may permit something of which he or she is unaware does not withstand analysis." The First District rejected such an interpretation, and instead stated that a licensee "has a general, affirmative duty to maintain a lawful establishment. Presumably this duty imposes upon the licensee the obligation to be diligent in anticipation of reasonably possible unlawful activity, and to instruct employees accordingly. Once a licensee knows of a particular violation of the law, that duty becomes specific and focuses on the elimination of the violation. Failure to prevent the problem from recurring, once the licensee knows of it, is to 'permit' by a failure to take preventive action." According to the court, "[t]his is a more reasonable alternative to the Board's interpretation of *McFaddin*, and one more consistent with logic and reasonable fairness."

In ***Laube***, the court noted that the evidence failed to establish that either the licensee's management or its employees knew of the drug transactions that occurred on the premises; as such, the court annulled the decision of ABC and the ABC Appeals Board. In ***De Lena***, the court remanded the matter to the ABC Appeals Board to determine whether De Lena was aware of the illegal activity.

In similar cases, ***Yu v. Alcoholic Beverage Control Appeals Board and Stroh***, No. H008497, and ***Min v. Alcoholic Beverage Control Appeals Board***, No. H008615 (Jan. 31, 1992), the Sixth District Court of Appeal reviewed these consolidated matters which presented the issue whether, because of frequently occurring illegal drug transactions on the premises, ABC may revoke the off-sale alcohol licenses of petitioners without requiring proof that petitioners knowingly permitted the drug transactions or that the sale of alcohol caused or contributed to the illegal conduct. Although both petitioners argued that the evidence did not sustain a finding that either knew of the drug transactions, the Sixth District determined that "the record amply sustains findings of implied knowledge as to Min and actual knowledge as to Yu" of numerous drug transactions on the premises. However, the court also found that there was no evidence of complicity on the part of either petitioner.

The California Constitution authorizes the revocation of an ABC license where the premises have essentially become a public nuisance; the existence on the premises of a condition injurious to the public welfare is enough for revocation. According to the court, fault is not relevant; the power of ABC derives from its police power to prevent nuisances regardless of anyone's fault in creating them. Because the evidence showed that "the premises have become law enforcement problems, that the owners were actually or constructively aware of the problems, and that they were not effective in controlling the rampant drug trade on the licenses premises," the court held that ABC did not abuse its discretion in revoking the licenses.

BANKING DEPARTMENT

Superintendent: James E. Gilleran
(415) 557-3232
Toll-Free Complaint Number: 1-800-622-0620

Pursuant to Financial Code section 99 *et seq.*, the State Banking Department (SBD) administers all laws applicable to corporations engaging in the commercial banking or trust business, including the establishment of state banks and trust companies; the establishment, operation, relocation, and discontinuance of various types of offices of these entities; and the establishment, operation, relocation, and discontinuance of various types of offices of foreign banks. The Department is authorized to adopt regulations, which are codified in Chapter 1, Title 10 of the California Code of Regulations (CCR).

The superintendent, the chief officer of the Department, is appointed by and holds office at the pleasure of the Governor. The superintendent approves applications for authority to organize and establish a corporation to engage in the commercial banking or trust business. In acting upon the application, the superintendent must consider:

(1) the character, reputation, and financial standing of the organizers or incorporators and their motives in seeking to organize the proposed bank or trust company;

(2) the need for banking or trust facilities in the proposed community;

(3) the ability of the community to support the proposed bank or trust company, considering the competition offered by existing banks or trust companies; the previous banking history of the community; opportunities for profitable use of bank funds as indicated by the average demand for credit; the number of potential depositors; the volume of bank transactions; and the stability, diversity, and size of the businesses and industries of the community. For trust companies, the opportunities for profitable employment of fiduciary services are also considered;

(4) the character, financial responsibility, banking or trust experience, and business qualifications of the proposed officers; and

(5) the character, financial responsibility, business experience and standing of the proposed stockholders and directors.

The superintendent may not approve any application unless he/she determines that the public convenience and advantage will be promoted by the establishment of the proposed bank or trust company; conditions in the locality of the proposed bank or trust company afford reasonable promise of successful operation; the bank is being formed for legitimate purposes; the capital is adequate; the proposed name does not so closely resemble as to cause confusion with the name of any other bank or trust company transacting or which has previously transacted business in the state; and the applicant has complied with all applicable laws.

If the superintendent finds that the proposed bank or trust company has fulfilled all conditions precedent to commencing business, a certificate of authorization to transact business as a bank or trust company will be issued.

