

# Introduction to Banking

# Michigan Bankers

# Association

Banking Outside the  
Box

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# An Overview

- Banking Industry
  - Organization
  - Heavily Regulated
  - Consumer Protections
- Trends in Banking
- Challenges for Bankers



# The Dual Banking System

## Federal Banking System



National banks



Federal associations



Federal credit unions

## State banking system



Banks



Savings & loans



Credit unions



Savings banks

***Back***



# Federal Banking System

- National Banking Associations (“national banks”)
  - National Bank Act. 12 USC 1 *et seq.*
  - Comptroller of the Currency (“OCC”)
- Federal Associations
  - Sometimes called federal savings and loans, federal savings banks, or federal savings associations.
  - Home Owners Loan Act of 1933. 12 USC 1461 *et seq.*
  - Office of Thrift Supervision (“OTS”)
  - Since Dodd/Frank effectively supervised by OCC
- Federal Credit Unions
  - National Credit Union Act. 12 USC 1751 *et seq.*
  - National Credit Union Administration (“NCUA”)



# State Banking System

- **Michigan Banking Corporations**
  - Michigan Banking Code of 1999. MCLA 487.1101 *et seq.*
  - Michigan Office of Financial and Insurance Regulation ("OFIR")
- **Michigan Savings and Loan Associations and Savings Associations**
  - Michigan Savings and Loan Association Act. MCLA 491.102 *et seq.*
  - OFIR
- **Michigan Credit Unions**
  - Michigan Credit Union Act. MCLA 490.1 *et seq.*
    - Significant amendments will soon be enacted.
  - OFIR
- **Michigan Savings Banks**
  - Michigan Savings Bank Act. MCLA 487.3101 *et seq.*
  - OFIR



# Dual Regulators for State Banks

- State member banks
  - State-chartered banks that are members of the Federal Reserve
  - Subject to examination and regulation by:
    - OFIR
    - The Board of Governors of the Federal Reserve under the Federal Reserve Act, 12 U.S.C. §§ 221 *et seq.*
- State non-member banks
  - State-chartered banks that are *not* members of the federal reserve.
  - Subject to examination and regulation by:
    - OFIR
    - FDIC under the Federal Deposit Insurance Act, 12 USC §§ 1811-1831.
- State savings associations and savings banks
  - Subject to examination and regulation by:
    - OFIR
    - FDIC
- State credit unions
  - Subject to examination and regulation by:
    - OFIR
    - National Credit Union Administration

# Examinations

- Banks and thrifts are periodically examined by their state at least every 18 months. Federal Banks every 12 months.
- Areas of examination:
  - Safety and soundness
  - Consumer Compliance
  - Bank Secrecy Act
  - Trust
  - Community Reinvestment Act compliance
  - Information technology
  - Bank Holding Company
  - Patriot Act



# In Michigan

- 16 national banks
- 23 state-chartered member banks
- 84 state-chartered nonmember banks
- 2 state savings banks
- 11 federal associations
- 203 state-chartered credit unions
- 124 federally-chartered credit unions



*Dual Banking System*

# Choice of Charter

- Why choose one charter over another?
  - Powers
  - Avoid state-by-state consumer regulation
  - Attitude of the regulator
  - Cost of Administration and examination





# Bank Holding Company (“BHC”)

- A non-bank company that controls a bank
  - Organized under state law.
- Regulated by the federal Bank Holding Company Act of 1956, 12 USC 1841 *et seq.*
  - Regulates any non-bank company that controls a bank (“**bank holding company**” or “**BHC**”) and any non-bank affiliate of a BHC.
  - Prohibits a BHC or any non-bank affiliate of a BHC from engaging in any activity that is not “closely related to banking.”
  - FRB administers the Act.
  - FRB’s Regulation Y, 12 CFR §§ 225.1 *et seq.*, defines in detail what activities are and are not permissible for a BHC.

# Financial Holding Company

- The Federal Reserve Act was amended in 1999 to permit a BHC that qualifies as a "financial holding company" to engage in "**financial activities**," which include:
  - insurance agency and underwriting activities,
  - securities brokerage and underwriting activities,
  - merchant banking investments, and
  - any other activity that the FRB considers to be "financial" in nature or incidental or complementary to a financial activity.
- To be eligible for "financial holding company" status a BHC must be well-capitalized, well-managed and have a satisfactory rating under the Community Reinvestment Act.
- FRB's Regulation Y regulates the activities of an FHC.



# Banks are not subject to the Bank Holding Company Act

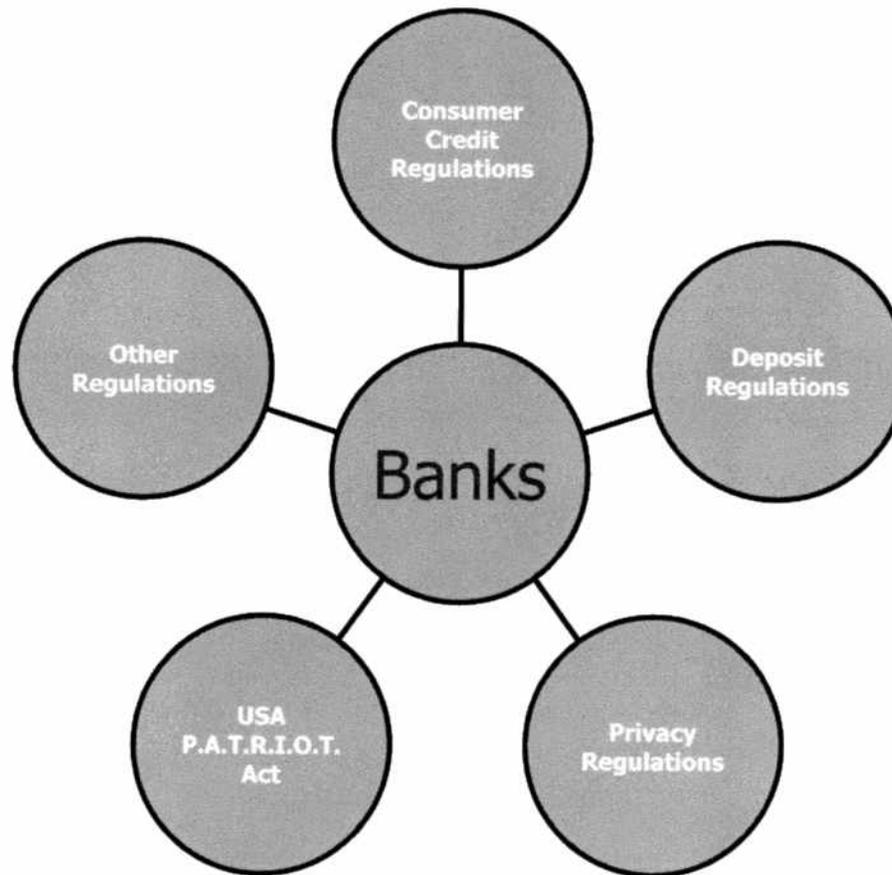
- A bank is not automatically subject to regulation under the Act.
- A bank can exercise its powers through subsidiaries without creating a BHC corporate structure.
- Bank directors chose to create a BHC.



