or both for transient occupancy in a dwelling unit in a common interest development, in a dwelling unit in an apartment building or complex, or in a single-family home. This bill was signed by the Governor on July 8 (Chapter 134, Statutes of 1992).

AB 3469 (T. Friedman) was amended to pertain only to savings and loan institutions (*see infra* agency report on DEPARTMENT OF SAVINGS AND LOAN).

The following bills died in committee: **AB 2154 (Hannigan)**, which would have changed the licensing/certification deadline applicable to any person who engages in federally related real estate appraisal activity, to the required date, including administrative extensions, set by the Appraisal Subcommittee of the Federal Financial Institutions Examination Council for regulation of federally related real estate appraisal activity; and **AB 2666 (Baker)**, which would have included in an existing exemption from the definition of a real estate broker any employee of a broker performing specified functions in connection with the renting or leasing of real property managed by the broker and used for vacation or recreational purposes, other than timeshare management persons who perform similar functions with regard to real estate sales, exchanges, loans, or loan servicing.

LITIGATION

On June 11, the bankruptcy reorganization plan of Pioneer Mortgage, which filed for bankruptcy in January 1991, was approved by U.S. Bankruptcy Court Judge James W. Meyers. *[11:2 CRLR 127]* Current Pioneer management estimates that over the next five years, investors may recover 35 cents on the dollar; an additional 15 cents on the dollar may be recovered by the investors from several civil suits against Pioneer's service providers. Approximately 2,000 investors put about $200 million into Pioneer prior to its 1991 collapse. In addition to the civil litigation, the U.S. Attorney's Office is investigating possible criminal violations by former Pioneer executives.

DEPARTMENT OF SAVINGS AND LOAN

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The Department of Savings and Loan (DSL) is headed by a commissioner who has "general supervision over all associations, savings and loan holding companies, service corporations, and other persons" (Financial Code section 8050). DSL holds no regularly scheduled meetings, except when required by the Administrative Procedure Act. The Savings and Loan Association Law is in sections 5000 through 10050 of the California Financial Code. Departmental regulations are in Chapter 2, Title 10 of the California Code of Regulations (CCR).

MAJOR PROJECTS

Merger Bill Vetoed By Governor. On September 30, Governor Wilson vetoed SB 506 (McCorquodale), which would have transferred the licensing and regulatory functions of DSL, the Savings and Loan Commissioner, the State Banking Department, and the Superintendent of Banking to a newly-created Department of State Banking and Savings and Loan. *[12:2&3 CRLR 185]* In his veto message, Governor Wilson stated that while he supports streamlining state government, SB 506 is "seriously flawed, and will not achieve its intended goal." According to Wilson, the bill would have eliminated current authority, rules, regulations, and orders of the established departments "without proper, consistent, and well defined transfer of these authorities to the new department. The effect of this is to leave some financial institutions, such as transmitters of money orders, business development corporations, local agency securities, among others, unregulated by any state agency." The Governor added that the "underlying need to consolidate the Department of Savings and Loan with another state agency still exists. However, this consolidation must be approached with careful attention to the regulatory, operational, and technical aspects of the policy to provide regulatory protection for the citizens of California."

HomeFed Seized by Federal Regulators. On July 6, federal regulators seized control of San Diego-based HomeFed Bank, the eighth largest savings and loan institution in the country. HomeFed, the largest S&L to fail in United States history, is said to have lost $1 billion since 1990 due to bad loans and foreclosed real estate. Despite this action, HomeFed remains open under the management of the Resolution Trust Corporation (RTC), the federal agency created by Congress to liquidate failed S&Ls. Although RTC and the Office of Thrift Supervision (OTS) had hoped to sell HomeFed as a less costly alternative to liquidation, RTC lacked sufficient funds to protect any prospective buyer from HomeFed's bad loans. OTS Director Timothy Ryan blamed Congress for causing HomeFed's takeover, claiming that when Congress failed to provide RTC with the additional funds it needed in order to complete the S&L clean-up, OTS was forced to seize institutions that otherwise would have been the subject of assisted sales; according to OTS, rescuing thrifts through assisted sales costs half as much as seizure and liquidation. In response to this criticism, House of Representatives Banking Committee staffers noted that RTC ran out of money because it failed to use all of the $25 billion Congress gave the agency in late 1991; although Congress established an April deadline for using up the money, $17 billion remained unused by RTC at that time and was thus frozen. *[12:2&3 CRLR 185–86]*

OTS determined that HomeFed's weak financial condition was due primarily to a high level of non-performing assets, largely the result of poor investment decisions implemented by former management. Although HomeFed Chair Kim Fletcher blamed the thrift's problems on various federal requirements, such as the strict capital regulations which were implemented in 1989, former HomeFed Corporation Director David Dunn agreed that the thrift was poorly run, adding that HomeFed "pursued growth aggressively without bringing judgment to bear on it." Further, HomeFed president Thomas Wageman has admitted that he knew at the beginning of 1992 that the S&L faced serious financial difficulties and would require federal assistance.

FDIC Raises Premiums for Weak S&Ls. Beginning January 1, the Federal Deposit Insurance Corporation (FDIC) will increase insurance premiums paid by S&Ls to FDIC to an average of 24 cents per $100 of deposits. However, the healthiest, best-managed institutions will be exempt from the increase; only the country's weaker S&Ls, whose risk of failure is greater, will be subject to the increased premiums. Presently, all FDIC-insured institutions pay 23 cents in premiums for every $100 of deposits; strong institutions—including about 60% of FDIC-insured S&Ls and 75% of FDIC-insured banks—will continue to pay this rate. Premiums for weaker institutions will increase by three to eight cents per $100 in deposits, depending on which of nine categories the institutions fall into; each category reflects a graduated safety rating. In determining risk category assignments, the Office of Thrift Supervision will use federal or state examination reports and other risk indicators.