The superintendent must also approve all changes in the location of a head office; the establishment, relocation, or discontinuance of branch offices and ATM facilities; and the establishment, discontinuance, or relocation of other places of business. A foreign corporation must obtain a license from the superintendent to engage in the banking or trust business in this state. No one may receive money for transmission to foreign countries or issue money orders or travelers checks unless licensed.

The superintendent examines the condition of all licensees when necessary, but at least once every two years. The Department is coordinating its examinations with the Federal Deposit Insurance Corporation (FDIC) so that every year each agency examines certain licensees. New and problem banks and trust companies are examined each year by both agencies.

The superintendent licenses Business and Industrial Development Corporations which provide financial and management assistance to business firms in California.

Acting as Administrator of Local Agency Security, the superintendent oversees security pools that cover the deposits of money belonging to a local governmental agency in any state or national bank or savings and loan association. All such deposits must be secured by the depository.

MAJOR PROJECTS:

FDIC Increases Insurance Fund

Fee. On May 12, the five-member governing board of the FDIC voted to increase the premiums—as of January 1, 1993—that banks and savings associations must pay to their insolvent insurance funds by an average of 22%; the FDIC also fundamentally altered the way in which the premiums are assessed.

The bank insurance fund, established in 1934 in the wake of the bank collapses of the Depression, lost $11 billion in 1991, and posted a $7 billion deficit position. The new rates are anticipated to raise an additional $1.25 billion per year by reducing the industry's after-tax earnings by about 4%.

The major change in premium assessment provides that rates will be determined relative to the perceived risks of each institution. Since the inception of the fund, premiums have been assessed on all banks at the same rate. Under the changes, which are now subject to a 60-day comment period, the fee would be increased to an average of $0.28 (from the current $0.23) per $100 of deposits and would be risk-assessed; the weak banks will pay an additional $0.03 per $100 of deposits and the strongest banks will pay $0.03 less.

The theory behind the degree-of-risk-based premiums is to reward the best managed institutions and deter risky lending. Under the proposed changes, banks would be rated in one of nine risk categories based on capital levels and on subjective judgments based on examiners' reports, public filings on performance, and other information available to regulators.

The FDIC board's 3–2 decision was made despite intense opposition from the banking industry and the Bush administration; T. Timothy Ryan, head of the federal Office of Thrift Supervision, and Stephen Steinbrink, Acting Comptroller of the Currency, voted against the changes.

The fiscal backdrop against which the vote was taken is grim. The fund, which stood at $18.3 billion six years ago, has since been devastated by the failure of 885 banks. The $26 billion cost of those failures was not adequately covered by increases in assessments three years ago, which raised the fee from $0.083 to the current level of $0.23 per $100 of deposit. A FDIC staff report stated that, "as bad as the past five years have been, the next two years could be even worse." According to the report, a rate of $0.50 per $100 of deposit is required to prevent the fund from deteriorating further; the FDIC expects 200 banks holding $80 billion in assets to fail this year and cost the fund about $14 billion. Industry groups complained that the FDIC estimates were overly pessimistic, noting that so far this year the government has seized only 51 banks holding $16.1 billion in assets.

New FDIC Policy Places Uninsured Deposits At Risk. Early this year, the FDIC began enforcing its long-standing—but historically unenforced—policy of protecting individual and business depositors only up to the insured maximum of $100,000 for each insured account. Although bank deposits exceeding the maximum insurable amount have always been at risk when a bank fails, the FDIC would previously attempt to find another bank to take over all deposits of the failed bank, thus minimizing losses for those big depositors. *[11:1 CRLR 11]* However, in an effort to instead minimize losses for the FDIC, Congress passed a law last year requiring that the FDIC close banks by the least costly method for the insurance fund. Under the new law, the FDIC may sell only the insured deposits of a failed bank, as that results in a smaller loss to the government than if the FDIC sold all of the deposits. According to the FDIC, only about 1.5% of the country's households have over $100,000 on deposit in any single bank.

Riot Aid: Banks Under Pressure to Lend. On May 1, Superintendent James Gilleran issued an emergency proclamation pursuant to Financial Code section 3602, authorizing banks located in the counties of Los Angeles and Alameda and the City and County of San Francisco to close their offices, due to the devastating riots in parts of Los Angeles and related unrest in the Bay Area. Banks that closed offices under the proclamation were authorized to reopen them at the discretion of their officers. In SBD's May 8 Weekly Bulletin, Superintendent Gilleran commended those banks that announced plans to assist in the task of rebuilding the areas of Los Angeles that were destroyed or damaged during the riots. Gilleran also encouraged all California banks to work with their customers and take cognizance of the economic hardship facing many California businesses and their employees. In addition, Superintendent Gilleran urged all California banks to review their lending policies in order to grant appropriate latitude to existing customers and to expedite the extension of new credit to finance rebuilding in the affected areas. However, even those banks pledging assistance to affected areas expressed concern about the effect that such lending may have when their capital ratios are appraised by federal and state banking authorities.

