in the ordinary course of business, a prohibition against selling assets below fair market value, a prohibition against selling or discounting accounts receivables, and a requirement that a sale of specific
assets be accompanied by prepayment of the indebtedness to the lender.

(g) **Covenants restricting the borrower’s payment of dividends, investments and other distributions in payments.** These types of covenants are important to regulate the borrower’s disposition of net income and cash flow generated by its operation. Covenants of this type may include a prohibition against loans to and investments in third parties, a prohibition against declaration and payment of dividends and other payments in respect of stock, a prohibition against investments in excess of a specified percentage of net income, a prohibition against authorizing distributions of capital stock not payable within a specified time period, a prohibition against issuance of shares of preferred stock, limitations on the payment of salaries and bonuses, prohibitions against transactions with affiliates, restrictions on voluntary prepayments of other indebtedness, and restrictions on capital expenditures.

(h) **Covenants restricting liens on other assets of the borrower.** When a lender lends in reliance on specific collateral, this covenant will
prohibit the borrower from selling such collateral or encumbering such collateral. In addition, even though specific collateral may not be pledged for the loan, the lender might require a covenant prohibiting the borrower from creating or incurring liens and encumbrances on its assets.

(i) Covenants respecting the borrower's right to deal with collateral. When specific assets are taken as collateral for a loan, the lender may require specific covenants concerning such collateral. These types of covenants would include a prohibition on sale or encumbrance of such collateral, delivery of periodic appraisal reports, special insurance requirements, further assurances by the borrower to perfect and maintain liens granted in favor of the lender, requirements to repair, reconstruct or replace damage or worn out collateral, requirement that proceeds from the disposition of the collateral or destruction of the collateral be used to repay the indebtedness, covenants pertaining to the relationship between collateral value and outstanding indebtedness.
(j) **Miscellaneous covenants of the borrower.**

Other miscellaneous covenants of the borrower which may be contained in the loan agreement would include a covenant regarding use of the proceeds of the loan, requirement that the proceeds not be used for purchase of carrying of margin stock, a covenant regarding place and manner of payment of the notes, a requirement that borrower indemnify the bank against losses and pay certain costs and fees, and covenants regarding compliance with covenants contained in other loan or credit agreements.

(k) **Special covenants of the borrower.** In every loan, special risks and features are presented. The lender and the lender's counsel must consider the special risks and features of a particular loan in order to construct the special covenants which may be required in connection with a specific loan.

The lender and the lender's counsel will find that the negotiation of the covenants section of the loan agreement may be burdensome and emotional in that covenants restricting the borrower's business activities may be viewed as insulting. The lender and the lender's counsel must have a strong grasp on the
borrower's business in order to craft and construct the appropriate language for the covenants to be contained in the loan agreement.

G. Events of Default. This section of the loan agreement lists events, the occurrence of any of which constitutes a default by the borrower under the loan agreement. The wording of default provisions can prove critical and should be prepared and reviewed carefully by all parties. The objective in drafting definitions of events of default is to articulate clearly the circumstances by which the lender should be able to exercise any one or more of available remedies in seeking repayment of the indebtedness. The drafter of the loan agreement should seek to identify the types of circumstances indicative of a material deterioration in the financial condition of the borrower from its condition at the time the loan was originally approved and extended.

The occurrence of an event which entitles the lender to exercise its remedies should be distinguished from an event or circumstance with requires the lapse of a specified time period or the giving of notice or both to become an event of default ("potential default"). The potential default does not entitle a lender to exercise its rights until such time as it ripens into an event of default. As an example, the failure of a borrower to perform a covenant could constitute an event of default which permits the lender to avail itself of its remedies. However, in most instances, the borrower is afforded some specified period of time following the occurrence of such covenant failure within which
to cure the default (grace period). The breach of the default will not ripen into an event of default until the lapse of the applicable grace period.

The event of default section in the loan agreement should govern and define the events of default for all related documents. Reference to an event of default in the loan agreement should be made in all other documents so that a centralized and uniform default section is applicable to each loan document.

As with the other sections of the loan agreement, the events of default section must be crafted to fit the needs of the particular transaction. However, the following is a list of events of default which are typically found in most all loan agreements:

(a) Failure by the borrower to pay principal, interest or fees when due;
(b) Failure by the borrower to comply with the covenants contained in the loan documents;
(c) Misrepresentation or a breach of warranty by the borrower;
(d) The borrower’s nonperformance under the terms and provisions of other agreements;
(e) Bankruptcy or insolvency of a borrower, guarantor or any subsidiary or a similar party and actions taken by the borrower in preference of other creditors;
(f) Failure of the borrower or guarantor to satisfy monetary judgments;
(g) Failure by borrower to comply with ERISA; and

(h) The occurrence of a material adverse change in the financial or business condition of the borrower or any guarantor.

H. Remedies. This section of the loan agreement will set forth the remedies that are available to the lender upon the occurrence of an event of default. The typical remedies found in a loan agreement include the following:

(a) Termination of a lender’s commitment to advance additional monies under the terms of the loan agreement;

(b) An option to declare all or any portion of the unpaid principal balance, accrued interest and fees of the borrower immediately due and payable;

(c) The exercise of the lender’s right of setoff;

(d) Foreclosure of all liens or the realization upon any and all collateral pledged to the lender; and

(e) Exercise of any and all other rights and remedies available at law, in equity or otherwise.

In crafting the remedies provisions as well as the default provisions of the loan agreement, lender’s counsel must have a working knowledge of certain bankruptcy concepts affecting the lender’s rights. Lender’s counsel and lender should not lose sight
of the fact that the default and remedies provisions in a loan agreement, despite being clearly drafted and finely tuned, may be circumvented in the event of a bankruptcy proceeding by or against the borrower.

I. Agency Provisions. In multi-bank loans, the loan agreement should include provisions appointing an agent for the bank group, defining the scope of the agent’s duties and responsibilities, providing for the procedure for the resignation or removal of the agent, providing for the governance of action taken by the bank group, describing rights of the agent to act with or without authorization or approval of the members of the bank group, providing for exculpatory and indemnity provisions to minimize the agent’s liability, and confirming independent credit investigation by each of the members of the bank group.

J. Miscellaneous Provisions. This section of the loan agreement will include provisions which govern the interpretation and interrelationship of the provisions of the loan agreement. This section of the loan agreement typically includes provisions regarding prior oral or written understandings of the parties, limiting implied waivers by the lender, requiring the borrower to pay expenses of preparation and enforcement of the loan documents, setting forth a procedure for the giving of notices under the loan documents, providing for severability of unenforceable provisions, prohibiting assignments by the borrowers and permit assignment by lender, setting forth jurisdictional and venue agreements, setting forth a usury savings clause and providing for waiver of jury
trial. This section may also include procedures for alternative dispute resolution.

K. Definitions. In order to provide ease of reference and readability, each loan agreement should include a definition of those terms which are used repeatedly in the loan agreement. In addition, terms used in financial covenants should be defined in the definition section of the loan agreement.

III. PROMISSORY NOTE.

The promissory note may take a variety of forms. The promissory note can range from a very simple instrument to one with a variety of complex provisions. Normally, promissory notes issued pursuant to a loan agreement will be simple in nature with references to the loan agreement for the more complex provisions. On the other end of the spectrum is the promissory note which, in the absence of a loan agreement, incorporates and includes many of the provisions which would otherwise be contained in the loan agreement.

In its simplest terms, the promissory note is a written contract whereby the borrower agrees to repay the loan in accordance with the terms of the note. To be enforceable the note must include the following elements:

(a) The date of the instrument;
(b) The name of the maker;
(c) A promise by the maker to pay a specific amount to the payee;
(d) The name of the payee;
(e) A provision as to whether the maker is to pay interest and the rate of interest which is to be paid and the method of computing the interest; and

(f) The times and the method of the payment of the principal and interest under the note.

The lender should be cognizant of the fact that most promissory notes in a commercial transaction, while being transferable, are probably not negotiable. Negotiability is determined under the provisions of the Uniform Commercial Code. If the note meets the strict requirements as set forth in the Uniform Commercial Code, then the transferee of the note will take the note free of certain defenses which the maker may have had against the original holder of the note. The fact that the note is not negotiable in accordance with the Uniform Commercial Code does not mean that the note may not be transferred. Thus, a non-negotiable note may be transferred to a third party by the original holder but the transferee would take the note subject to any claims or defenses which the maker has against the original holder. The note will not be transferable if it contains a provision which specifically prohibits the holder from transferring the note to a third party.

If not included in a loan agreement, the note should set forth the amount and due dates of the payments of both principal and interest. If a loan agreement is not utilized, those provisions
discussed in Section II.B. above regarding interest rates, should be included in the promissory note.

If the lender desires to calculate interest using a method other than the 365 day year method, the note must specifically so state. Typically, the lender will use a 360 day year.

Any charges to be paid by the maker for late payment of principal and/or interest should be specifically set forth in the note. The calculation of such late charges and the method and time of payment must also be designated in the note.

The note should contain a specific provision specifying events of default. If a loan agreement is utilized in conjunction with a note, the note should specifically refer to the comprehensive events of default contained in the loan agreement and specify that the occurrence of any such events also constitutes a default under the note. In conjunction with the default provision, the note must specifically state that upon the occurrence of an event of default, at the lender’s option, the entire outstanding principal balance and all accrued and unpaid interest on the note shall become immediately due and payable without demand or notice.

If the note is made by multiple makers, the note should specifically provide that the makers are "jointly and severally liable" for the payment of all principal and interest under the note.

While not specifically required, it is advisable to reference the collateral and the collateral documents which secure the repayment of the note. The note should contain a waiver by the
makers of, among other things, presentment, demand, notice of dishonor, protest, notice of nonpayment and all other notices to which the makers may be entitled. If multiple makers execute the note, the note should contain a specific provision permitting the lender to release any one or more of the makers without affecting the liability of the remaining makers under the note.

IV. SECURITY AGREEMENT AND UNIFORM COMMERCIAL CODE FINANCING STATEMENTS.

The security agreement must be in writing, must evidence a present intention to grant a security interest, must contain a description of the collateral sufficient to identify it and must be signed by the debtor. KRS 355.9-203. In addition, if the collateral includes crops, oil, gas or minerals, and/or timber to be cut, the security agreement must also include a description of the subject real property. KRS 355.9-203.

While the debtor is normally deemed to be the borrower, if the collateral is being pledged by a person or entity other than the borrower, the debtor for purposes of the enforceable security agreement, is the entity or individual who owns the collateral.

The lender and lender’s counsel should pay particular attention to describing the collateral to be pledged under the security agreement. Kentucky case law appears to enforce stringent requirements with respect to the description of collateral to be contained in security agreements.

KRS 355.9-204 permits the security agreement to secure future or other indebtedness owed to the lender. Thus, by using a future
or other indebtedness clause in its security agreement, the lender can collateralize other loans whether then existing or thereafter created.

If the security agreement is not executed in conjunction with a loan agreement, the security agreement should contain similar representations and warranties as required in the loan agreement (see discussion under Section II above). If not contained in the loan agreement, the security agreement should include provisions requiring the collateral to be insured. The lender should be named as loss payee under such policies of insurance. If not required under the loan agreement, the security agreement should provide that the debtor will keep the collateral in good condition and free from liens and other encumbrances. The lender should be permitted to perform certain of the debtor's obligations under the security agreement, without obligation to do so. For example, if the debtor fails to obtain and maintain insurance, the lender should be permitted to obtain such insurance and charge same back to the debtor.

If the security agreement is executed in conjunction with a loan agreement, and provided the loan agreement contains the comprehensive default section as suggested in Section II above, the security agreement should provide that the occurrence of an event of default under the loan agreement constitutes an event of default under the security agreement. If the security agreement is not executed in conjunction with a loan agreement, the security
agreement or the related note should contain the comprehensive
default section as suggested in Section II above.

