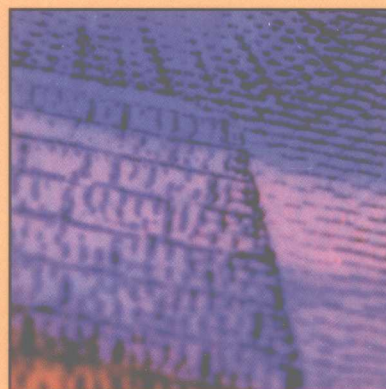
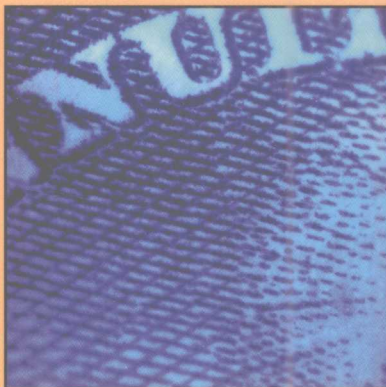


# *Law & Banking*

FIFTH EDITION



**Kathlyn L. Farrell**  
**David Buzzell**



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**Kathlyn L. Farrell**  
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# Preface

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

Specific objectives of this book are to:

- Explain the legal and legislative sources of U.S. banking law and the judiciary's and regulatory agencies' role in interpreting the law. (Chapter 1)
- Describe the major torts and crimes that affect the banking industry. (Chapter 2)
- Identify the customer relationships of individuals, sole proprietorships, and partnerships, and a bank's legal obligations and responsibilities when transacting business with these customers. (Chapter 3)
- Identify the legal entities of corporations, government agencies, limited liability companies, estates, and trusts, and a bank's legal obligations and responsibilities when transacting business with these entities. (Chapter 4)
- Explain how contractual relationships are formed and enforced and the different elements of contracts. (Chapter 5)
- Describe how property can be acquired, transferred, and owned, and how creditors obtain property interests. (Chapter 6)
- Describe the requirements of negotiable instruments as defined by Uniform Commercial Code Article 3 and other laws. (Chapter 7)
- Describe the parties and their rights in the transfer of negotiable instruments and the legal responsibilities of banks in collections and returns as governed by the UCC and federal regulation. (Chapter 8)
- Explain the legal obligations of banks to act responsibly as a business and in their dealings with customers. (Chapter 9)
- Identify the laws and regulations that protect bank deposits and govern the relationship between a bank and its depositors. (Chapter 10)
- Describe the legal protections provided to borrowers and the rights and responsibilities of banks when they offer credit and make loans. (Chapter 11)
- Identify the laws and regulations that protect borrowers and lenders in real estate transactions and that serve the community interest. (Chapter 12)
- Explain how the asset liquidation and reorganization provisions of bankruptcy law, including those provided by the new bankruptcy legislation, protect the interests of both debtors and creditors. (Chapter 13)
- Describe the legal obligations of banks when they serve in a fiduciary capacity and when they provide insurance and securities products and services. (Chapter 14)
- Describe how the global trade and investment activities of U.S. banks are affected by both domestic and international law. (Chapter 15)
- Explain laws and regulations that govern bank marketing practices. (Chapter 16)



- Identify the bank safety and soundness laws that help protect bank assets, guard against deposit insurance system losses, and reduce risk in the banking system. (Chapter 17)
- Explain some requirements placed on banks to report financial and customer information to government authorities and the responsibilities placed on banks to ensure safeguards when receiving, using, and disclosing customer information. (Chapter 18)

In addressing these topics, this text substantially updates the material covered in the previous edition of *Law and Banking Principles* and *Law and Banking Applications*. Among the new information presented in this book:

- A preview of major U.S. banking, including the Gramm-Leach-Bliley Act (GLBA), the Fair and Accurate Credit Transactions Act (FACT Act), the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act), and the Sarbanes-Oxley Act. (Chapter 1)
- A discussion of the evolution in bank supervision and regulation as it pertains to bank safety and soundness and functional modernization. (Chapter 1)
- A description of crimes that affect banking, including insider trading and money laundering, as well as the newer forms of cybercrime, including identity theft, phishing, and hacking. (Chapter 2)
- An introduction to limited partnerships, limited liability partnerships, and their formation and operation. (Chapter 3)
- A discussion of the new legal responsibilities and liabilities of directors, audit committees, and senior management. (Chapter 4)
- A discussion of how the law, such as the Uniform Electronic Transactions Act (UETA), governs electronic commerce and e-contracts, including the use of click-on agreements and e-signatures. (Chapter 5)
- A look at the Check Clearing for the 21<sup>st</sup> Century Act, commonly known as “Check 21,” and how the law treats substitute checks and the legal responsibilities among banks and customers. (Chapter 7)
- A discussion of electronic check processing and the legal issues. (Chapter 7)
- An explanation of the bank’s duties, warranties, and indemnities associated with substitute checks. (Chapter 8)
- New material on corporate ethics and provisions of the Sarbanes-Oxley Act governing internal controls over financial reporting, executive certification of financial reports, director and management conflict of interest, and fraud accountability. (Chapter 9)
- A discussion of bank codes of conduct, the Americans with Disabilities Act, and customer information privacy. (Chapter 9)
- New details on FDIC insurance regulation pertaining to a variety of deposit products. (Chapter 10)
- An analysis of the legal issues pertaining to overdraft protection services and customer identification programs. (Chapter 10)
- A discussion of a bank’s legal obligations with regard to payday loans. (Chapter 11)
- An analysis of credit information reporting and use under the Fair Credit Reporting Act and the Fair and Accurate Credit Transactions Act. (Chapter 11)
- A discussion of the legal protections provided by the Servicemembers Civil Relief Act to military men and women who have credit obligations. (Chapter 11)
- A discussion of sales restrictions and disclosures necessary for debt cancellation contracts and debt suspension agreements. (Chapter 11)