In the immediate aftermath of the riots, the four major federal bank regulatory agencies—the Federal Reserve Board, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision—issued an "Interagency Statement on Supervisory Practices Regarding Depository Institutions and Borrowers Affected by Disturbances in Los Angeles." SBD supports and endorses the Interagency Statement, which asserts that lenders which restructure the debt of borrowers financially affected by the riots will not be criticized by examiners if their activities are "carried out in a prudent manner." The Interagency Statement also makes the following comments:

–Depository institutions in areas affected by widespread disruption may deem it appropriate to ease credit-extending terms for new loans to certain borrowers, consistent with prudent banking practices, in order to assist the borrowers in recovering their financial strength and place them in a better economic position to service their debts.

–Depository institutions in the affected areas may find that their levels of delinquent and nonperforming loans will increase. Consistent with long-standing practice, the federal bank and thrift regulatory agencies in supervising these institutions will take into consideration the unusual circumstances they face.

–In carrying out their supervisory responsibilities, the federal bank and thrift regulatory agencies recognize that efforts to work with borrowers in communities under stress, if conducted in a reasonable way, are consistent with safe and sound banking practice and are in the public interest.

California Banks' 1991 Performance. In 1991, California's 433 banks had a total new income of $597.4 million. Although this is a decrease from previous years, some financial indicators show improvement. For example, the median equity capital ratio increased to 7.78%, and banks over $2 billion in size have 78% of their non-current loans covered by reserves. At $2.65 billion, non-current loans show—for the first time since June 1990—a decline from the preceding quarter.

Construction Loan Survey Update. During the mid- to late-1980s, real estate loans in general, and construction loans in particular, increased so dramatically that real estate loans—on an aggregate basis—now account for over 50% of the aggregate loan portfolio of state-chartered banks. SBD initially surveyed the construction loan activity of California banks in April 1991. *[11:2 CRLR 115]* Following up on that survey, SBD released further data in January; significant findings include the following:

–Real estate loans continued to grow, increasing 7.2% from December 1990. However, the construction loan portion of the real estate portfolio declined both in dollar volume and as a percentage of the total real estate portfolio.

–The percentage of banks having concentrations in construction loans remains high, with 72% of the banks surveyed having construction loans and/or undisbursed commitments in excess of 100% of capital, and 28% of banks having construction loans and/or undisbursed commitments of over 250% of capital. In terms of loan portfolio, 22% of the banks had over 25% of their portfolios in construction loans.

–The expected payoff/turnover of the portfolios is good, with 92% of the loans (excluding land loans) expected to mature within the period ending June 30.

–Over 28% of the banks surveyed derive 30% or more of their total gross revenues from construction loans.

–A definite correlation exists between the amount of construction loans and the amount of delinquent loans reported by bankers; the higher the amount of construction loans, the higher the amount of delinquent loans.

In view of the substantial amount of real estate credits in bank portfolios, SBD suggests that each bank's management develop an overall strategy to be kept apprised of the condition of its loan portfolio. SBD made a number of other recommendations, such as maintaining comprehensive written policies which set overall limitations on types of real estate lending based upon percentages of capital and total loan portfolio. Also, boards of directors should establish procedures to monitor management's compliance with established policy and to keep themselves current with economic changes affecting real estate development.

LEGISLATION:

AB 3469 (T. Friedman). Existing provisions of the Savings Association Law prescribe various criminal offenses and penalties for violations thereof, and provide for forfeiture of property or proceeds derived from these violations. As amended May 11, this bill would enact similar criminal forfeiture provisions for violation of the Banking Law, and would expand the list of criminal offenses, as specified, the violation of which subjects the violator to the forfeiture provisions. This bill would also provide that a petition for forfeiture may be filed prior to, in conjunction with, or subsequent to a criminal proceeding, and if filed prior to the criminal proceedings, the prosecuting agency shall provide concurrent notice to any parties subject to the proposed forfeiture that they are targets of an anticipated criminal action. The petition and any injunctive order shall be dismissed unless a criminal complaint is filed within 120 days after the filing of the petition. The bill would also provide that no injunctive order shall impair the ability of a defendant or interested party to pay legal fees relating to the criminal charges.