The security agreement should include an expansive remedy
 provision. The remedies provision should include, without
 limitation, the right of the secured party to declare all obliga-
tions secured by the security agreement to be immediately due and
payable upon the occurrence of an event of default as well as the
right of the secured party to exercise any and all other rights and
remedies that are available at law or in equity.

The security interest created by the security agreement is
virtually worthless unless the security interest is properly
perfected in accordance with the terms of the Uniform Commercial
Code. Except in certain instances described in the Uniform
Commercial Code, the security interest created by the security
agreement is perfected by the filing of a financing statement. The
financing statement gives notice that the lender has a security
interest in the collateral described in the financing statement.
The financing statement does not create the security interest.

The financing statement when properly filed perfects those
security interests created by the security agreement which can be
perfected by the filing of a financing statement. Perfection
permits the security interest to be enforceable against third
parties. In addition, the security interest once perfected will be
superior to all unperfected security interests and security
interests perfected after the filing of the financing statement.
While this discussion will be limited to perfecting the security interest by the filing of the financing statement, the lender and the lender's counsel should note that security interests in certain types of collateral may be perfected by means other than the filing of a financing statement and that in certain instances, security interest in collateral can be perfected solely by possession.

The legal requirements for a financing statement are set forth at KRS 355.9-402:

(a) The financing statement must be signed by the debtor;

(b) The financing statement must set forth the address of the secured party and the mailing address of the debtor;

(c) The financing statement must contain a statement indicating the types or describing the items of the collateral; and

(d) If the financing statement covers crops or fixtures, the financing statement must include a description of the real estate.

If the security agreement meets the requirements of a financing statement, the security agreement can serve as the financing statement.

As noted above, the financing statement must not only be executed but must be filed in the proper office. In multi-state transactions, the determination of which state or states to file
the financing statement is very complex. The discussion below will be limited to a determination of where to file the financing statement in the Commonwealth of Kentucky, assuming that the transaction will be governed by the Uniform Commercial Code as adopted in the Commonwealth of Kentucky.

The general rule is that the financing statement should be filed in the county of the debtor's residence if the debtor is a resident of Kentucky or in the Office of the Secretary of State of Kentucky if the debtor is a nonresident. KRS 355.9-401. The determination of the debtor's residence is to be made in accordance with KRS 355.9-401(5).

V. MORTGAGE.

If the collateral being pledged for a particular loan includes real estate, a mortgage should be prepared, executed and recorded. The statutory requirements of a mortgage in Kentucky are set forth below:

(a) The county, state of residence and post office address of the mortgagee must be stated in the mortgage (KRS 382.430);

(b) The date of the obligations secured and the maturity date of the obligation secured must be set forth in the mortgage (KRS 382.330);

(c) If the mortgage is to secure a revolving credit, the mortgage should specifically set forth that the obligation secured is a revolving credit and the maximum amount that may be
outstanding under the revolving credit at any time (KRS 382.385);

(d) If the mortgage is to secure future loans to the mortgagor, the mortgage must specifically disclose that the mortgage secures future loans and set forth the maximum amount of such future loans (KRS 382.520);

(e) If the mortgage is to secure construction financing, the mortgage must include a statement that the mortgage is taken to secure a loan made for the purpose of erecting, improving or adding to a building (KRS 376.050);

(f) The mortgage must include the name and address of the individual who prepared the mortgage and shall be manually signed by the preparer (KRS 382.335);

(g) The signature of the mortgagor must be properly acknowledged;

(h) The mortgage must be recorded in the county clerk's office in which the greater part of the mortgaged property is located (KRS 382.110); and

(i) The legal description of the mortgaged property must include a reference to the mortgagor's source of title (KRS 382.110);
In addition to the provisions noted above, the mortgage typically includes: (a) representations and warranties of the mortgagor as to the title of the mortgaged property; (b) restrictions against selling, transferring or further encumbering the real property, (c) provisions requiring maintenance of insurance, (d) default provisions, and (e) remedy provisions. Once again, many of these provisions may be contained in the loan agreement and the mortgage should simply cross-reference such provisions.

It should be noted that the mortgaged property under a mortgage will typically include fixtures. The mortgage may act as a fixture filing if the mortgage specifically states that it is a fixture filing and otherwise meets the requirements of a fixture financing statement.

VI. MISCELLANEOUS DOCUMENTS.

Depending upon the structure of the transaction, other miscellaneous documents may be required in connection with the credit facilities established by the lender in favor of the borrower.

The lender may require that a third party guarantee the payment and performance of the borrower's obligations under the loan documents. Such an arrangement will necessitate the execution and delivery of a guaranty agreement. The guaranty agreement should clearly specify the obligations which are guaranteed and should provide immediate recourse to the guarantor for the entirety of the obligations guaranteed. This right of recourse should be
immediate and without need to pursue rights against the primary obligor or any other party. The guaranty agreement should contain provisions which permit the lender to administer the loan in the ordinary course without the need to constantly obtain modifications or re-execution of the guaranty agreement. The guarantors should consent in advance to all terms and agreements theretofore or thereafter made by the borrower with the lender. The lender should be permitted, from time to time, to renew, extend or modify the terms of the guaranteed obligations or any instrument or agreement evidencing same without the consent of the guarantor. The guarantor should waive notice of the present existence or future incurring of any of the defined obligations or any terms or amounts thereof or any change therein. If the guaranty agreement is executed by multiple guarantors, the guaranty agreement should specifically state that the guarantors are jointly and severally liable and that the obligation of each guarantor is absolute and unconditional and exist independently of the presence, absence, or modification of any of the rights which the lender may have with respect to any other guarantor. The guaranty agreement should specifically permit the lender to exchange, release or surrender the primary obligor or any guarantor, or any collateral, or waive, release or subordinate any security interest in whole or in part that has been pledged for the guaranteed obligations. The guaranty agreement should specifically provide that it is a guarantee of payment and not of collection. In addition, in Kentucky, the
guaranty agreement should comply with the provisions of KRS 371.065.

If the collateral includes a tenant's pledge of its interest in and to a leasehold interest under a lease agreement, the documentation must include a leasehold mortgage. The leasehold mortgage typically will mirror a fee simple mortgage with the exception that the mortgaged property will include the mortgagor's interest in the leasehold estate in and to the real property. The lease agreement to which the mortgagor's leasehold interest pertains must be recorded. In addition, the lender should obtain a consent and attornment agreement from the landlord under the lease agreement being mortgaged.

If stock of a corporation is being pledged as collateral for the loan, then the loan documentation will include the preparation, execution and delivery of a stock pledge agreement. The stock pledge agreement should be executed and delivered by the record owner of the stock. The lender should obtain and maintain possession of the original stock certificates evidencing the shares pledged by the stockholder. The possession of the original certificates will perfect the lender's security interest in and to the stock. As a precautionary matter, the lender should also file a Uniform Commercial Code Financing Statement listing the stockholder as debtor and describing the stock which has been pledged. The Uniform Commercial Code Financing Statement should then be filed in the proper office.
If the loan is secured by mortgage lien in and to an office building or other multi-tenant facility, the loan documentation should include an assignment of the borrower’s interest in and to all of the leases of all tenants occupying the premises. The assignment of leases should be recorded in the office of the county clerk where the facility is located. In addition, the loan documentation should also include estoppel certificates from each of the tenants whereby the tenants consent and agree to the assignment of the leases and agree to attorn to the lender or any subsequent owner of title to the facility.

If the borrower has incurred other indebtedness which the lender desires to be subordinated to the loan made by the lender to the borrower, then the loan documentation should also include a subordination agreement whereby the holder of such other indebtedness agrees that its indebtedness will not be repaid until payment in full of the indebtedness owed by the borrower to the lender.
RECENT DEVELOPMENTS IN ARBITRATION - 1995 -
Including
Allied - Bruce Terminix Companies v. Dobson,
U.S. Supreme Court, January 18, 1995

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SECTION M
This outline is designed to provide general information on the subject matters covered. It is not intended to provide either a complete survey of all possible developments or a comprehensive explanation or analysis of those developments mentioned. Readers should consult the original source materials referenced. Furthermore, this outline is not intended nor should it be used as a substitute for specific legal advice or opinion. Finally, this outline is published with the understanding that the publisher is not engaged in rendering legal service.
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SECTION M
Recent Developments In Arbitration


A. Three parts.


   a. Does "not" apply to an "agreement or award arising out of such a relationship ['commercial'] which is entirely between citizens of the United States .. . unless that relationship involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states."

   b. A corporation is deemed a U.S. citizen if it is incorporated or has its principal place of business in the U.S.


"A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

1. "the award was procured by corruption, fraud, or undue means."

2. "there was evident partiality or corruption in the arbitrators, or either or them."

3. "the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of the party have been prejudiced."

4. "the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made."


1. "Enforcement of arbitral agreements, confirmation of arbitral awards, and execution upon judgments based on orders confirming such awards shall not be refused on the basis of the Act of State doctrine."


3. "Act of State" doctrine has been described by the U.S. Supreme Court as a rule of decision (rather than a mandate of the constitution or of international law) that precludes examining into a foreign nation's act on its own soil. See First Nat'l City Bank v. Banco Nacional de Cuba, 406 U.S. 759 (1972).

II. Two Important Recent U.S. Supreme Court Cases.


1. Court held that, under the Federal Arbitration Act, the state of Alabama could not pass legislation invalidating an arbitration clause in a contract between a termite extermination company and an individual consumer.

2. The Alabama Supreme Court considered the Federal Arbitration Act to be inapplicable because the connec-
tion between the termite contract and interstate commerce was too slight. In the Alabama Supreme Court's view, the FAA applies to a contract only if "at the time [the parties entered into the contract] and accepted the arbitration clause, they contemplated substantial interstate activity." The Alabama Supreme Court concluded that this test had not been met.

3. The Supreme Court decided that the Alabama court's test for when the Federal Arbitration Act applies was much too narrow. Writing for the 7 Justices in the majority, Justice Stephen J. Breyer held that the scope of the Act extends to the limits of Congress' power to legislate concerning interstate commerce and over admiralty. Thus, the Federal Arbitration Act will apply if the transaction to which the contract applies "in fact involve[s] interstate commerce."

4. The Supreme Court identified several facts which supported a finding of interstate commerce - the "multistate nature of Terminix and Allied-Bruce, [and that] the termite-treating and house repairing material used by Allied-Bruce in its (allegedly inadequate) efforts to carry out the terms of the Plan, came from outside Alabama."

5. In the Court's concluding remarks, Justice Breyer directed that states must treat arbitration clauses just like they would treat any other section of a contract.

"What states may not do is decide that a contract is fair enough to enforce all its basic terms - price, services, credit - but not fair enough to enforce its arbitration clauses," wrote Justice Breyer. The Federal Arbitration Act "makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal foot."


1. Securities contract specified that New York law would govern and also provided for arbitration. New York does not permit arbitrators to award punitive damages.
2. U.S. Supreme Court held that Federal Arbitration Act would not permit New York state law from preventing arbitrators from awarding punitive damages if the parties intended to allow arbitration of punitive damages claims.

3. Court held that parties did not, by choosing New York law, intend to waive claims for punitive damages.

   a. arbitration clause which referred "all disputes" to an arbitration whose arbitration rules allowed any form of "remedy or relief" which is "just and equitable" would include an award of punitive damages in an appropriate case.

   b. "Agreements to arbitrate are generously construed."

   c. Court also cited to Rule 21(f)(4) of the NASD Rules of Fair Practice which reads: "No agreement [between a member and a customer] shall include any condition which . . . limits that ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make any award."

   (1) However Rule 21(f)(4) was not in effect at the time the parties' agreement was entered into.

   d. Court also cited Restatement (Second) Contracts §206 (1979) requiring that an ambiguous contract be construed "against the interest of the party that drafted it."