# Laws and regulations affecting banks and other financial institutions

*Back*   *Federal*   *Michigan*

# Federal Regulations



*Michigan*



# Federal Consumer Credit Regulations



***Back***

# Equal Credit Opportunity Act (“ECOA”)

- Prohibits discrimination in the granting or terms of credit on the basis of:
  - race,
  - religion,
  - national origin,
  - marital status,
  - sex,
  - color,
  - age, receipt of public assistance, or
  - the good faith exercise of rights under the Consumer Credit Protection Act.
- Applies to any “creditor,” as defined.
  - Not limited to depository institutions.

***Back***

# Fair Housing Act

- Prohibits discrimination in all aspects of residential real-estate related transactions on the basis of:
  - race,
  - color,
  - religion,
  - sex,
  - national origin,
  - familial status, or
  - handicap.
- Enforced by the Department of Housing and Urban Development and the Department of Justice.

*Back*

# Community Reinvestment Act (“CRA”)

- Requires banks and S&Ls, savings associations and savings banks to make efforts to meet the credit needs of their entire communities, including low- and moderate-income areas.
- Administered by the following federal regulatory agencies:
  - OCC: National banks
  - FRB: State banks that are members of the Federal Reserve System
  - FDIC: State banks that are not members of the Federal Reserve System
  - OTS: State and federal S&Ls, savings associations and savings banks.
- State and federal credit unions are *not* subject to the CRA.
- Enforced through the application process.
  - Banks are rated for performance and these results are used to review the bank CAMELS rating.

***Back***

# Truth in Lending Act (TILA)

- Applies to any “creditor,” as defined.
  - Not limited to depository institutions.
- Requires a creditor to make certain disclosures to the borrower in connection with an extension of “consumer credit.”

*Back*

# Real Estate Settlement Procedures Act (“RESPA”)

- On a federally-related, residential mortgage loan (i.e., just about any residential mortgage loan made by a financial institution), the lender must make certain disclosures to the borrower about settlement costs.
- RESPA also prohibits compensating anyone for referring settlement services business to anyone.
- It also limits the amounts a lender can require be paid into an escrow for taxes, insurance or other items.
- Administered by Department of Housing and Urban Development.
- Private cause of action. Source of significant class action litigation.

*Back*

# Home Mortgage Disclosure Act (“HMDA”)

- Requires financial institutions to compile, aggregate and annually disclose certain home mortgage loan data.
  - Federal government prepares reports by institutions and for geographic markets.
  - Data serves as a basis for comparison of financial institutions and markets.
- Administered by FRB. Regulation C.

*Back*

# Fair Credit Reporting Act (“FCRA”)

- Regulates the consumer reporting industry, places disclosure obligations upon uses of consumer reports and ensures the fair, timely and accurate reporting of credit information.
- Regulates the sharing of information between affiliated entities.
- Federal Trade Commission (“**FTC**”) enforces FCRA and has issued interpretive guidelines. 16 CFR Part 600 App.

*[Back](#)*

*[Privacy](#)*

# Unfair and Deceptive Credit Practices

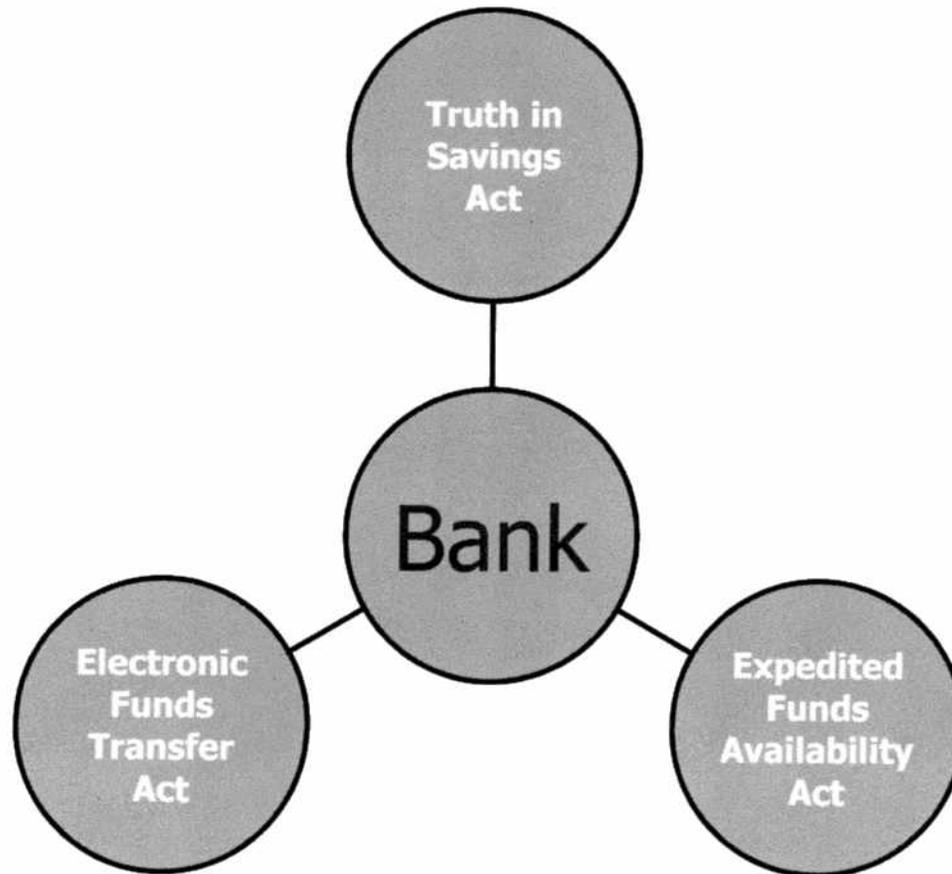
- 1985 FTC regulations defined certain creditor remedies as unfair, prescribed a required notice to co-signers and barred the use of accounting methods that allowed “pyramiding” of late charges.
  - Applies to consumer credit transactions.