Existing law provides that the proceeds of forfeited property shall be distributed to the bona fide or innocent purchaser, conditional sales vendor, or holder of a valid lien, mortgage, or security interest, as specified. This bill would provide that the balance of any forfeited funds shall also be distributed to the victim of specified crimes committed by the defendants. *[A. W&M]*

ABX 45 (Peace) would prohibit state, city, and county governments from contracting for services with financial institutions with $100 million or more in assets unless those companies file reports annually with the state Controller; those reports would include specified information regarding the nature of the governance of the companies and their lending and investment practices, with regard to race, ethnicity, gender, and income of the governing boards and of the recipients of loans and contracts from the institutions. *[A. CPGE&ED]*

SB 1396 (Marks). Existing law provides that any person who regularly assembles, evaluates, or disseminates information on the checking account experiences of consumer customers of banks or other financial institutions is subject to the laws that govern consumer credit reporting agencies. As amended May 13, this bill would require banks and other financial institutions that permit that activity to give specified notices to new customers. This bill would also prohibit persons who assemble, evaluate, or disseminate this information from reporting information which is more than three years old, except as to cases resulting in a criminal conviction. (*See supra* report on CONSUMER ACTION for related discussion.) *[S. Floor]*

AB 3025 (Lancaster). Under existing law, whenever it appears that the contributed capital of a bank or trust company is impaired, the Superintendent of Banking is required to order the bank to correct impairment within sixty days; if it fails to do so, the bank or trust company is required to levy and collect an assessment upon its common shares. Also, when the contributed capital is impaired, the Superintendent is authorized to take possession of the bank. As introduced February 19, this bill would eliminate the provisions relating to the impairment of contributed capital and assessments of shares. Instead, it would provide that when the tangible shareholders' equity is less than certain sums, the Superintendent is authorized to take possession of the bank. *[S. BC&IT]*

AB 3683 (Peace). Under existing law, with the prior written approval of the Superintendent of Banking, a bank or trust company may close or discontinue the operation of any branch office provided public notice thereof is given in the manner the Superintendent directs at least 90 days before the date of closing or discontinuance. As amended May 11, this bill would require every banking corporation to mail written notice with customer statements of the planned closing to its customers, and to post notice of the planned closing at the branch office. *[S. BC&IT]*

SB 1463 (Calderon), as amended April 9, would provide that the robbery of any person who is using an automated teller machine (ATM) or immediately after the person has used an ATM while the person is in the vicinity of the ATM shall be punished by an additional term of one year in state prison. *[S. Appr]*

AB 2389 (Moore) would require the operator of any ATM in this state to disclose any transaction surcharge with respect to customers utilizing an access device not issued by that operator prior to completion of any transaction. *[A. BF&BI]*

The following is a status update on bills reported in detail in CRLR Vol. 12, No. 1 (Winter 1992) at pages 110–11:

S. 263 (Dixon) was federal legislation which would have reformed the regulation of financial services and strengthened the enforcement authority of depository institution regulatory agencies. Despite the efforts of its author, Senator Alan Dixon (D-Illinois), the bill was dropped due to opposition by the Bush administration. Because Senator Dixon was defeated in his primary race, the bill will not be reintroduced under his aegis.

SB 506 (McCorquodale), as amended January 6, would direct the Business, Transportation and Housing Agency to conduct a study on the feasibility and advisability of consolidating some or all of the state's regulatory functions involving banks and savings associations and, at the discretion of the Agency, other financial institutions. The study would be required to be reported to the legislature and the Governor on or before March 1, 1993. *[A. BF&BI]*

AB 696 (Lancaster). Existing law

provides that with the prior written approval of the Superintendent, a bank may change the location of a place of business from one location to another in the same vicinity upon application and a fee of $100. This bill would increase that fee to $250. *[S. BC&IT]*

The following bills died in committee: ***AB 1593 (Floyd)***, which would have transferred the licensing and regulatory functions of SBD, the Department of Savings and Loan, and the Department of Corporations to a Department of Financial Institutions, which the bill would have created; ***SB 893 (Lockyer)***, which would have authorized the establishment of the California Financial Consumers' Association to inform, advise, and represent consumers on financial service matters; ***SB 949 (Vuich)***, which would have increased a specified fee from $100 to $300; ***AB 1596 (Floyd)***, which would have amended the California Public Records Act's exemption for records of any state agency responsible for the regulation or supervision of the issuance of securities or of financial institutions; ***SB 950 (Vuich)*** and ***AB 1463 (Hayden)***, which would have specified the application of a certain percentage limitation with respect to the aggregate amount of accounts subject to a negotiable order of withdrawal, savings deposits, money market accounts, super now accounts, and other time deposits of a commercial bank, including certificates of deposit; and ***AB 1195 (Lancaster)***, which would have provided that for compensation or in expectation of compensation, a bank or trust company may, on behalf of another or others, sell, buy, lease, exchange, or offer to sell, buy, lease, or exchange, or solicit prospective sellers, purchasers, or lessees of, or negotiate the sale, purchase, lease, or exchange of any business opportunity.