4. Court upheld arbitration award of $159,327 in actual damages and $400,000 in punitive damages.

III. The Kentucky Uniform Arbitration Act - KRS Chapter 417.

A. When Arbitration Clauses Enforceable - KRS 417.050.

"A written agreement to submit any existing controversy to arbitration or a provision in written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law for the revocation of
any contract. This chapter does not apply to agreements between employers and employees or between their respective representatives and does not apply to insurance contracts."

B. Standards for a court to set aside an arbitrator's award - KRS 417.160(1).

1. "award was procured by corruption, fraud or other undue means;"

2. "evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party;"

3. "arbitrators exceeded their powers;"

4. "arbitrators refused to postpone the hearing upon sufficient cause being shown therefor or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of KRS 417.090, as to prejudice substantially the rights of a party;" or

5. "There was no arbitration agreement and the issue was not adversely determined in proceedings under KRS 417.060 and the party did not participate in the arbitration hearing without raising the objection; but the fact that the relief was such that it could not or would not be granted by a court is not ground for vacating or refusing to confirm the award."

C. Standards for a court to modify an arbitrator's award - KRS 417.170(1).

1. "an evident miscalculation of figures or an evident mistake in the description of any person, thing or property referred to in the award;"

2. "arbitrators have awarded upon a matter not submitted to them and the award may be corrected without affecting the merits of the decision upon the issues submitted;" or

3. "award is imperfect in a matter of form, not affecting the merits of the controversy."
IV. Recent Kentucky Cases.


1. Court affirmed vacating an arbitration award based upon the statute of limitations where arbitration agreement contained the following provision:

"6.2 In no event shall the demand for arbitration be made after the date when institution of legal or equitable proceedings based on such claim, dispute or other matter in question would be barred by the applicable statute of limitations."


1. Court refused to set aside an arbitration award even though the Appellant claimed not to have received formal notice of the arbitration hearing.

2. Appellant had actual notice that a hearing would be scheduled, failed to pick up certified mail containing the hearing notice, and failed to follow proper procedures to reschedule hearing when he actually learned about the hearing a few days prior to the hearing.

3. "The issue of whether notice was effected is a procedural matter which is relegated to the arbitrator."

4. "The settlement of disputes by arbitrators is favored in the law of this Commonwealth. Generally, much latitude and deference are accorded to an arbitration decision. It will not be disturbed by the courts merely because it was unjust, inadequate, excessive or contrary to law."

5. Court did acknowledge that "there are cases where equity demands intervention by the courts" but did not provide examples.

V. KRS 336.700(2).

A. Enacted in 1994 and a part of Title XXVII of the KRS relating to "Labor And Human Rights."
B. The statute provides:

"Notwithstanding any provision of the Kentucky Revised Statutes to the contrary, no employer shall require as a condition or precondition of employment that any employee or person seeking employment . . . arbitrate . . . any existing or future claim, right or benefit to which the employee or person seeking employment would otherwise be entitled under any provision of the Kentucky Revised Statutes or any federal law.

C. Who is an "employer"? KRS 336.700(1).

1. "any person, either individual, corporation, partnership, agency, or firm, that employs an employee and includes any person, either individual, corporation, partnership, agency, or firm, acting directly or indirectly in the interest of an employer in relation to an employee."

2. No minimum employee number threshold.

D. Who is an "employee"? KRS 336.700(1).

1. "any person employed by or suffered or permitted to work for an employer."

E. To the extent that the employment "in fact involve[s] interstate commerce", it is arguable that the Federal Arbitration Act as interpreted in Allied-Bruce will allow employers to require arbitration of employee claims despite KRS 336.700.


A. Upholding Bank of America's sweeping mandatory arbitration policy which was implemented by the Bank in 1992.

B. The case is a blueprint for what issues to be concerned about and how to implement such a new policy change.

C. Some Important Issues Addressed:

1. What language needs to be in account contracts to authorize such a change?
2. What notice should be given to customers of the change?

3. How does such a change relate to any "good faith" duties that a bank may have to its customers?
USURY UPDATE

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# USURY UPDATE

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I. INTRODUCTION

A. RATE OF INTEREST PERMITTED BANKS DEPENDS UPON:

(1) The type of credit extension, e.g., is it a simple interest loan, short term single payment loan, pre-computed interest installment loan, purchase of dealer paper, manufactured home financing, credit card or other revolving credit transaction?

(2) The amount of the credit transaction, e.g., is it in excess of $15,000?

(3) The identity of the debtor, e.g., is the credit extended to an individual, corporation, business?

(4) The purpose of the credit transaction.

(5) Federal pre-emption of state usury limitations and applicability of "most favored lender" status.

B. WHETHER THE CREDIT TRANSACTION FALLS WITHIN ONE OR MORE OF THE FOREGOING CHARACTERISTICS DETERMINES WHETHER THE INTEREST RATE IS CONTROLLED BY

(1) KRS 360.010 - Fixing the "legal" and "contract" rate of interest in Kentucky.

(2) KRS 360.025 and 360.027 - Removing the defense of usury from corporations and certain limited partnerships and business trusts.

(3) 12 USC 85 - Authorizing national banks to charge interest at the greater of the amount permitted by the laws of the state where the national bank is located or 1% in excess of the discount rate, i.e., "most favored lender" status.

(4) KRS 287.214 - Authorizing Kentucky state banks to charge interest on contracts or obligations of $15,000 or less at any rate permitted national banks by the laws of the United States.

(5) 12 USC 1831d - Permitting state insured banks to charge the same rate as national banks under 12 USC 85.

(6) Sec. 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 - Pre-empting state usury laws on certain real estate and mobile home loans.

(8) KRS 287.215 - Fixing rates on discount and add-on installment loans.

(9) KRS 287.710 to 287.770 - Relating to banks credit card and other revolving credit plans.

(10) KRS 371.210 to 371.330 and KRS 190.090 to 190.140 - Relating to retail installment contracts covering consumers goods and motor vehicles.

(11) KRS 360.150 - Relating to manufactured home financing transactions.

II. GENERAL USURY STATUTE (KRS 360.010).

A. STATUTORY RATES

(1) Legal Rate - 8% per annum

(2) Contract Rate -

   (a) If original principal amount is $15,000 or less - the lesser of 19% or 4% in excess of the discount rate (11% at March 10, 1989).

   (b) If original principal amount is more than $15,000 - any rate if agreed to in writing.

(3) Minimum Interest - $10 "if the legal interest does not account to that sum."

B. LOANS NOT SUBJECT TO KRS 360.010 LIMITATIONS.

(1) Loans of more than $15,000 (KRS 360.010). Duff v. Bank of Louisville & Trust Co., Ky., 705 S.W.2d 920 (1986).

(2) Loans to corporations, limited (but not general) partnerships and business trusts - other than a limited partnership or business trust, the principal asset of which is a one or two-family dwelling - (KRS 360.025 and 360.027).

(3) Individual guarantors of corporate, limited partnership or business trust loans may not plead usury as a defense, E'Town Shopping Center, Inc. v. Lexington Finance Co., Ky. App., 436 S.W.2d 267 (1969).

(4) Lines of credit and Master Notes over $15,000 -
The Attorney General has indicated that a "master note" device is basically a line of credit and that the actual amount advanced to the borrower under the line of credit or master note determined the applicable rate of interest under KRS 360.010. Thus, if a borrower executes a master note for $16,000 but is advanced only $8,000 at the time of executing the note, the maximum interest rate is 4% above the "discount rate," or 19%, whichever is less. See OAG 79-169 (March 12, 1979).

A contrary position is arguable where the future advances will exceed $15,000 and are obligatory and not discretionary with the bank.

C. LOANS ($15,000 OR LESS) SUBJECT TO KRS 360.010

(1) Computation of Interest:

The general view is that the "per annum" interest rate limitation in KRS 360.010 requires use of either the 365/365 or 360/360 method of computation when a loan of $15,000 or less is involved. Use of the 365/360 method has been held usurious if the maximum rate of interest is charged. American Timber & Trad. Co. v. First Natl. Bank of Oregon, 511 F.2d 980 (9th Cir. 1973). If the original principal amount exceeds $15,000, use of the more favorable 365/360 method should be specifically agreed to by the borrower in writing by, for example, describing the computation method in the note.

(a) 365/365: Under this method, the rate of interest is divided by 365 to produce a daily interest factor. The number of days that the loan is outstanding is then multiplied by this daily interest factor. Under this method, a different amount of interest is charged for months of different lengths.

(b) 360/360: Under this method, each month is treated as having 30 days. Thus, interest for each month is the same. However, for a calendar year, the interest is exactly the same as that calculated by using the 365/365 method.

(c) 365/360: This method is a combination of the first two: the interest rate is divided by 360 days (30 days for each month) to create a daily factor. The number of days that a loan is outstanding is then multiplied by this daily factor. Thus interest charged for months of different lengths is different and interest
charged for a calendar year is greater than interest charged under either the 365/365 or 360/360 method.

(2) **Determination of Interest.**

Amounts paid to and retained by a bank which has the effect of increasing the bank's "yield" will be considered "interest" for usury purposes. Thus, "points", "stand-by", commitment, loan fees or other sums paid to a bank, however denominated, will be, in my judgment, deemed "interest" for usury limit computations. See *Union Cent. Life Ins. Co. v. Edwards*, 219 Ky. 748, 294 S.W. 502 (1927); *Commonwealth Farm Loan Co. v. Caudle*, 203 Ky. 761, 263 S.W.2d 24 (1924).

(3) **Closing Costs and Other Fees.**

(a) Closing costs paid to third parties permitted, i.e., title search, appraisal and title insurance fees, cf. *Palmer v. Bank of Louisville & Trust Co.*, Ky. App., 682 S.W.2d 789 (1985);

(b) Moreover, at common law, a bank could, in addition to interest at the maximum rate, properly charge its borrower with the necessary, reasonable expenses incident to the loan without being guilty of usury. Such expenses included the cost of ascertaining whether the security offered was adequate, title examination costs, appraisals, recording fees and the expenses of preparation of the loan and security documents. *Union Cent. Life Ins. Co. v. Edwards*, 219 Ky. 748, 294 S.W. 502 (1927), *supra.*, *Ashland Nat. Bank v. Conley*, 231, Ky. 844, 22 S.W.2d 270 (1929);

(c) In like manner, fees imposed for the privilege of prepaying a debt are not deemed to be usurious, *Hamilton v. Kentucky Title Savings Bank & Trust Co.*, 159 Ky. 680, 167 S.W. 898 (1914); *Webb v. Southern Trust Co.*, 227 Ky. 79, 11 S.W.2d 988 (1928); and

(d) Although the Kentucky courts have never ruled on the status of a "late charge," the Kentucky Department of Financial Institutions has historically taken the position that such charges are in the nature of liquidated damages and are permitted so long as they are reasonably related to the expenses incurred by the lender. June 16, 1981, Letter of Ronda S. Paul
to William H. Mohr. The Department is also of the view that the right to impose "late charges" must be included in the loan documents. Also see: April 14, 1970 Memorandum of E. Frederick Zopp, General Counsel to the Department of Banking, to Executive Management of [Various] Financial Institutions, pg. 3, item 8 ("Kentucky statutes support the majority view that a borrower's default and resulting late charges do not make a loan usurious"); OAG 70-276 (May 6, 1970) ("... [If the consideration is for services actually rendered to the borrower and the agreement for services is made in good faith, and is not a cloak to conceal usury, the transaction is not an usurious loan.")

(4) **Discounting Notes** - interest in advance at the highest rate.

(a) KRS 287.180(1) empowers banks to "discount" notes.