- An analysis of recent changes in real estate lending law, including the legal requirements of the Home Ownership and Equity Protection Act of 1994, the termination of private mortgage insurance under the Homeowners Protection Act, and new restrictions on subprime lending. (Chapter 12)
- A detailed explanation of the impact of the 2005 bankruptcy law on debtor's ability to use property exemptions under state law, bankruptcy filings, and eligibility for Chapter 7 versus Chapter 11 relief. (Chapter 13)
- A discussion of fiduciary duties under Regulation 9 and the uniform trust laws developed by National Conference of Commissioners on Uniform State Laws. (Chapter 14)
- An analysis of financial modernization legislation's impact on insurance and securities activities. (Chapter 14)
- An explanation of how UCC Article 8 provides legal structure for U.S. commercial transactions. (Chapter 14)
- A discussion of the Lost and Stolen Securities Program. (Chapter 14)
- An analysis of laws applying to international banking activities. (Chapter 15)
- A discussion of the Office of Foreign Assets Control and what it requires of banks in fighting money laundering and terrorism. (Chapter 15)
- A discussion of the International Chamber of Commerce's uniform rules to promote global commerce. (Chapter 15)
- An introduction to the types of legal organizations that engage in global banking, such as Edge Act corporations, foreign branches, shell branches, international banking facilities, foreign representative offices, subsidiaries, and foreign exchange services. (Chapter 15)
- An explanation of the laws and rules governing issuer responsibilities and liabilities in letter of credit arrangements and banker's acceptances. (Chapter 15)
- A look at the marketing and sales rules, including the FTC's Telemarketing Sales Rule that implemented the Do Not Call Registry. (Chapter 16)
- An explanation of the legal requirements for unsolicited advertisements via fax, credit card disclosures, and opt-out notices given with prescreened solicitations for credit or insurance. (Chapter 16)
- An analysis of electronic commerce and internet marketing regulation, including advertising on the Web, restrictions on commercial e-mail messages (spam), children's online privacy protections, and trade names for Internet banking facilities. (Chapter 16)
- A discussion of laws that promote bank safety and soundness, including Federal Reserve Act Section 23A limits on transactions between member banks and affiliates, Bank Protection Act's requirements for security devices, Employee Polygraph Protection Act, and rules on bank lending limits. (Chapter 17)
- An analysis of the suspicious activity reporting and filing requirements of the USA Patriot Act, the customer identification and recordkeeping requirements of the USA Patriot Act, OFAC's reporting requirements, and IRS reporting requirements. (Chapter 18)

In addition to these text updates, this edition was restructured. The previous edition, which was divided into two books, one on legal principles and the other on legal applications, has been replaced with a combined text that is organized by topic. The text format is different from the past. The text, typeset in a one-column format, features sidebars that highlight relevant information. Graphics and prominent color visually enhance the reading and learning experience. Instructional design features include:

- learning objectives at the beginning of the chapter that convey what should be learned from the material presented
- an introduction that sets the stage for topics covered in the chapter

- historical facts, “did you know?” sidebars, charts, and exhibits that supplement chapter content
- definitions in sidebars for key terms bolded in the text
- legal case studies with questions that test understanding of legal concepts and principles
- situations that present the application of legal principles
- a summary that reviews the chapter’s main points
- self-check review questions for testing comprehension of chapter content
- a list of additional resources, including publications and Web sites, that contain material related to chapter content
- separate sections at the back of the book with answers to chapter self-check review and legal case study questions
- a glossary that provides definitions for terms used in the text
- an index that can be used to locate content

## **PART ONE: PRINCIPLES**

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

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

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

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

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

## **PART TWO: APPLICATIONS**

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

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

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

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

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

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

Chapter 17 examines the laws that help ensure bank safety and soundness. The federal and state governments impose safety and soundness laws because of the central role that banking plays in the economy. These laws are wide-ranging and affect everything from the bank's physical premises to the use of its loanable funds, its transactions with insiders and affiliates, and the value of collateral. This textbook concludes with an examination of laws that govern the collection and reporting of personal, financial, and identifying information, which is the subject of Chapter 18.

Kathlyn Farrell  
David Buzzell



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