*Back*

# Other Federal Statutes & Regulations

- FTC Holder in Due Course Rule
- Consumer Leasing Act.
  - Requires certain disclosures in connection with a lease of goods for personal, family or household use.
  - 15 USC §§1667-1667e.
  - Administered by FRB. Regulation M.
- Fair Debt Collection Procedures Act
  - Prohibits certain tactics in debt collection.
  - 15 USC §§ 1692-1692o.
  - FTC has issued an Official Staff Commentary as a guideline to interpreting the Act. 53 Fed Reg 50,097 (1988).
- Flood Insurance Act

# Deposit Account Regulations



*Back*



# Truth in Savings Act

- Requires certain disclosures for all deposit accounts available to, or held by a consumer, based on the model of the Truth in Lending Act.
- Administered by FRB under Regulation DD, 12 CFR Part 230.

*Back*

# Expedited Funds Availability Act

- Requires a bank to make deposited funds available to a customer within a specified availability schedule and to speed up the collection and return process.
- Administered by FRB, under Regulation CC, 12 CFR Part 229.

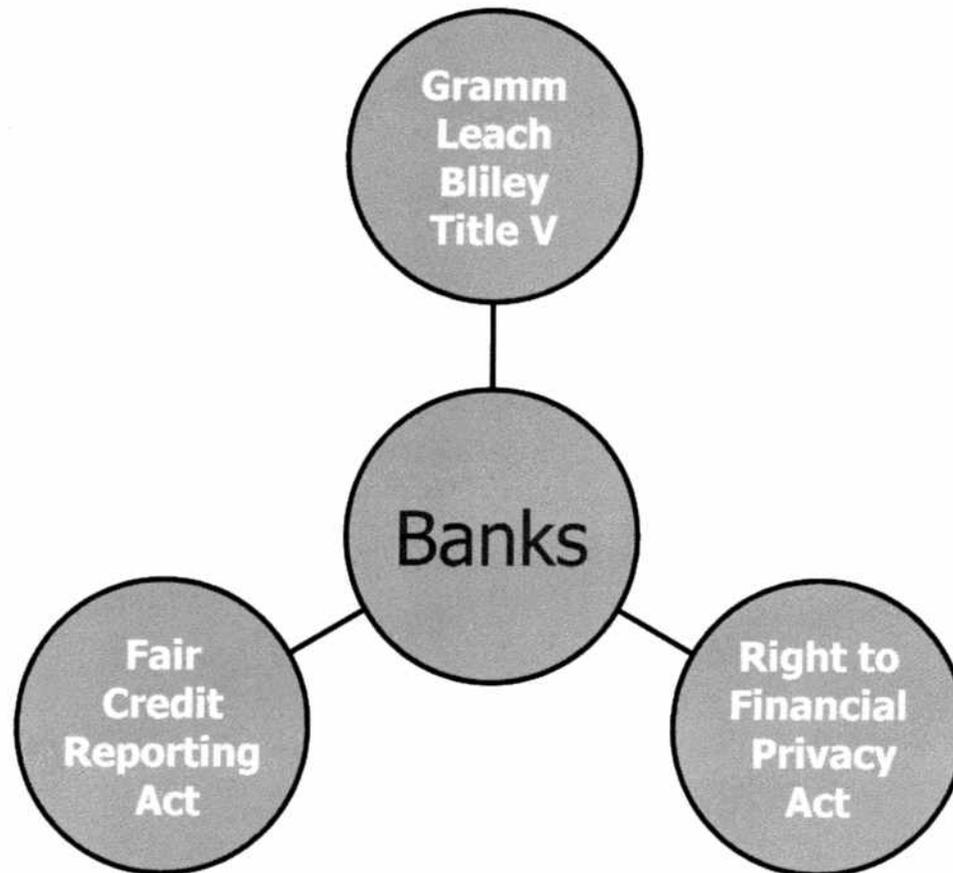
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# Electronic Funds Transfer Act (“EFTA”)

- Establishes the rights, liabilities, and responsibilities of participants in electronic funds transfer systems.
- Administered by FRB under Regulation E, 12 CFR Part 205.

*Back*

# Privacy Laws and Regulations



*Back* *Next*

# Title V of the Financial Services Modernization Act of 1999 (the Gramm- Leach-Bliley Act)

- Requires a financial institution to tell its customers the institution's policy regarding sharing of nonpublic personal information with affiliated and unaffiliated third parties.
- Before a financial institution shares nonpublic personal information with an unaffiliated third party, the institution must give the customer an opportunity to opt out of the sharing.
- "Financial institution" is broadly defined.

*Back*

# Right to Financial Privacy Act

- Restricts federal government access to financial records of financial institutions.

# U.S.A. P.A.T.R.I.O.T. Act

- US reaction to attacks on 9-11 controversial until 2009.
- Provisions that apply to banks apply to all “financial institutions.”
  - Broadly defined to include, among others, banks, trust companies, thrift institutions, private bankers, investment bankers, broker-dealers, investment companies.