What is "short term paper" is an open question. See November 12, 1981 Memorandum for Ronda Paul, Attorney for Department of Banking, to all Examiners ("The Departmental position is that short-term (one year or less) notes may be discounted even though the resultant Annual Percentage Rate (APR) would be greater than the rate allowed by KRS 360.010.")

(5) **Penalties (KRS 360.020)**

(a) If an usurious rate of interest is knowingly charged, the entire interest is forfeited.

(b) Where a greater rate of interest has been paid, the debtor may, if the action is brought within two years from the time the usurious transaction occurred, recover twice the amount of interest paid.
D. RENEWAL (EXTENDING THE TIME OF PAYMENT) OF LOANS.

(1) Position of Department of Financial Institutions

(a) If a $15,000 or less fixed-rate loan is renewed and the maximum rate permissible under KRS 360.010 has changed (either increased or decreased) since the loan was made, the renewal is viewed as a new contract and the decreased maximum rate must be used. (Similarly, any increased maximum rate may be used.) See June 26, 1984 Memorandum from Ballard W. Cassady, Jr., Commissioner.

Example: Bank makes a 6-month $10,000 loan to X at 11%, which is 4% above the discount rate of 7%. Six months later, the loan is renewed (i.e., the time of payment is extended for an additional six months) and the discount rate has decreased to 6 1/2%. The maximum rate of interest which may be charged is 10 1/2%.

(b) If a bank makes a demand loan of $15,000 or less bearing interest payable in installments at the maximum rate permitted by KRS 360.010 at the time the loan is made, it is required to reduce the interest rate on such loan on the next succeeding interest installment payment date after a decline in the maximum interest rate permitted under KRS 360.010—notwithstanding the fact that the bank has not demanded payment of the loan's principal. This conclusion is apparently on the basis that a demand loan bearing interest payment in installments is in some manner "continued" or "renewed" on every interest payment date.

(2) Changes in usury law. Although there apparently is no Kentucky decision directly on point, where the "renewal" only extends the time of payment of the original note and makes no change in the principal thereof or in any of its other terms, a strong argument can be made that the rule in Kentucky is that the rate of interest originally agreed to between the parties may continue to be charged on the basis that:

(a) It is long been established that a note bearing lawful interest at the time it is entered into is not made usurious by a subsequent change in the law reducing the permitted rate of interest. See Lee v. Davis, 8 Ky. 397, 1 A.K. Marsh. 397 (1818); Jump v. Johnson, 12 Ky. Law
(b) Where a note is given merely in renewal for another note and not in payment, the renewal does not extinguish the original debt or in any way change the debt except for postponing the time of payment, even though the first note is surrendered. See Cantrell Construction Company v. Carter, 418 F.2d 705 (6th Cir. 1969); White v. Winchester Land Development Corp., Ky. App., 584 S.W.2d 56 (1979); Georgi v. First National Bank of Louisville, Ky. App., 557 S.W.2d 442 (1977), In re Zemansky, 39 F.Supp. 628 (D.C.S.D. Cal. 1941); Dufresne v. Hammersten, 106 Pac.2d 861 (1940).

(3) The Department's second position on the "renewal" of a demand note appears to be inconsistent with Mastin v. Cochran's Ex'r., 25 Ky. L. Rep. 712, 76 S.W. 343 (1903).

III. FEDERAL PREEMPTION - RESIDENTIAL REAL PROPERTY

Sec. 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (Pub. L. 96-221) (codified at 12 U.S.C. 1735f-7 note) provides that state constitutions or laws limiting the rate or amount of interest, discount points, finance charges or other charges are preempted and do not apply to loans secured by a first lien on:

(a) "residential real property,"

(b) "all stock allocated to a dwelling unit in a residential cooperative housing corporation," or

(c) a "residential manufactured home" so long as the loan documents contain certain consumer protection provisions prescribed by regulations of the Federal Home Loan Bank Board.

A. Purpose of Credit Irrelevant. Sec. 501 focuses upon the type of collateral and the priority of the lender's interest in the collateral. If a first lien is taken on
residential real property, a residential manufactured home or a dwelling unit in a residential cooperative housing corporation, the test is met.

(1) Thus, a corporate loan secured by a first mortgage on a shareholder's residential real property is preempted under Sec. 501.

(2) Similarly, it is not necessary that the loan be a "purchase money" loan. So long as the requisite type of collateral and a first lien interest therein is obtained, Sec. 501's preemption provision are applicable.

B. **Residential Real Property** - is defined in FHLBB Regulations issued under Sec. 501 of the 1980 Act [12 C.F.R. 590.2(f)] as:

"... real estate improved or to be improved by a structure or structures designed primarily for dwelling, as opposed to commercial use."

C. **Not All Charges Preempted.** Sec. 501 only relates to "interest, discount points, finance charges or other charges." Other provisions of state law, (i.e., laws limiting prepayment charges, attorney's fees and the like) are not preempted and will apply to the loan.

D. **"Residential Manufactured Home" Loans.** Sec. 501 of the 1980 Act preempts state usury laws with respect to loans secured by a first lien on a "residential manufactured home" (which includes mobile homes) only if the consumer protection provisions of the FHLBB regulations (12 C.F.R. 590) are complied with. See regulations at pages B-49 to 55 of the Appendix which contain provisions:

(1) Covering balloon payments, prepayment penalties, late charges and defenses;

(2) Requiring the creditor to give 30 days prior notice of any action leading to repossession or foreclosure (except in the case of abandonment or other extreme circumstances);

(3) Requiring the creditor, upon repayment in full, to refund the unearned portion of any pre-computed finance charge in an amount not less than the amount which would be calculated by the actuarial method (not the "rule of 78's") except that the debtor is not entitled to a refund which is less than $1.
IV. "MOST FAVORED LENDER" STATUS

A. NATIONAL BANKS - 12 U.S.C. 85 grants most favored lender status to national banks by giving them a choice:

(1) They may charge interest at the highest rate allowed by state law to lenders generally in the state where the bank is located, i.e., national banks may "borrow" competing lenders' rates; or

(2) They may charge interest at 1% over the discount rate on 90-day commercial paper in effect at the district federal reserve bank.


B. KENTUCKY STATE INSURED BANKS - KRS 287.214 and 12 U.S.C. 1831d grant "most favored lender" status to Kentucky state banks - with KRS 287.214 granting such status independent of the deposit insurance status of the bank.


C. OTHER PROVISIONS - If a bank "borrows" a competing lender's rates, it must also comply with other provisions of state law relating to that class of loans that are material to the determination of the interest rate, e.g., provisions relating to the amount of the loan, the term, method of repayment, delinquency and other charges, and the like. See Northway Lanes v. Hackley Union Nat. Bank & Trust Co., 464 Fed.2d 855 (6th Cir. 1972); August 11, 1988, letter from Robert B. Serino, Deputy Chief Counsel, Comptroller of the Currency to Ms. Linda T. Lowe, Assistant Attorney General of the State of Iowa.
V. "BORROWING" CREDIT UNION AND PETTY LOAN COMPANY RATES.

A. GENERAL CONSIDERATIONS

Under its "most favored lender" status discussed under Section IV above, a national bank or state insured bank may, with respect to loans of $15,000 or less, elect to "borrow" the rates and charges permitted state chartered credit unions or petty loan companies. A bank wishing to do so should obtain competent counsel to advise it with respect to the technical issues which arise when "most favored lender" status is sought. Generally, if a bank "borrows" the higher rates permitted by KRS Chapters 290 or 288, it must also comply with the other provisions of those chapters relating to loan amount, maturity, methods of payment, delinquency and other charges, and the like.

The general departmental policy of the Kentucky Department of Financial Institutions "permit[s] use of the interest rate structure found in both KRS Chapter 288, the Consumer Loan Company Act, and KRS Chapter 290, the Credit Union Act." See February 8, 1985 letter of James M. Baker, General Counsel, Department of Financial Institutions, to Joseph A. Cleves, Jr.

However, the Department requires, for examination and evaluation purposed, that loans made by state insured banks pursuant to their "most favored lender" status:

"... be segregated on ... [the bank's] books according to the statutes under which they are made .... It is suggested that ... [the bank's] EDP servicer provide a special numeric coding for this."

B. CREDIT UNION LOANS AND CHARGES (KRS CH. 290)

(1) Loan Conditions, Rates and Charges

(a) A credit union may loan to members for such purposes and upon such conditions as the bylaws may provide (KRS 290.425) "Interest rates on loans shall be determined by the board of directors, not to exceed two percent (2%) per month on unpaid balances" (KRS 290.435).

(2) Types of Loans

(a) KRS Ch. 290 does not contain any restrictions upon the types of loans which a credit union may make and authorizes the credit union's board of directors to "[e]stablish the
policies of the credit union with respect to
the granting of loans and the extending of
lines of credit, including the maximum amount
which may be loaned to any one (1) member" [KRS 290.225(4)], with the only limitations
being that (i) a member's loan may not exceed
10% of the credit union's capital and (ii)
aggregate loans secured by first mortgages on
real estate may not exceed 50% of the credit
union's unimpaired capital (KRS 290.465 and
290.505).

(b) Thus, national and state insured banks in
Kentucky may establish demand, single payment
and simple interest installment loan programs
of $15,000 or less and charge not more than 2%
per month on the unpaid balances of such
loans. In order to conform to the provisions
of KRS Ch. 290, the board of directors of a
bank electing to "borrow" the state chartered
credit union rate should adopt resolutions
establishing the loan programs, the policies
to be followed in connection with such pro­
grams, the interest rates to be charged and
the other conditions to be complied with in
implementing such programs (see KRS
290.225(4), 290.425, 290.435, 290.465 and
290.505). Since credit union rates can only
be computed on "unpaid balances," it appears
that such programs cannot include pre­
computed, add on or discount loans.

The Kentucky Department of Financial Institu­
tions' General Counsel has opined that:

"KRS 290.425 permits a credit union to make
loans for such purposes and upon such condi­
tions as its bylaws may provide. If a bank's
written loan policy permit demand, variable
rate and short-term loans, these loans would
be compatible with KRS 290.425 so long as the
interest rate at no time exceeds two percent
(2%) per month on the unpaid balance."

C. PETTY LOAN COMPANY LOANS AND CHARGES (KRS CH. 288)

(1) Amount and Types of Loans: Petty loan company
licensees are authorized to lend up to $15,000
excluding charges [KRS 288.530(1)]. No scheduled
repayment of such loan may be more than 60 months
and 15 days from the date of the loan if the amount
of the loan is $3,000 or less, or 120 months if the
amount of the loan is more than $3,000, and every
contract of loan must provide for repayment of the
amount lent in substantially equal installments at approximately equal periodic intervals of time" [KRS 288.580(2)]

Since KRS 288.580(2) does not require that the equal periodic installments be on a monthly or other specified period, it would appear that KRS Chapter 288 loans can be made on a quarterly, semiannual or other periodic installment basis so long as such installments are substantially equal as to amount and time. If the loan is made on other than a monthly installment basis, however, KRS 288.530(5) would appear to limit any deferral charge on such loans to $.02 for each dollar of deferred installment rather than $.02 for each dollar of the installment times the number of months which the maturity of the contract is extended. See "Deferral Charges" discussed below.

On the other hand, the specific provisions of KRS 288.580(2), requiring that all loans must provide for repayment of the amount lent in substantially equal installments, would appear to limit petty loan companies to installment loans and preclude them from making demand and single payment loans.

(2) Permitted Charges: KRS 288.530(1) authorizes a petty loan company to charge and receive:

(a) On loans of $3,000 or less--3% per month on that part of the unpaid principal balance not in excess of $1,000 and 2% per month on that part of the unpaid principal balance exceeding $1,000 but not exceeding $3,000.

(b) On loans exceeding $3,000--2% per month on the unpaid balance of the principal amount of the loan [§3(1)].

