Issues in Bank Regulation
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Compared to other areas, Federal regulation of banking has for years been one of the more successful fields of governmental action. It is certainly not a simple system, and I, for one, don't claim to understand it, but I would consider it more even-handed and efficient than much regulation because at best, it is a partnership between the government and the private sector.

I know a lot of businessmen feel that the government is out to get them, but most of the time, bankers don't take that position. I hope they will continue to feel that way. The problem is, the relationship between lenders and regulators has undergone considerable stress in recent months.

And it appears we are headed for more such stress.

Sometimes the government will act, with a good purpose in mind, pursuing the most laudable ends, and the result will be unfortunate for almost everyone concerned. A good case in point is the "holder-in-due-course" situation. As you know, the Federal Trade Commission made a ruling that went into effect on May 14, 1976 that was supposed to prevent abuses in consumer credit. Some unethical sellers assign consumer loan contracts to third parties, and then do not stand behind their products or services.

These abuses do occur, and the public is mistreated in some cases, but the FTC's cure was at least as bad as the disease. What the FTC did was to make the holder of the loan contract subject to all claims and defenses which the debtor can assert against the seller. The effect is to severely limit the time-honored "holder-in-due-course" doctrine, and, worst of all, it pre-empts a great number of state laws.

Now, you may know that there are some people in the Federal government, and even in the Congress who seem to feel that state governments and state laws are inferior, insignificant little things that the central government can overturn at will. I don't happen to feel that way. I believe strongly in the Federal system, in which the states hold all the powers not specifically granted to the Federal government by our Constitution.

There are some of us that didn't like the way the FTC had overturned state laws limiting the holder-in-due-course doctrine and we are trying to do something about it. We wrote a bill that would have reinstated the "holder-in-due-course" doctrine in any state which was determined by the Federal Reserve Board to have laws that would afford the consumer greater protection.

When I was the Attorney General of the State of North Carolina I formed a Consumer Protection division. I think this is where almost all kinds of consumer issues should be handled--at the state level. I can tell you it works. I fought for the people's best interest for years in North Carolina, where I knew the people, and the business community, and the climate of opinion, and the courts and the laws. If we hadn't started out in this country with a number of separate states, we would have had to invent them to get the people's business done.

In August of 1975, I was visiting with people in North Carolina, going around holding office hours in little court houses, so people could come in and tell me about whatever was on their minds. You get all kinds of responses. You get people who just want to be friendly, and drop in to say hello. You get people who have opinions about everything in the world. But best of all, you get the occasional constituent who has a problem government AND can explain what might be done about it.

This is how I ran into the problems people had with RESPA, the Real Estate Settlement Procedures Act. A man came in to the court house, and he not only told me what RESPA was in a general sort of way--which I knew already--but he showed me what he had to do for the government before he could finish a business deal. As a direct result of that process of communication with somebody who knows his business and knows what the law means to his business, I introduced a bill, along with Senator Garn, that revised the RESPA regulations. No amount of library research, or special interest group pleading, or editorial writing, or lobbying, could have convinced me as firmly as that simple demonstration by one man that the government requirement was wrong.

I strongly encourage you to let me, and the other members of Congress, know what a law means to you, in real terms. I get letters all the time, on fine company stationery, from company presidents, that do little more than complain about "government regulations." What we need is to be told about your problems with regulations in enough detail to be able to do something about it.

Write your Congressman or Senator and give him "exhibit A"---he'll appreciate that a lot more than a thousand letters merely repeating a stock phrase or two. And you might get more results, as well.

Of course the RESPA problem was caused by a lack of foresight. The trouble was that a two-week waiting period was built into the RESPA bill which proved to be a nuisance, both for the mortgage lender, and for the consumer, who was trying to get his loan and call the moving company.

But what the Banking Industry is up against now is something much more far-reaching. Last week, broad new equal credit regulations went into effect. Consumer lenders have had a hard time finding out what the new rules are going to be, and we may not find out until the courts have heard a few cases.

The central problem is this: whereas in the RESPA bill, Congress painted with too fine a brush, and attempted to control the timing of mortgage loans, with the Equal Credit Opportunity Amendments Congress may have painted with too broad a brush.

Specifically, the amendments borrowed a doctrine from judicial rulings on job discrimination, and applied it to the problem of credit discrimination.

That doctrine is commonly known as the "effects test."

In the 1971 case of Griggs v. Duke Power Co., and in subsequent rulings, the Supreme Court held essentially that hiring practices which have the effect of eliminating "disproportionate numbers" of minority applicants are unlawful.

Since then, the Court has limited the ruling, and there is some speculation it may go even farther and require that discriminatory elements of job applicant evaluation be willfully applied.

Nevertheless, the legislative history of the Equal Credit Amendments applies the "effects test" to credit transactions, at the same time that it prohibits credit discrimination on the basis of race, color, religion, national origin, age, or the fact that an applicant is on public assistance.

This is a classic case of Congress's leaving tremendous discretionary power to the regulatory agencies. Their rules will decide how the lenders shall try to avoid the effect of discrimination. And that is in itself a problem.

In promulgating its regulations so far, the Federal Reserve Board has footnoted the "effects test," but has not spelled out what loan application review processes will pass that test. Everyone, regulators and lenders alike, seem to be nervously looking toward the courts to define what is, after all, a judicial doctrine.

As usual, the smaller businesses are the ones which have reasons to be the most nervous.

The Equal Credit Amendments will require lenders to be able to justify their loans, and that means they will have to objectify their standards. We are simply a long way from the time when a small-town banker could look an applicant in the eye, lean back in his chair, and form an opinion satisfactory to himself as to whether the person before him was worth risking the depositors' money.

No, it appears that more and more small lenders who still operate this way will have to have loan practices based on "point scoring systems" used by the big banks. Their problem is, this will not be cheap, and it could turn out that their point system--if that is what they adopt--might be found in violation of the "effects test."

Of course, the cost of developing a point-scoring system will be nothing compared to the $144 million dollars it will cost credit bureaus and others to redo their records, to keep husbands and wives files separately, but it will no doubt be expensive for the small operator.

Now I have no intention of standing up here and criticizing the Congress, just to be doing it. I just want to let you know, as one Senator, and as one member of the Banking Committee, that I want to understand your problems, and that I am willing to listen.

I value the words of my own constituents, especially, and I plan to keep in touch with them in the coming months, to see what their experience with these amendments is going to be.

Our society tends to tie itself in knots over what is and is not discrimanatory. Our laws and court rulings in this area reflect that. We are about to take up the matter of "reverse discrimination," which could further complicate the issue. And the Supreme Court may rule later this year as to whether discriminatory practices are unlawful if there was no intent that they be discriminatory. Both issues could have a bearing on the burden lenders and will be required to bear, in attempting to comply with the law.

But I believe lenders and borrowers alike have the right to reasonable and competent rules governing their relationship, if the federal government is going to write such rules.

Although what one Senator can accomplish is limited, I am willing to do what I can to keep that burden reasonable and proper.