*Back*

## *U.S.A. P.A.T.R.I.O.T. Act*

# Requirements

- Requires each financial institution to establish a formal anti-money laundering program.
- Requires a financial institution to meet certain minimum standards for identifying a customer who wishes to open a new account.
- Requires each financial institution to take special measures when the Secretary of the Treasury determines that a foreign country, a financial institution operating in a foreign country, a class of transactions involving or occurring in a foreign country, or a class of accounts is "of primary money laundering concern."
- Requires each financial institution to establish policies and procedures to detect and report each instance of money laundering through a correspondent banking account with a foreign banking operation or through a private banking account.

***Back***

## *U.S.A. P.A.T.R.I.O.T. Act*

# Requirements

- Permits a financial institution to share information with other financial institutions regarding any individual or organization engaged in, or reasonably suspected to be engaged in, terrorist or money laundering activities.
- Expands the protection for a financial institution that files a suspicious activity report and permits a financial institution to make limited disclosure to other financial institutions of information reported in a suspicious activity report.
- Requires each financial institution to monitor each concentration account to ensure it is not used to mask the identity of persons who move funds through the account.

***Back***

## *U.S.A. P.A.T.R.I.O.T. Act*

# Requirements

- Prohibits a financial institution from opening a correspondent account with a shell bank.
- Establishes a 120-hour deadline for responding to a request for information regarding anti-money laundering compliance, including information about a customer of the financial institution.
- Encourages regulators and law enforcement authorities to share information with financial institutions regarding individuals and organizations engaged in, or reasonably suspected to be engaged in, terrorist or money laundering activities.

***Back***

# Federal Regulations (The Regs)

- Regulation D: Reserve Requirements (12 CFR Part 204)
- Regulation K: International banking operations of U.S. banks (12 CFR Part 211)
- Regulation O: Loans to Executive Officers, Directors, and Principal Shareholders (12 CFR Part 215)
- Regulation Q: Prohibition on Paying Interest on Demand Deposits
- Regulation U: Extensions of credit to finance the purchase or carrying of margin securities
- Regulation W: Transactions between a member bank and its affiliates

# Michigan Laws

- Michigan Consumer Mortgage Protection Act
- Creditor Placed Insurance Statute
- Anti-redlining Act
- Consumer Protection Act
- Electronic Funds Transfer Act

*Federal*

# Consumer Mortgage Protection Act (“CMPA”)

- Prohibits certain lending practices and requires lenders to make new disclosures to applicants for credit secured by a mortgage or lien on real property used as the borrower’s principal dwelling.
- Any lender who makes a consumer or commercial loan or a home improvement installment contact secured by a borrower’s principal dwelling must comply with the CMPA.

*Back*

# Consumer Mortgage Protection Act (“CMPA”)

- Prohibits on balloon loans with a term less than five years.
- Prohibition on financing single premium credit insurance.
- Prohibition on false, deceptive or misleading statements.
- Miscellaneous other prohibitions.
- Requires mortgage lenders and home improvement installment sellers to give two notices to applicants when they receive an application for a mortgage loan or home improvement credit:
  - a “Borrower’s Bill of Rights” and
  - A “Consumer Caution and Home Ownership Counseling Notice”
- MCLA §§ 445.1631 - 445.1645

*Back*

# Creditor Placed Insurance Statute

- Applies to creditor-placed insurance that covers damage to personal property collateral securing an extension of credit obtained for personal, family or household purposes.
- Act imposes a number of conditions, prohibitions and requirements including:
  - Conditions that must be met before a creditor may obtain creditor-placed insurance (“CPI”) and charge the debtor for it.
  - Notices and disclosures to debtors, including disclosures when the credit is extended and notices before the creditor obtains the insurance.
  - A prohibition on charging a debtor for several types of insurance coverages, including insurance for repossession costs or skip, confiscation or conversion.
  - A prohibition on requiring CPI costs to be charged as a balloon payment at maturity of the credit or by payments beyond the scheduled maturity date, unless the debtor “specifically agrees” at the time the charge for CPI premiums is added to the loan balance.
- MCLA §§ 500.1601 - 500.1631

***Back***

# Anti-Redlining Statute

- Prohibits a lender from denying a mortgage loan or home improvement loan or varying the terms of such a loan due to:
  - racial or ethnic characteristics or trends in the neighborhood where the real property is located or
  - the age of the structure to be taken as security or the age of other structures in the neighborhood.
- Contains other prohibitions, requirements and exceptions.
- MCLA §§ 445.1601 *et seq.*

*Back*

# Consumer Protection Act

- Prohibits “unfair, unconscionable, or deceptive methods, acts or practices in the conduct of trade or commerce.”
- Lists 31 unlawful “methods, acts or practices.”
- Court of Appeals case says a business is protected under the Act.
- Will not apply to “a transaction or conduct specifically authorized under laws administered by a regulatory board or officer acting under statutory authority of this state or the United States.”
- MCLA §§ 445.901 *et seq.*

***Back***

# Electronic Funds Transfers Statute

- Regulates the electronic transfer of funds.
- Similar, but not identical to the federal Electronic Funds Transfer Act.
- Federal Reserve Board has issued a preemption determination indicating the portions of this statute that are preempted and those that are not.
- MCLA §§ 488.1-488.31

*Back*

# Recent and Pending Developments

- OCC preemption of state laws affecting banks.
  - Opposition by states in *Watters v. Wachovia*.
  - Dodd/Frank eliminates national bank preemption.
- Credit unions become special banking institutions.
- Rise of the pay day lending format.
- Sharing of consumer information under the Fair Credit Reporting Act
- Lending discrimination and predatory lending
- State of Michigan Dodd/Frank regulatory obligations.
- Property appraisal protections.
- Mortgage Modifications
  - - Bank programs
  - - State Programs
  - -Federal Programs