Since KRS 288.530(1) provides that the foregoing changes shall "not [be] in excess" of the specified rates, variable rate loans would appear to be authorized. It is understood that the Kentucky Department of Financial Institutions interprets KRS 288.580(2), requiring loan repayments to be in substantially equal installments, to only require the repayment of principal in substantially equal installments. See August 30, 1982 letter of J. Rick Jones, Attorney for Department of Financial Institutions, to David W. Harper, Greenebaum, Doll and McDonald.

The foregoing charges may either be (1) computed in advance at the agreed rate on scheduled unpaid
principal balances of the cash advance on the assumption that all scheduled payments will be made when due and then added to the original cash advance with the resulting sum being the face amount of the note [KRS 288.530(1)]; or (2) at the option of the petty loan company, computed on the unpaid principal balance of the loan from time to time outstanding, [KRS 288.530(b)].

It should be noted that under the first option, the interest calculation needs to be studied carefully since it is not the same method as would be employed if the loan were made under KRS 287.215 (add-on or discount installment loans made by banks).

If the charge is computed under the second option (a) the charge may not be paid, deducted, received in advance or compounded and must be computed only on unpaid principal balances for the time actually outstanding [KRS 288.530(8)]; and (b) no delinquency or deferral charges are permitted:

(3) Other Charges: In addition to the foregoing, a petty loan company is authorized to charge and collect the following:

(a) Closing Costs: On loans secured by real estate mortgages, the following costs if they are not paid to the petty loan company or to a person "related" to the company:

1. Fees or premiums for title examination, abstract of title, title insurance, survey or similarly purposes;

2. Fees for preparation of a deed, settlement statement, or other documents;

3. Escrows for future payment of taxes, including assessments for improvements, insurance and water, sewer and land rents;

4. Fees for notarizing deeds and other documents; and

5. Appraisal fees.

(b) Filing Fees and Premiums: Fees for filing and releasing liens and instruments securing the loan and premiums for property damage and credit insurance [KRS 288.530(10)].
(c) **Delinquency Charges:** If 1/2 or more of any installment remains unpaid more than seven (7) days after it is due, a delinquency charge of $.02 for each dollar of the "scheduled installment" may be collected for each full month the installment remains unpaid [KRS 288.530(4)].

(d) **Deferral Charges:** If a wholly unpaid installment is deferred one or more full months, a deferral charge may be collected not exceeding $.02 for each dollar of the installment so deferred multiplied by the number of months the maturity of the contract is extended [KRS 288.530(5)]. However, the number of months by which the deferral charges is multiplied to arrive at the total deferral charge cannot exceed the number of installments which are due and wholly unpaid or due within 15 days from the deferral date.

(e) **Rebates:** KRS 288.530(6) requires precomputed charges to be refunded if the loan is prepaid in full; refund is required for partial prepayments. Although, KRS 288.530(6) requires that the refund be of "the portion of the charges applicable to the full installment periods following the installment date nearest the date of prepayment", KRS 288.530(2) provides:

"The portion of the charges applicable to any particular monthly installment period, as originally scheduled or following a deferment, shall bear the same ratio to the total charges, excluding any adjustments made pursuant to subsection (3) of this section, as the balance scheduled to be outstanding during that monthly period bears to the sum of all monthly balances scheduled originally by the contract of loan."

This language appears to be the operational equivalent of the "rule of 78's" and to sanction rebates on that basis. The Sixth Circuit has so held. Maddox v. Kentucky Finance Company, Inc., Fed.2d ___ (6th Cir. 1984).

(4) **Collateral:** Loans made under KRS Chapter 288 may be either secured or unsecured. If secured, any type of collateral (including first mortgages on real estate) may be taken as security except that if the amount of the loan is $3,000 or less only
second or more inferior real estate mortgages are permitted. [KRS 288.580(3)]. KRS 288.570(2) also permits loans made under KRS Chapter 288 to be secured by wage assignments so long as the amount collected from the employer does not exceed 10% of the amount owed to the borrower for each pay period.

(5) **Insurance:** Under KRS 288.560(1) as amended, a petty loan company may request a borrower to insure tangible property, other than household goods, offered as security for a loan exceeding $300 and may also request that life, health or disability insurance be obtained by the borrower or any two of them if there are two or more borrowers as additional security for the loan; however, only "one (1) policy of life insurance may be written in connection with any loan transaction" [KRS 288.560(2)]. Premiums for such insurance may be deducted from the loan proceeds and paid to the insurance carrier [KRS 288.560(3)].

(6) **Maximum Indebtedness:** KRS 288.530(1) prohibits a petty loan company from splitting or dividing a loan or permitting a borrower to become indebted "under more than one (1) contract of loan at the same time" if, as a result, more interest or other consideration is received by the petty loan company than would otherwise be permitted by KRS Chapter 288. Thus, if a borrower desires to borrow $10,000, the petty loan company cannot divide the loan into ten $1,000 loans so as to charge 3% per month on each; rather, it is limited to a 2% a month since the loan exceeds $3,000.

Also, KRS 288.530(12) prohibits a petty loan company from charging interest or other consideration at a rate greater than it would be permitted to charge if it were not a petty loan company licensee in any case when the unpaid principal, excluding charges, exceeds $15,000 at any time on account of "any loan or loans" from the petty loan company licensee to the borrower as principal obligator, guarantor or surety. This prohibition has the effect of limiting the maximum principal obligation of any borrower to a petty loan company to $15,000.

To the extent that a Kentucky national or state bank "borrows" the petty loan company rates in making loans permitted by KRS Chapter 288, this prohibition would likewise limit the maximum principal indebtedness on "petty loan" types of credit extensions to $15,000.
VI. INSTALLMENT LOANS – PRE-COMPUTED INTEREST (KRS 287.215)

A. INTRODUCTION AND APPLICABILITY

(1) KRS 287.215 is basically "rate" legislation authorizing banks to make installment loans with precomputed ("add-on" or "discount") interest. KRS 287.215 is not limited to "consumer loans"; rather, it is applicable to all types of credit.

(2) Since Duff v. Bank of Louisville & Trust Co., Ky., 705 S.W.2d 920 (1986), KRS 287.215's applicability is effectively limited to loans of $15,000 or less although the statute has no explicit dollar limitation.

B. INTEREST RATE AND CALCULATION

(1) "Add-on". KRS 287.215(1)(a) permits an 8% "add-on" rate; that is, a rate which does not exceed $8 per $100 per annum upon the principal amount of the loan.

(2) "Discount". If the loan does not exceed 5 years and 32 days, the "$8 per $100 per annum" interest rate can be received (which has the effect of "discounting" the interest from the loan proceeds). KRS 287.215(1)(b).

C. OTHER PERMITTED CHARGES.

(1) KRS 287.215 contains very limited language on the types of other charges which a bank can directly or indirectly charge, contract for or receive. They are:

(a) An investigation fee equal to the lesser of $1 for each $50 or fraction thereof, or $16, KRS 287.215(2).

(b) Lawful fees actually paid to a public officer for filing, recording or releasing any instrument securing the loan, KRS 287.215(2).

(c) Delinquency charges, which cannot exceed $.05 for each dollar of each installment more than 10 days late (only one delinquency charge can be made on any one installment payment), KRS 287.215(3).

(d) Attorney's fees, which cannot exceed 15% of the unpaid balance, and court costs; provided the note is referred to an attorney who is not
the salary employee of the bank for collection, KRS 287.215(3).

(2) In addition to the foregoing charges, the bank may collect from the debtor or add to principal amount of the loan, charges for title exam, appraisals and title insurance so long as such charges are not retained by the bank but are, rather, paid to third parties. Palmer v. Bank of Louisville & Trust Co., Ky. App., 682 S.W.2d 789 (1985).

D. OTHER PROVISIONS.

(1) Wage Assignments. Assignments, pledges or transfers of wages to be earned or paid in the future are prohibited, KRS 287.215(5).

(2) First Mortgages on Real Estate. First mortgages on real estate are prohibited (except (a) where created by virtue of a judgment or decree, (b) first mortgages on unimproved real estate not exceeding 10 acres, or (c) first mortgages on real estate on which there is located or to be located a residential mobile home), KRS 287.215(5).

(3) Splitting-Up Loans. A loan cannot be split up or divided to permit a person to become obligated to the bank under more than one loan at the same time for the purpose of obtaining a greater charge than otherwise permitted under KRS 287.215. (See OAG 74-304 (April 22, 1974), which takes the position that a bank cannot have in its loan files two or more loans at the same time involving the same person where one of the loans is made pursuant to KRS 287.215. The fact that the loans were made at different times is "inconsequential"), KRS 287.215(6).

(4) Balloon Payments. If any payment is more than twice as large as the average of the earlier scheduled payments, the debtor has the right to refinance without penalty the "balloon" payment on terms "no less favorable" to the debtor than the original loan, KRS 287.215(1)(c).

(5) Prepayment and Rule of 78's. The borrower has the right to prepay the loan in whole or in part at any time. If the loan is fully prepaid prior to maturity, a rebate must be made at a rate not less than in accordance with the Rule of 78's if the maximum financing charge permitted by the statute has been taken. If a lesser charge has been taken, a rebate at not less than a proportional rate must be made, KRS 287.215(4)
(a) In computing the rebate, a minimum charge of $10 can be retained to cover acquisition costs, and where the rebate is less than $1, no rebate need be made. (Note: the $10 charge cannot be taken before the Rule of 78's rebate computation is made. According to the Attorney General, the rebate computation must be based on the total finance charge. See OAG 82-260 (April 9, 1982)).

(6) **Provisions Required in Note.** Every note evidencing a loan under KRS 287.215 must contain the following information and provisions:

(a) The original principal amount of the loan excluding any charge made under KRS 287.215;

(b) A statement of the total charges for the loan;

(c) The amount and the date of each installment;

(d) The date of final maturity; and

(e) An agreement that the debtor may repay the loan in whole or in part at any time, and that if the loan is paid in full before final maturity, the debtor will receive a refund of the unearned portion, KRS 287.215(7).

(7) **Copy to Debtor.** At the time of the loan, the debtor must receive either a copy of the note or a statement of the transaction containing the provisions and information required to be contained in the note, KRS 287.215(7).

(8) **Payment Receipts.** The bank must deliver a receipt for each payment received, KRS 287.215(7).

(9) **Advertising.** In advertising for a loan subject to KRS 287.215, every advertisement stating the amount of the loan must state the original principal amount and show in detail any charges to be made, KRS 287.215(8).

E. **PENALTY**

If a willful violation of any provision of KRS 287.215 occurs, the loan is void and the bank loses its right to collect or receive any interest or charges whatsoever on the loan. However, the unpaid principal remains payable, KRS 287.215(10).
VII. BANK CREDIT CARDS AND OTHER REVOLVING CREDIT (KRS 287.710 - 287.770)

A. COVERED TRANSACTIONS

Generally KRS 287.710 to 287.770 authorize banks to engage in revolving credit transactions - the principal one being credit cards. However, other types of revolving credit - such as overdraft checking and home equity lines of credit - are also covered so long as the arrangement contemplates that:

(1) The bank may extend credit by permitting the debtor to make purchases of goods or services, or obtain loans, from time to time, directly from the bank or indirectly by use of a credit card, check or other device;

(2) The unpaid balances of purchases made, the principal of loans obtained, and finance and other appropriate charges are debited to the debtor's account;

(3) A finance charge, if made, is computed on the outstanding unpaid balances of the debtor's account from time to time; and

(4) The bank renders statements to the debtor at regular intervals and the amount of such statements is payment on a specified date or, at the borrower's option, may be paid in installments, KRS 287.710(6).

B. FINANCE CHARGES; PERIODIC RATE.

(1) A periodic rate not exceeding 1 3/4% per month of either the "average daily unpaid balance" of the debtor's account during the billing cycle, or of the "unpaid balance" of such account on the same day of each billing cycle, KRS 287.740.