LITIGATION:

On March 12, the California Supreme Court denied review of the First District Court of Appeal's decision in ***Beasley v. Wells Fargo Bank***, No. A048490, in which the court affirmed a $5 million judgment in a class action challenging Wells Fargo's assessment of fees against credit card customers who failed to make timely payments or exceeded their credit limits. Also on March 12, the California Supreme Court denied review in a related action, ***Beasley v. Wells Fargo Bank***, No. A049948, in which the First District upheld the trial court's award of almost $2 million in attorneys' fees and costs to plaintiffs in the class action discussed above. *[12:1 CRLR 111]*

DEPARTMENT OF CORPORATIONS

Commissioner: Thomas Sayles
(916) 445-7205
(213) 736-2741

The Department of Corporations (DOC) is a part of the cabinet-level Business, Transportation and Housing Agency and is empowered under section 25600 of the California Code of Corporations. The Commissioner of Corporations, appointed by the Governor, oversees and administers the duties and responsibilities of the Department. The rules promulgated by the Department are set forth in Chapter 3, Title 10 of the California Code of Regulations (CCR).

The Department administers several major statutes. The most important is the Corporate Securities Act of 1968, which requires the "qualification" of all securities sold in California. "Securities" are defined quite broadly, and may include business opportunities in addition to the traditional stocks and bonds. Many securities may be "qualified" through compliance with the Federal Securities Acts of 1933, 1934, and 1940. If the securities are not under federal qualification, the commissioner must issue a "permit" for their sale in California.

The commissioner may issue a "stop order" regarding sales or revoke or suspend permits if in the "public interest" or if the plan of business underlying the securities is not "fair, just or equitable."

The commissioner may refuse to grant a permit unless the securities are properly and publicly offered under the federal securities statutes. A suspension or stop order gives rise to Administrative Procedure Act notice and hearing rights. The commissioner may require that records be kept by all securities issuers, may inspect those records, and may require that a prospectus or proxy statement be given to each potential buyer unless the seller is proceeding under federal law.

The commissioner also licenses agents, broker-dealers, and investment advisors. Those brokers and advisors without a place of business in the state and operating under federal law are exempt. Deception, fraud, or violation of any regulation of the commissioner is cause for license suspension of up to one year or revocation.

The commissioner also has the authority to suspend trading in any securities by summary proceeding and to require securities distributors or underwriters to file all advertising for sale of securities with the Department before publication. The commissioner has particularly broad civil investigative discovery powers; he/she can compel the deposition of witnesses and require production of documents. Witnesses so compelled may be granted automatic immunity from criminal prosecution.

The commissioner can also issue "desist and refrain" orders to halt unlicensed activity or the improper sale of securities. A willful violation of the securities law is a felony, as is securities fraud. These criminal violations are referred by the Department to local district attorneys for prosecution.

The commissioner also enforces a group of more specific statutes involving similar kinds of powers: Franchise Investment Statute, Credit Union Statute, Industrial Loan Law, Personal Property Brokers Law, Health Care Service Plan Law, Escrow Law, Check Sellers and Cashers Law, Securities Depositor Law, California Finance Lenders Law, and Security Owners Protection Law.

A Consumer Lenders Advising Committee advises the commissioner on policy matters affecting regulation of consumer lending companies licensed by the Department of Corporations. The committee is composed of leading executives, attorneys, and accountants in consumer finance.

On March 26, the Senate approved Governor Pete Wilson's appointment of Thomas S. Sayles as Commissioner of the Department of Corporations.

MAJOR PROJECTS:

Feasibility of Establishing Separate Department to Regulate State-Chartered Credit Unions Examined. Senate Resolution 66 (Kopp), approved in 1990, required the Legislative Analyst's Office (LAO) to examine the "fiscal feasibility" of establishing a separate department to regulate state-chartered credit unions. Currently, regulation of credit unions is just one of the functions performed by DOC, which regulates the 267 credit unions in California that operate under a state charter (another 674 credit unions operate under a federal charter).

In its recently released analysis, LAO indicates that the establishment of a separate regulatory department would increase state administrative costs by about $453,000 for 1992 (assuming that there is no change in the regulatory workload). These increased costs would have to be paid by the state-chartered credit unions. For 1992, assessments paid by these credit unions would have to be increased by approximately $0.04 per $1,000 of assets, resulting in assessment increases that range from 2.9% (for credit unions with