***Back***

# Depository Banking Changes

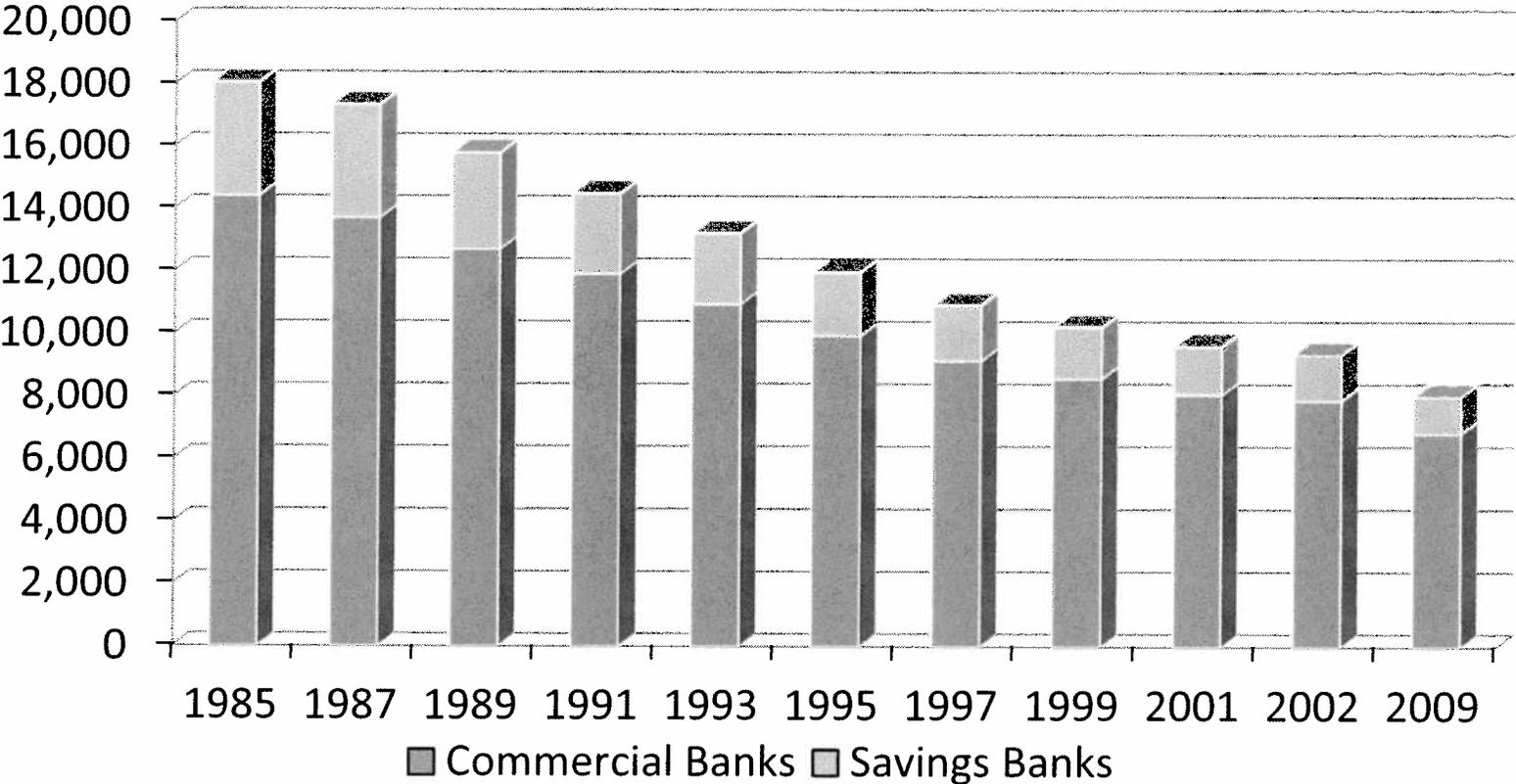
- Banks are only as profitable as the communities they serve.
- Regulatory demands for data security, homeland security, shareholder security, consumer and legal protections, and expanded mortgage lending force increase cost of operations.
- Consumer demands for more broader and instantaneous services increase infrastructure costs.
- Regulators demand that depository banks are profitable every year.
- As business cost increases consolidation of banking operations result in the quest to maintain profitability.

# Michigan Headquarter Banks

- Asset Size: Michigan Headquartered Banks
  - Largest \$13 billion
  - Smallest \$ 30 million
- Market: Virtually everywhere in the state Branch offices average 22 per bank