(2) A variation of not more than four days from billing cycle to billing cycle is deemed "the same day for each billing cycle," KRS 287.640.

C. OTHER PERMITTED CHARGES.

(1) If provided for in the revolving credit plan, the following additional fees, charges and costs may be collected:

   (a) Annual Fee. An annual fee of $20, KRS 287.750.
(b) **Delinquency Charges.** Delinquency charges not exceeding $5 each month, if payments required by the revolving credit plan are not made when due, KRS 287.750(1).

(c) **Real Estate Closing Costs.** All fees and closing costs incurred in connection with the taking of a mortgage on real estate, if bona fide and not retained by the bank, can be collected, KRS 287.750(2).

(d) **Attorney's Fees.** Reasonable attorney's fees and court costs, if the account is referred to an attorney who is not a salaried employee of the bank for collection, KRS 287.750(3).

D. **MISCELLANEOUS**

(1) **Initial Disclosure.** Before opening a revolving credit plan, the bank must deliver or mail to the debtor a statement of the provisions of the plan containing the disclosures required by KRS 360.210 to KRS 360.265, the requisite federal Truth-in-Lending disclosures, and a statement that the debtor may pay the unpaid balance of his or her account in whole or in part at any time. If two or more persons having the same residence are authorized to obtain credit under the plan, the disclosures and any subsequent periodic statements may be delivered or mailed to the one person designated by the plan, KRS 287.720.

(2) **Periodic Statements.** The information required by the federal Truth-in-Lending Act in the form of a periodic statement for each billing cycle is also required by KRS 287.730(1). A legend to the effect that the debtor may at any time pay the aggregate balance owed or any part thereof is also required, KRS 287.730(1).

(3) **Free Ride Period.** Where the revolving credit plan involves the use of a credit card for the purchase of goods or services from a third-party, no finance charge can be imposed upon the debtor if payment in full of the entire outstanding unpaid balance owed on the debtor's account is received at the place designated by the bank by the date of the statement for the next billing cycle, KRS 287.730(2).
VIII. RETAIL INSTALLMENT SALES ACT (KRS 371.210 - 371.330)

A. SCOPE

(1) This act generally applies to consumer transactions, i.e., the sale of "goods" or "services" when purchased primarily for personal, family or household use.

(2) The sale of "motor vehicles" are specifically excluded from coverage, KRS 371.210(3).

(a) With respect to KRS 371.210(3)'s exclusion of "motor vehicles," that term is defined to include a "mobile home . . . used primarily to transport persons or property on a public highway . . ." There has been some confusion over whether the "stationary" mobile home (as opposed to a motor home, which clearly is a "motor vehicle") is subject to the provisions of the Motor Vehicle Retail Installment Sales Act (KRS 190.090 et. seq.) or the Installment Sales Act (KRS 371.210, et seq.).

1. In 1980, the Attorney General stated in a footnote to his opinion that retail installment sales of mobile homes "would not fall within the ambit of KRS Chapter 190 . . . Therefore, such contracts are covered by the provisions of KRS 371.210, et. seq."

2. Later, in another opinion, the Attorney General attempted to resolve the apparently conflicting statutes by stating that stationary mobile homes with a cash price of $5,000 or less were covered by the Motor Vehicle Retail Installment Sales Act, while stationary mobile homes having a cash price in excess of $5,000 were covered by the Retail Investment Sales Act. OAG 80-111 (February 8, 1980).

3. In 1984, the General Assembly removed the "$5,000 cash sale price" qualification from the definition of a "motor vehicle" in the Motor Vehicle Retail Installment Sales Act. As a result, the Attorney General's distinction between the two statutes appears to be no longer applicable.
4. Finally, also in 1984, the Attorney General again opined that a manufactured home financing transaction providing for a rate of interest that may be adjusted at certain regular intervals is governed by the provisions of KRS 360.150. The manufactured home financing transaction providing for a fixed rate of interest is governed by the Motor Vehicle Retail Installment Sale Act. KRS 190.090 et seq. (OAG 84-353)

(b) As a result, the most conservative approach is to finance stationary mobile homes transactions (i.e., purchase installment contracts) as if the more restrictive finance charge rates authorized by the Motor Vehicle Retail Installment Sales Act were applicable.

B. FINANCE CHARGE RATES.

(1) KRS 371.260(1) specifically permits the seller to receive a "time price differential" in retail installment contracts payable in substantially equal monthly installment, but places no limitation upon the amount of the time price differential.

(2) Thus, because of the traditional distinction between "interest" and a "time price differential," see Munson v. White, 309 Ky. 295, 217 S.W.2d 641 (1920), the Retail Installment Sales Act contains no limit on the amount of finance charge which can be collected.

C. OTHER PROVISIONS.

(1) Disclosure Requirements. There are specific disclosure requirements relating to type size and the like, and a "NOTICE TO THE BUYER" provision which must be contained in the contract. The retail installment contract also must disclose certain information with respect to the sale, such as the cash sale price, the down payment, official fees, the amount of the time price differential and other similar information, KRS 371.220.

(2) Prepayment and Rebates. The buyer must have the right to prepay the contract at any time without penalty. He is entitled to receive a refund of unearned charges under the Rule of 78's. Acquisition costs of $10 can be deducted before computing the rebate. Rebates of less than $1 need not be made, KRS 371.260(2).
(3) Delinquency Charges. Delinquency charges for payments more than 10 days late are collectable in an amount not exceeding 5% of the installment or $5, whichever is less. However, a minimum delinquency charge of $1 may be collected, KRS 371.270(1).

IX. MOTOR VEHICLE RETAIL INSTALLMENT SALES ACT (KRS 190.090 - 190.140)

A. SCOPE.

This act relates to:

(1) Any sale of a motor vehicle for other than business or commercial use evidenced by a retail installment contract in which the buyer agrees to pay a "time sale price" payable in two or more installments, KRS 190.090(2).

(2) "Motor Vehicle" generally includes any device in, upon, or by which any personal property is or may be transported or drawn upon a highway, KRS 190.090(4).

   (a) Some exceptions exist for road machinery and farm implements.

   (b) Under a literal reading of this definition, a "stationary" mobile home could be a "motor vehicle" subject to the Motor Vehicle Retail Installment Sales Act, rather than "goods" covered by the more general Retail Installment Sales Act contained at KRS 371.210 et. seq. This is the view of the Kentucky Attorney General, see Section VIII, A(2)(a)4 above.

   (c) Formerly, the defunction of a motor vehicle was limited to vehicles having a cash sales price of $5,000 or less. This dollar qualification was deleted by the 1984 General Assembly.

B. FINANCE CHARGE RATES AND COMPUTATION.

(1) For any new or used motor vehicle sold in its model years, a $11/$100 "add-on" rate can be charged, KRS 190.110(1).

(2) For any new motor vehicle not sold in its model year, $13/$100 "add-on" rate can be charged, KRS 190.110(1).
(3) For any used motor vehicle having a model year of one or two years prior to the year in which the sale is made, $13/$100 "add-on" rate can be charged, KRS 190.110(1).

(4) For all other motor vehicles, a $15/$100 "add-on" rate can be charged, KRS 190.110(1).

(5) At the seller's option, the finance charge can be computed on a simple interest basis, and at a fixed or variable rate, but in this event the amount of finance charge that may be collected cannot exceed the amount that could have been collected if the finance charge were pre-computed, KRS 190.110(4).

NOTE: The Kentucky Court of Appeals has held [Roberts v. Capitol Cadillac-Olds, Inc. No. 87-CA-1245-MR (October 21, 1988)] that in calculating the finance charge permitted by KRS 190.110(1), the duration of the contract is ignored.

Thus, in its decision, the Court of Appeals calculated the maximum permissible finance charge allowed under KRS 190.110 by multiplying the amount financed by the buyer ($10,997.31) by $11 and dividing the produce by $100. The result, $1,209.70, was determined to be the maximum permissible finance charge despite the fact that the loan was not for one year but for five (5) years. In effect, the court held that for five-year installment sales contracts, the maximum permissible annual finance charge is approximately 4.19 percent (computed on a simple interest basis charging interest daily on the unpaid balance). A motion for rehearing is currently pending before the court. The Kentucky Bankers Association has requested leave to file an amicus curiae brief.

C. MISCELLANEOUS PROVISIONS.

(1) Disclosure Requirements. KRS 190.110 contains requirements of what the retail installment contract must contain. At least 8 point type is required. The cash sale price, the amount of the down payment, official fees, the amount, if any, included for insurance and other benefits (together with a description of the type of coverage and benefits), the principal balance, the amount of finance charge and the "time balance" must be disclosed.

(2) Collateral. A motor vehicle installment sale contract cannot take a security interest in any
goods other than the motor vehicle and its accessories, KRS 190.100(1)(b).

(3) **Prepayment and Rebates.**

(a) If the finance charge is pre-computed, the buyer may prepay the contract at any time and is entitled to receive a refund of a portion of the finance charge computed in accordance with the Rule of 78's. However, an acquisition cost of $25 can be deducted from the finance charge before computation of the refund is made. No refund of less than $1 need be made, KRS 190.120(1).

(b) If the finance charge is determined by the "simple interest" method, the right of repayment also exists without any rebate but a minimum finance charge of $25 can be collected in any event, KRS 190.120(2).

(4) **Deferred Payments.** The scheduled due date or a schedule payment can be deferred. Additional finance charges computed at the same rate and by the same method as set out in the original contract can be collected. A refinancing charge for such extension, deferment or renewal not exceeding $5 can also be collected, KRS 190.130.

(5) **Delinquency Charges.** When the finance charge has been determined by a pre-computed method, a delinquency charge on each installment not paid within 10 days of its due date, in an amount not exceeding 5% of each installment of $5, whichever is less, can be collected, KRS 190.100(1)(d).

(6) **Attorney's Fees.** When the finance charge has been determined by the pre-computed method, attorney's fees not exceeding 15% of the amount due and payable under the contract, plus court costs, can be collected if the contract is referred to an attorney not a salaried employee of the holder of the contract for collection, KRS 190.100(1)(d). (Because of the statute's peculiar wording, a question exists as to whether attorney's fees can be collected where the finance charge is determined on a "simple interest" basis. Arguably, the more general "attorney's fees" provisions of KRS 453.250 should permit the collection of attorneys' fees in a "simple interest" situation.)
X. MANUFACTURED HOME FINANCING (KRS 360.150)

A. SCOPE.

First enacted in 1982, KRS 360.150 is limited to a "manufactured home financing transaction," which involves the sale of a "manufactured home" or a direct loan used to finance the purchase of a "manufactured home," if the transaction provides "that the rate of interest may be adjusted at certain regular intervals." Thus, KRS 360.150 is only applicable to variable rate transactions.

On the other hand, if the transaction provides "for a fixed rate of interest payable in substantially equal successive installments over a fixed term, KRS 360.150 is NOT applicable.

(1) "Manufactured Home". As amended in 1984, the term includes the typical single family mobile home as well as a pre-fabricated dwelling that is manufactured in two or more modules at a location other than a homesite, and which is designated to be used as a residence when the modules are transported to the homesite, and the modules are joined together and installed on a permanent foundation systems. The term includes the plumbing, heating, air conditioning and electrical systems contained in the structure, KRS 360.150(1)(c).

(2) Affect of Federal Preemption Laws. To the extent that a "manufactured home financing transaction" will result in the taking of a first lien on "residential real property" or "residential manufactured housing," as defined in Section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980, the provisions of that statute, which preempt certain state laws to the contrary, may also apply. See Section III above for a discussion of the 1980 Act.

(3) Option To Comply With Federal Agencies' Regulations. In lieu of complying with KRS 360.150, the debtor and lender may agree on terms authorized or permitted in any program for residential mortgage loans by the FHLBB, the Comptroller of the Currency, or any other federal department, agency or board, KRS 360.150(13).

B. VARIABLE RATE TRANSACTIONS

If the transaction provides that the rate of interest may be "adjusted" at certain regular intervals, KRS 360.150 requires that specific indices be used.
Further, the frequency with which such adjustments may be made, and limitations on the amount thereof, are specified, KRS 360.150(2).

(1) Available Indices. KRS 360.150(3) only permits the use of two indices:

(a) The monthly average yield on U.S. treasury securities adjusted to a constant maturity of 5 years; or

(b) An index approved by the FHLBB or by the Comptroller of the Currency for adjustable or variable interest rates on residential mortgage loans.

(2) Minimum Interval Between Adjustment. The rate of interest cannot increase or decrease during the six-month period following the loan transaction. Further, at least six months must elapse between subsequent changes, KRS 360.150(4).

(3) Ceiling on Amount of Adjustment.

(a) Where the stated regular interval between rate adjustments is six months, an adjustment may not result in a rate of interest which is more than 1% greater or less than the interest rate in effect prior to such adjustment, KRS 360.150(6).

(b) If the stated regular interval between rate adjustments exceeds six months, then the maximum adjustment, either up or down, is $1\%$, multiplied by the number of whole consecutive six month periods in the interval between rate adjustments, KRS 360.150(6).

(4) Decreased Mandatory. Any increases in the rate of interest permitted are optional with the creditor; however, decreases are mandatory whenever the total decrease in the index equals or exceeds one-quarter (1/4) of 1%, KRS 360.150(7).

(5) Prior Written Notice. The creditor must send written notification of any rate adjustment, by first class mail, postage pre-paid, at least one month before the date that the new rate of interest takes effect, KRS 360.150(12).

(6) Computation of Adjustment.

(a) First Adjustment. Adjustments, either up or down, to the rate of interest shall, for the
first adjustment following the loan transaction, be equal to the difference between the index value in effect on the first day of the second calendar month preceding the particular adjustment date, and the value in effect on the first day of the month in which the loan transaction occurred, KRS 360.150(5).

(b) Subsequent Adjustments. Adjustments after the first adjustment must be equal to the difference between the index value in effect on the first day of the second month preceding the adjustment date and the index value in effect on the first day of the second month preceding the date of the immediately preceding rate adjustment, KRS 360.150(5).

(7) Result of Adjustment on Payment Terms. By agreement, adjustments to the rate of interest may result in changes in the amount of regular installment payments due, or changes in the term of the financing, or a combination of both, KRS 360.150(10).
INTERNAL REVENUE SERVICE RETURNS REGARDING DEBT FORGIVENESS

W. Bradford Boone
Stites & Harbison
Lexington, Kentucky

SECTION 0
Form 1099-C

Caution: The following instructions (except those under Coordination With Form 1099-A and related instructions under Box 5 and Box 7 later) are based on temporary regulations under section 6050P issued in December 1993. Final regulations under section 6050P are expected to be issued in early 1995. For debts discharged before the effective date of those final regulations, no penalties will be imposed if you do not report:

2. A debt discharged as the result of the expiration of the statute of limitations for collection of the debt.
3. Any amount other than principal for a debt that arose in connection with a lending transaction. A lending transaction is a transaction in which a lender extends credit, including revolving credit, to a borrower.
4. A debt discharged for a person other than the primary (or first-named) debtor in the case of multiple debtors, for debts incurred before January 1, 1995.

File Form 1099-C, Cancellation of Debt, for each debtor for which you canceled (or discharged) a debt (or indebtedness) owed to you of $500 or more and you are a financial institution, a credit union, or a Federal Government agency (including one of the three agencies listed under Who Must File below). You must file even though the debtor may not be subject to tax on the canceled debt. That is, you are not required to determine whether the debtor qualifies for exclusion under section 108. For example, debts discharged in bankruptcy are reportable.

You are not required to aggregate multiple discharges of debt of less than $500 during a year unless the separate discharges are under a plan to evade the Form 1099-C reporting requirements.

File Form 1099-C if the debtor is an individual, corporation, partnership, trust, estate, association, or company. Backup withholding does not apply.

Coordination With Form 1099-A—If, in the same calendar year, a debt is canceled in connection with the acquisition or abandonment of secured property and you would be required to file both Form 1099-A, Acquisition or Abandonment of Secured Property, and Form 1099-C, you must file both Forms 1099-A and 1099-C. You may file Forms 1099-A and 1099-C, but make no Form 1099-A entries in boxes 5 and 7 on Form 1099-C. See the instructions for Form 1099-A earlier and Box 5 and Box 7 later.

Who Must File—File Form 1099-C if you are a financial institution described in section 591 or 591(a) (such as a domestic bank, trust company, building and loan or savings and loan association); a credit union; a Federal executive agency defined in section 6050M, the Federal Deposit Insurance Corporation (FDIC), the Resolution Trust Corporation (RTC), the National Credit Union Administration (NCUA), or any successor or subunit of a Federal executive agency, FDIC, RTC, or NCUA. Also file Form 1099-C if you are a corporation that is a subsidiary of a financial institution or credit union, but only if, because of your affiliation, you are subject to supervision and examination by a federal or state regulatory agency.

Debt Defined—A debt is any amount owed to you including principal, interest, penalties, administrative costs, and fines, to the extent they are indebtedness under section 61(a)(12). The amount of debt discharged or canceled may be all or only part of the total amount owed.

When Is a Debt Canceled or Discharged?—A debt is canceled or discharged when an identifiable event

O - 1
occurs that indicates the debt will never have to be paid by the debtor, taking into account all the facts and circumstances.

An identifiable event includes, but is not limited to:
1. A discharge of a debt under title 11 of the U.S. Code (bankruptcy).
2. An agreement between the creditor and the debtor to cancel all or part of a debt (including an agreement that results in an exchange under section 1001), if the last event necessary to cancel the debt has occurred.
3. A cancellation or extinguishment of the debt by operation of law that makes the debt unenforceable (for example, the statute of limitations for collection of the debt expires).

A bookkeeping entry, such as a deduction for book or regulatory reporting purposes or a partial or full bad debt deduction for tax purposes, is not, alone, an identifiable event. However, such bookkeeping entry is one of the facts and circumstances to take into account to determine if a discharge or cancellation has occurred.

Collection activity by the creditor is another one of the facts and circumstances to take into account to determine if a discharge or cancellation has occurred. In determining that part of a debt is canceled, disregard collection activity on the remaining part of the debt.

Multiple Debtors.—If you cancel a debt with more than one debtor, you must file Form 1099-C for each debtor that had a debt of $600 or more canceled. If the multiple debtors are jointly and severally liable on the debt, report the entire amount of the canceled debt on each debtor's Form 1099-C.

Recordkeeping.—If you are required to file Form 1099-C, you must retain a copy of that form or be able to reconstruct the data for at least 4 years from the due date of the return.

Requesting TINs.—You must make all reasonable efforts to obtain the taxpayer identification number (TIN) of the person whose debt was canceled. You may obtain the TIN when the debt is incurred. Even if you do not obtain the TIN before the debt is canceled, you must request the debtor's TIN. Your request must clearly notify the debtor that the Internal Revenue Service requires the debtor to furnish its TIN and that failure to furnish such TIN subjects the debtor to a $50 penalty imposed by the IRS. No particular form is required to request the TIN, but if you use Form W-9, you will satisfy the reasonable efforts requirement. A debtor is not required to certify his or her TIN under penalties of perjury.

Statements to Debtors.—Furnish each debtor with Copy B of Form 1099-C or a substitute statement that complies with the requirements of Pub. 1179. See part H under General Instructions earlier. You also must furnish a statement to the debtor if it is mailed to the debtor's last known address.

Box 1.—Enter the date the debt was canceled. See When is a Debt Canceled or Discharged? earlier. Use the format MVDDYY to indicate the date. For example, for January 7, 1995, enter 010795.

Box 2.—Enter the amount of the canceled debt. See Debt Defined earlier.

Box 3.—Enter any interest included in the canceled debt in box 2.

Box 4.—Enter any penalties, fines, or administrative costs included in the canceled debt in box 2.

Box 5.—Enter a description of the origin of the debt, such as student loan, mortgage, or credit card expenditure. Be as specific as possible. If you are filing a combined Form 1099-C and 1099-A, also enter a description of the property.

Box 6.—Enter an "X" in the checkbox if the debt was discharged in bankruptcy, if known.

Box 7.—Make an entry in this box only if you are filing a combined Form 1099-C and 1099-A. For a foreclosure, execution, or similar sale, enter the fair market value of the property. Generally, the gross foreclosure bid price is considered to be the fair market value. If an abandonment or voluntary conveyance to the lender in lieu of foreclosure occurred, enter the appraised value of the property.

Form 1099-DIV

File Form 1099-DIV, Dividends and Distributions, for each person (a) to whom you have paid gross dividends and other distributions on a stock (box 1a) of $10 or more, (b) for whom you have withheld and paid any foreign tax on dividends and other distributions on stock, (c) for whom you have withheld any Federal income tax under the backup withholding rules, or (d) to whom you paid $500 or more as part of a liquidation.

Section 404(k) Dividend.—Report on Form 1099-DIV dividends distributed under section 404(k) on stock held by an employee stock ownership plan (ESOP) or a tax credit ESOP. If a section 404(k) distribution is made in the same year as a total distribution, the entire amount should be reported as an amount includible in income on Form 1099-R.

Exceptions.—You are not required to file Form 1099-DIV for payments made to certain payees including a corporation, a tax-exempt organization, an individual retirement arrangement (IRA), a U.S. agency, a state, the District of Columbia, a U.S. possession, or a registered securities or commodities dealer.

Dividends.—If you make a payment that may be a dividend, but you are unable to determine whether any part of the payment is a dividend by the time you must file Form 1099-DIV, the entire payment must be reported as a dividend. See regulations under section 6042 for a definition of dividends.

Note: Certain distributions commonly referred to as "dividends" are actually interest and are to be reported on Form 1099-INT. These include so-called "dividends" on deposit or on share accounts in co-operatives, banks, credit unions, domests, building and loan associations, S&Ls and Federal savings and loan associations, and mutual savings banks.

An exempt-interest dividend from a regulated investment company retains its tax-exempt status and is not reported on Form 1099-DIV or 1099-INT.

Substitute Payments in Lieu of Dividends.—Report payments received by a broker on behalf of a customer in lieu of dividends as a result of the transfer of a customer's securities for use in a short sale, see Form 6 under Form 1099-MISC later.

RICs.—If a regulated investment company (RIC) declares a dividend in October, November, or December payable to shareholders of record on a specified date in such a month, the dividends are treated as paid by the RIC and received by the shareholders or December 31 of such year as long as the dividends are actually paid by the RIC during January of the following year. Such dividends should be reported on Form 1099-DIV for the year preceding the January in which the payments are actually paid. See section 652(b)(7).

If such a dividend is paid in January is subject to back up withholding, it must be withheld when the dividend is actually paid. Therefore, backup withholding in January, deposit in the withholding when appropriate, and reflect it on Form 945 for the year withheld. However, since the dividend is reportable on Form 1099-DIV for the year prior, it is related backup withholding is a so reportable on the prior year Form 1099-DIV.


Statements to Recipients.—For an explanation of the requirement to furnish an official form to recipients in person by statement mailing, see part H under General Instructions earlier. Also see Pub. 1179.

2nd TIN Not.—You may enter an "X" in this box if you were notified by the IRS twice within 3 calendar years that the payee provided an incorrect taxpayer identification number (TIN). If you mark this box, you will comply with a safe harbor due diligence requirement of Temporary Regulations section 35a.9999-3, Q&A-89, and the IRS will not send you any further notices about the account. Also see Regulations section 301.6724-1(g).