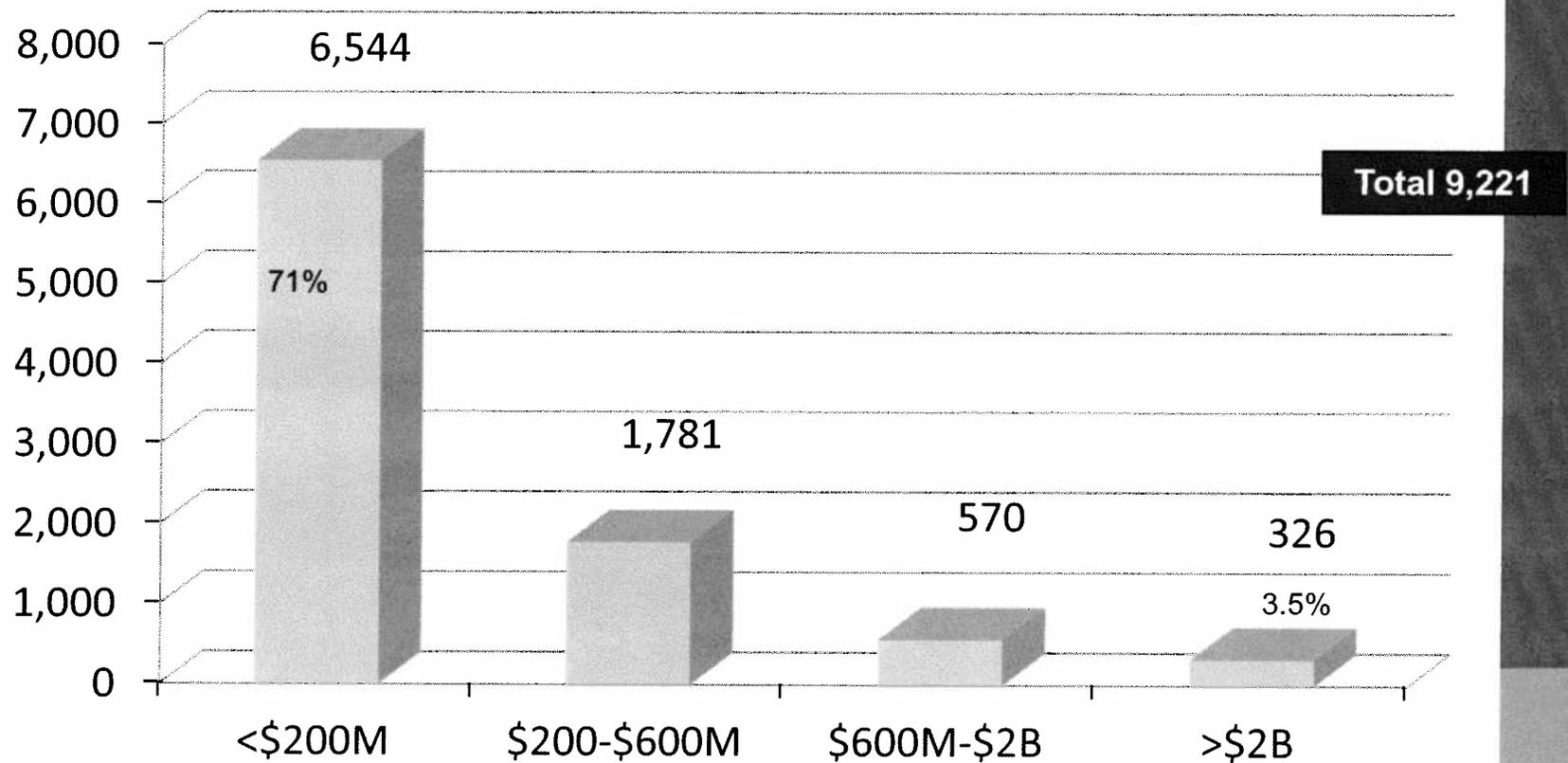


# Total Number of US Institutions



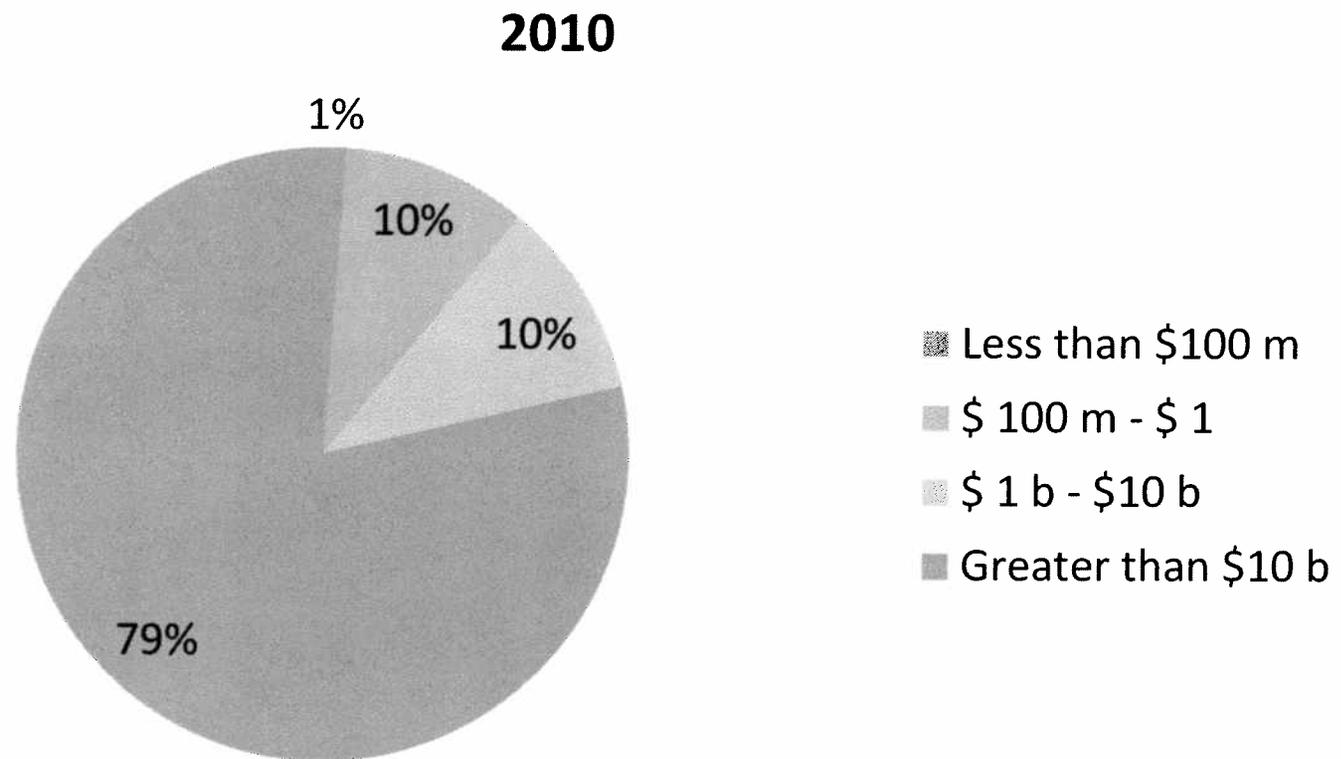
FDIC Historical Statistics on Banking;  
FDIC QBP Stats-At-A-Glance December 2002