Box 1a.—Enter gross dividends, including those from mony market funds, and other distributions on stock. Include reinvested dividends as gross dividends. Include all amounts shown in boxes 1b, 1c, 1d, and 1e. Do not include in box 1a amounts reported in boxes 5 and 6.

Box 1b.—Enter ordinary dividends. Also include this amount in box 1a.

Box 1c.—Enter capital gain distributions. Also include this amount in box 1a.
CREDITOR'S name, street address, city, state, and ZIP code

DEBTOR's Federal identification number

DEBTOR's identification number

Date canceled

Amount of debt canceled

Interest included in box 2

Penalties, fines, admin. costs included in box 2

Debt description

Check for bankruptcy

Fair market value of property

For Paperwork Reduction Act Notice and Instructions for completing this form, see Instructions for Forms 1099, 1098, 6498, and W-2G.

Do NOT Cut or Separate Forms on This Page
### Instructions for Debtor

If a Federal Government agency, financial institution, or credit union cancels or forgives a debt you owe of $600 or more, this form must be provided to you. Generally, if you are an individual, you must include the canceled amount in your income on Form 1040. If you are a corporation, partnership, or other entity, report the canceled debt on your tax return. See the instructions for your tax return.

However, some canceled debts, such as certain student loans (see Pub. 525), certain purchase money debt (see Pub. 334), qualified farm debt (see Pub. 225), or debts canceled in bankruptcy (see Pub. 908), are not includible in your income. Do not report a canceled debt as income if you did not deduct it but would have been able to do so on your tax return if you had paid it. Also, do not include canceled debts in your income to the extent you were insolvent. If you exclude canceled debt from your income because it was canceled in a bankruptcy case or during insolvency, or because the debt is qualified farm debt or qualified real property business debt, file Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment).

### Box 1.
- Shows the date the debt was canceled.

### Box 2.
- Shows the amount of debt canceled.

### Box 3.
- Shows the amount of interest included in the canceled debt in box 2.

### Box 4.
- Shows penalties, fines, or administrative costs included in box 2 as part of the canceled debt.

### Box 5.
- Shows a description of the debt. If box 7 is completed, also shows a description of the property.

### Box 6.
- If the box is marked, the creditor has indicated the debt was canceled in a bankruptcy proceeding.

### Box 7.
- If, in the same calendar year, a foreclosure or abandonment of property occurred in connection with the cancellation of the debt, the fair market value of the property will be shown, or you will receive a separate Form 1099-A, Acquisition or Abandonment of Secured Property. You may have income or loss because of the acquisition or abandonment. See Pub. 544, Sales and Other Dispositions of Assets, for information about foreclosures and abandonments.
Creditors, Please Note—

Specific information needed to complete this form and other forms in the 1099 series is given in the 1995 Instructions for Forms 1099, 1098, 5498, and W-2G. A chart in those instructions gives a quick guide to which form must be filed to report a particular payment. You can order those instructions and additional forms by calling 1-800-TAX-FORM (1-800-829-3676).

Furnish Copy B of this form to the debtor by January 31, 1996.

File Copy A of this form with the IRS by February 28, 1996.
NOTES FOR

I R S RETURNS REGARDING DEBT FORGIVENESS SESSION
UNIFORM COMMERCIAL CODE UPDATE -1995-

John T. McGarvey
Morgan & Pottinger
Louisville, Kentucky

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SECTION P
I. RECENT DECISION UNDER ARTICLE 9 - SECURED TRANSACTIONS

A. Ford Motor Credit Company v. Hall, Ky. App., 879 S.W.2d 487 (1994). This was a typical case instituted by a creditor to recover a deficiency following the sale of a repossessed motor vehicle. FMCC sent its debtor a notice of private sale (the date after which the vehicle would be sold) and proceeded to sell the vehicle at a dealers only auto auction in North Carolina. FMCC moved for summary judgment. The debtor argued that the circumstances of the sale, an auction, attended by a number of bidders, constituted a public sale and that FMCC's notice thus failed to meet the standards of KRS 355.9-504(3). The Harlan Circuit Court concurred and denied FMCC summary judgment on due process grounds.

The Court of Appeals reversed. Relying on the Iowa Supreme Court in John Deery Motors, Inc. v. Steinbronn, 383 N.W.2d 553 (Iowa 1986), the Court found that a secured party's sale of collateral at an auction open only to automobile dealers is a private sale within the meaning of the Uniform Commercial Code. Only because FMCC failed to submit proof on the dealers only rule of the auction, the case was remanded to the Harlan Circuit Court for proceedings consistent with the opinion of the Court of Appeals. The Court of Appeals specifically found "that the circuit court erred by holding that Ford Motor Credit was required to give Hall specific notice of the date, time and place of the sale of the automobile, even if it were a private sale."

B. Wayne Supply Company, Inc. v. Commonwealth of Kentucky Revenue Cabinet, No. 93-CA-1111, 1995 Ky. App. Lexis 24 (February 10, 1995). In an opinion that the Court described as resulting in "an absurd windfall for the Commonwealth", the Court of Appeals ruled that a previously filed state tax lien takes priority to a purchase money security interest properly perfected under the Uniform Commercial Code. While the majority suggests legislative relief to cure the problem, Judge Howerton, in a strong dissent, relying on the Tennessee Supreme Court's decision in Commerce Union Bank v. Possum Holler, Inc., 620 S.W.2d 487 (Tenn. 1981), finds that the debtor had no equity in the equipment to which the state tax lien could attach.
C. **Farmers Bank & Trust Co., v. Brazell, No. 93-CA-000424**, 1995 Ky. App. Lexis 27 (February 15, 1995). The bank took a security interest in three certificates of deposit issued in the name of its debtor "or" her daughter. The debtor pledged the certificates as collateral on several loans. The bank took possession of the certificates thus perfecting its security interest under KRS 355.9-305. Upon the death of the debtor, the daughter claimed the certificates passed to her free of the bank's security interest. The Court of Appeals ruled that the decedent's pledge of the certificates of deposit had the same effect as if she had cashed them and used the money to secure the bank. Relying on KRS 355.3-116 the court found the transactions to be authorized by law. The court ruled that "Farmers' right to the certificates of deposit survives the death of the decedent and is superior to (the daughters). This is a case of first impression in Kentucky.

D. **Peoples Bank & Trust Company of Madison County v. Madison Tobacco Warehouse.** In a typical agricultural lending arrangement, the borrower obtained a production loan to be secured by his tobacco crop. He executed a security agreement that was properly filed by the bank to perfect its interest. Further, complying with KRS 355.9-307, the bank mailed notice of its lien to the two tobacco warehouses listed by its debtor as potential sellers of his crop. The warehouse where the crop was sold failed to pick up the notice, sent certified mail return receipt requested, and the notice was returned to the bank.

The trial court ruled in favor of the warehouse and was reversed by the Court of Appeals. The Court of Appeals accepted the bank's argument that it had met the notification requirements when it took the steps reasonably required to inform the warehouse of the bank's security interest. The definition of "notifies or gives" under the Code does not require actual knowledge. KRS 355.1-201(26).

II. FUTURE DEVELOPMENTS IN KENTUCKY'S UNIFORM COMMERCIAL CODE.

A. **The model revisions to Articles 3 and 4.**

1. Since there promulgation in 1990, the revised Articles 3 and 4 have been adopted by 38 states and are before the legislatures of most other states. They will be introduced in the 1996 session of the Kentucky General Assembly.

2. Benefits to banks under the revised Articles include certainty as to what transactions are
covered under Article 3, a clear definition of the standard of "ordinary care" required in the handling of checks for processing or for payment by automated means, a uniform statute of limitations, expansion of the per se negligence rule to the case of endorsements forged by an employee, and authorization of electronic presentment of items and related provisions to truncation.

B. Revised Article 8 - Investment Securities.

1. The 1977 revisions to Article 8 envisioned uncertificated securities but did not envision the extent to which securities are now held in brokerage accounts. The revisions establish a system of rights and remedies in regard to these accounts.

2. Perfection of liens on both certificated and uncertificated securities will be returned to Article 9. A creditor will have better control over collateral that includes securities accounts.
COMMUNITY DEVELOPMENT
AND
REGULATORY IMPROVEMENT ACT OF 1994

TITLE I:
SUBTITLE B: HOME OWNERSHIP AND EQUITY PROTECTION

- Reverse Redlining Amendments To The Truth-In-Lending Act -

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SECTION 9
Title I
Subtitle B -- Home Ownership and Equity Protection

- Amendments To the Truth-In-Lending Act -

Subtitle B — Home Ownership and Equity Protection

Consumer Protection For Certain Mortgages

This subtitle amends the Truth-in-Lending Act to require enhanced disclosures and limitations for “covered mortgages.” Covered mortgages are closed-end home mortgages (other than a mortgage to finance the acquisition or initial construction of the residence, or “reverse mortgages”), if: (1) the annual percentage rate of the mortgage exceeds by more than 10 percent, the yield on Treasury securities having a comparable maturity period; or (2) the total points and fees payable by the consumer at or before closing exceed the greater of $400 or 8 percent of the total loan amount.

The Federal Reserve Board is given limited discretion to adjust the 10 percent amount beginning two years after final regulations are promulgated, but it may not be lower than 8 percent or higher than 12 percent. The $400 amount is to be adjusted annually for inflation. (Sec. 151).

Disclosures

In addition to other disclosures, creditors must make prescribed new disclosures at least three business days prior to the consummation of the loan transaction. Among the new disclosures required are statements that the consumer is not required to complete the loan agreement, and that if the consumer obtains the loan, he could lose his home if he does not meet his obligations under the agreement. (Sec. 151).

Prohibitions and Restrictions

The legislation imposes certain substantive prohibitions and restrictions on covered loans. For example, prepayment penalties are
generally prohibited unless the consumer’s monthly debts were less than 50 percent of his gross monthly income at the time the mortgage was consummated. Balloon payments are prohibited for covered mortgage loans if the term of the loan is less than five years. Covered mortgage loans may not include terms under which the outstanding principal balance increases over the course of the loan because the regular payments do not cover the full amount of interest due (unless the loan qualifies as a “reverse mortgage” as described below). (Sec. 151).

The legislation provides that a creditor may not engage in a “pattern or practice” of extending credit to consumers through the issuance of covered mortgages without regard to the consumers’ “repayment ability, including the consumers’ current and expected income, current obligations, and employment.” A creditor is also prohibited from making a payment to a contractor under a home improvement contract from funds extended through a covered mortgage, unless the payment is made through an instrument that is payable jointly to the consumer and the contractor, or at the election of the consumer, to a third party escrow agent. (Sec. 151).

Assignee Liability — Waiver of Holder In Due Course Doctrine

Any person who purchases or is otherwise assigned a covered mortgage will be subject to all claims and defenses with respect to that mortgage that the consumer could have raised or asserted against the originator of the loan, unless the assignee demonstrates, by a preponderance of the evidence, that a reasonable person exercising ordinary due diligence, could not determine, based on the documentation and disclosures required by law, that the mortgage falls within the description of a covered mortgage. Any person who sells or assigns a covered mortgage must include a prominent notice of the assignee’s potential liability under this section. (Sec. 153).

Reverse Mortgages

A “reverse mortgage” is defined as a non-recourse transaction in which a mortgage or equivalent security interest is created against the consumer’s principal dwelling, securing one or more advances, and with respect to which the payment of any principal, interest, or shared equity is payable only after the transfer of the dwelling, the death of the consumer, or if the consumer ceases to occupy the dwelling as
a principal residence. A reverse mortgage is not subject to the disclosures and restrictions described above, but instead is subject to a special set of disclosures. These disclosures must be made at least three days prior to consummation of the transaction, and among other things, must disclose the potential total cost to the consumer under varying scenarios. (Sec. 154).