# Total Number of US Institutions by Asset Size Group

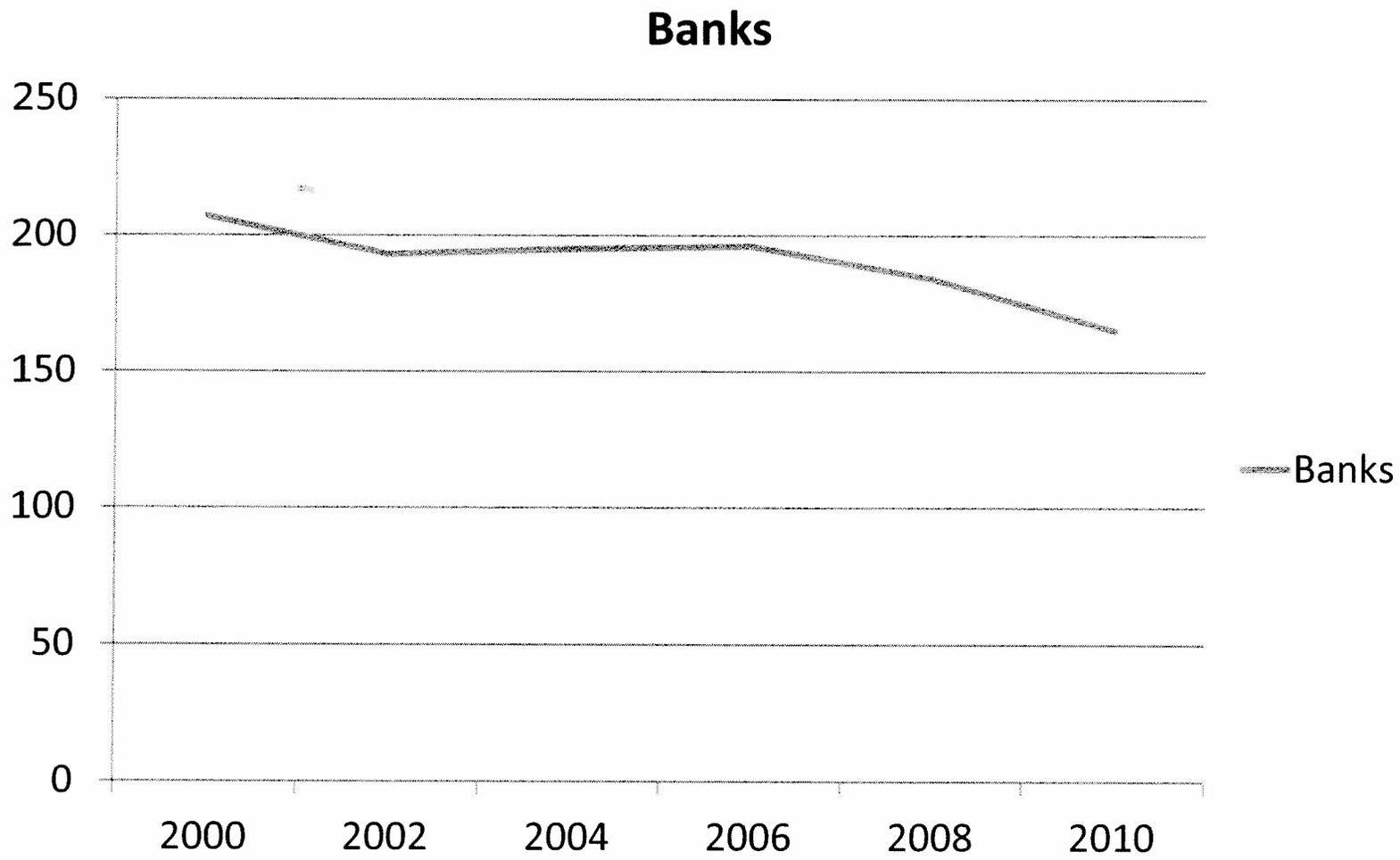


FDIC Year End 2002 Data

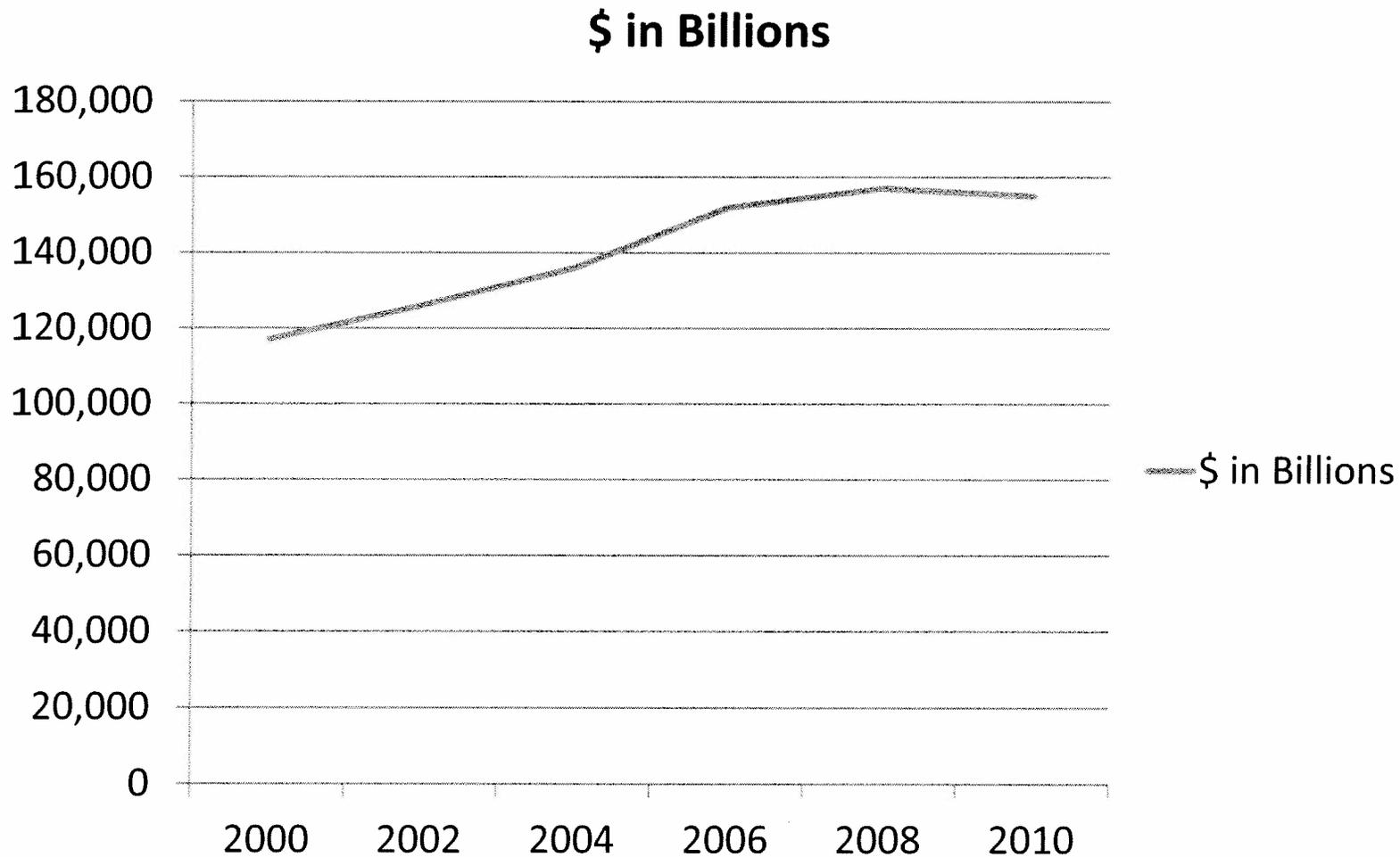
# Distribution of assets held in US Banks \$ in billions by size of institution



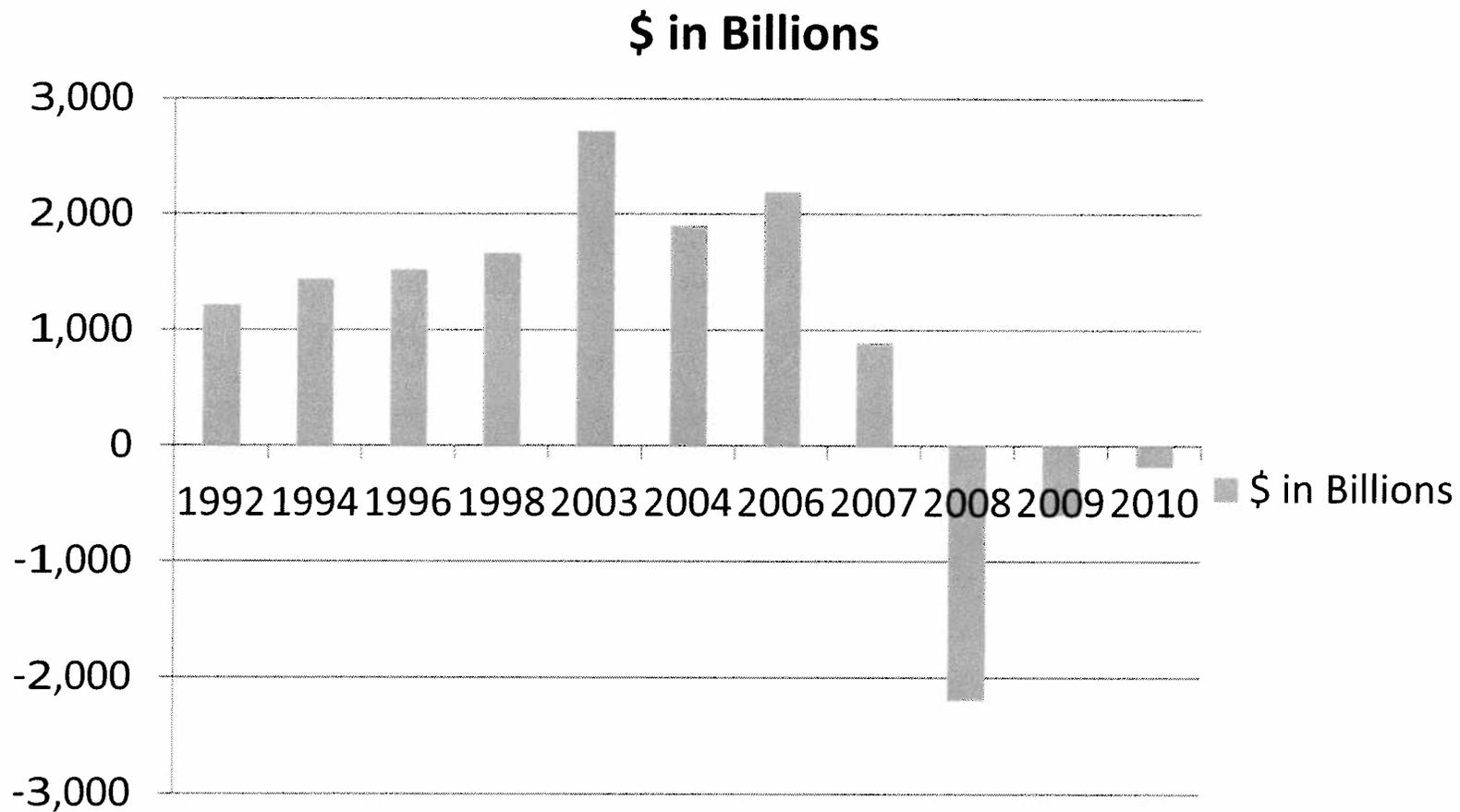
# Banks with branches in Michigan



# Deposits in Michigan Banks



# Michigan Commercial Bank Net Income



# Banking outside the Box

- Competition – from every direction!
- Banks without a vault.
- Computer terminal branching.
- Smart phone/notepad banking.
- Immediate and complete financial services to customers.



# The Competition

- Credit Unions
- AAA, USAA, State Farm, Allstate Banks
- MetLife Bank
- Edward Jones, Raymond James, E trade
- Internet Banks/Lenders
  - GMAC – Ally Bank
  - Chrysler – Toronto Dominion Bank
- Walmart Bank – A Mexico Chartered institution



# The Bank of the Future

- Financial Services Center for both retail and commercial customers
- Deposits and Loans
- Investment Center
- Insurance Center
- Real Estate Sales Office
- Financial Planning Office
- Government observation and reporting post



# Questions

- Will non-traditional banking become the norm? A necessity?
- Can a community banks continue to provide a unique value for the community it serves?
- Can a community bank provide broad financial services on a competitive basis?
- What is a Bank really?



# Banking after Dodd/Frank

- Estimated 20,000 pages of new federal regulation.
- 5 years for implementation.
- New structures and new examination requirements.
- New costs to banks to implement new systems.
- New record keeping and reporting.
- More costly examination processes.
- More employees dedicated to regulatory compliance.
- More comprehensive lending processes -slower.
- More restrictive lending thresholds – tighter.
- Fewer lending institutions due to increased costs?