The plan is designed to place the burden of strengthening the deposit insurance fund on the institutions which pose the greatest risk of failure. Although federal regulators contend that such troubled institutions ought to pay more for deposit insurance, they admit that the higher premiums will increase the likelihood of these S&Ls failing or being forced into mergers because it will raise the cost of doing business for S&Ls that already are having difficulties making money. U.S. Senator Donald Riegle, Jr. (D-Michigan), chair of the Senate Banking Committee, is critical of the plan, which he has stated is too lenient. Riegle believes that all federally-insured institutions should bear the costs of rebuilding the insurance fund. The rate increase is expected to raise an additional $200 million per year from the savings and loan industry, and approximately $600 million per year from banks, which are subject to the same premium increases.

New Federal Rules Hasten Shutdown of Ailing S&Ls. In late September, the Office of Thrift Supervision adopted tough new rules which will speed the closure of troubled S&Ls. The corrective action scheme, which took effect on December 19, implements new section 38 of the Federal Deposit Insurance Act, and divides financial institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Regulatory responses are similarly graded—stronger restrictions are imposed as an institution falls into lower categories. An institution will be deemed to be:

–well-capitalized if it has a total risk-based capital ratio of 6% or greater, and a leverage ratio of 5% or greater, and the institution is not subject to an order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure;

–adequately capitalized if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 4% or greater, and a leverage ratio of 4% or greater (or a leverage ratio of 3% or greater if the institution is rated composite 1 in its most recent report of examination, subject to appropriate federal guidelines), and the institution does not meet the definition of a well-capitalized institution;

–undercapitalized if it has a total risk-based capital ratio that is less than 8%, a Tier 1 risk-based capital ratio that is less than 4%, or a leverage ratio that is less than 4% (or a leverage ratio that is less than 3% if the institution is rated composite 1 in its most recent report of examination, subject to appropriate federal guidelines);

–significantly undercapitalized if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 3%, or a leverage ratio that is less than 3%; or

–critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2%.

Section 38's most severe response occurs when an institution is determined by regulators to be critically undercapitalized. Once an institution reaches that level, regulators generally will be required to close it within 90 days, unless its condition dramatically improves. According to the latest federal estimate, about 29 S&Ls with a total of $57.5 billion in assets currently fit this category, and are in danger of being closed either prior to or within 90 days of the December 19 effective date.

Section 38's specific capital targets and progressive responses provide S&L executives with adequate knowledge of their capital classification. Formal notification is given through inspection reports by federal regulators; in addition, informal hearings are provided when an institution's capital classification is downgraded. This new regulatory action is intended to alert executives and regulators to an institution's declining health, encourage weaker institutions to correct their problems quickly, and save insurance fund money by closing weak S&Ls while there is still some capital left in them.

California Thrifts Lead Nation in Bad Loans. According to a report by Texas-based Sheshunoff Information Services, a bank consulting firm, California's S&Ls led the nation in the amount of bad loans during the first quarter of 1992. According to the report, the state's S&Ls had $8.7 billion in bad loans, more than three times the amount in any other state. However, problem loans at the state's savings and loan institutions comprised 3.8% of total loans, just slightly above the national average of 3.3%.

Regulators Criticized for Ignoring Lending Bias. In conjunction with a September hearing of the Senate Banking Committee's Housing Subcommittee, Senator Alan Cranston (D-California) contended that bank and thrift regulators have been lax in their enforcement of the Community Reinvestment Act (CRA) and other fair lending laws; the CRA requires lenders to meet the credit needs of their entire communities, including low- and moderate-income neighborhoods. Cranston stated that regulators have given 87% of the banks and savings and loan institutions reviewed a rating of "satisfactory" or better during examinations over the last two years, despite evidence that minority and inner city areas continue to be underserved by depository lending institutions. For example, a recent *Los Angeles Times* study of lending patterns in Los Angeles County showed that Wells Fargo and Bank of America—the biggest financial lenders in the state—made a combined total of 113 loans to African-Americans in 1990; however, both banks received "outstanding" CRA ratings from their federal evaluator, the Comptroller of the Currency. That same *Los Angeles Times* study also showed that S&Ls are much more active than banks in lending to African-Americans and other minority group members.

Senator Cranston said his staff found instances when FDIC examiners found possible violations of the Equal Credit Opportunity Act and the Federal Fair Housing Act, but failed to report the situation to the Justice Department as is required under federal law. Representatives of the banking industry said that lenders do not intentionally discriminate against low-income, inner city communities, although they acknowledge that low-income, minority borrowers sometimes face obstacles in obtaining credit. According to the Independent Bankers Association of America (IBAA), bankers cite the CRA as one of the most onerous regulations with which they must comply; small banks with limited resources find the CRA's requirements for providing and analyzing data particularly burdensome, according to IBAA. Cranston criticized the federal regulators' apparent sympathy toward the financial institutions, stating that "[t]he tendency of agencies to act as protectors of the banks rather than as regulators profoundly distorts the process."

LEGISLATION

The following is a status update on bills reported in detail in CRLR Vol. 12, Nos. 2 & 3 (Spring/Summer 1992) at page 186:

SB 506 (McCorquodale) would have transferred the licensing and regulatory functions of DSL, the Savings and Loan

Commissioner, the State Banking Department, and the Superintendent of Banking to the Department of State Banking and Savings and Loan, which the bill would have created. This bill was vetoed by the Governor on September 30.

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. This bill expands those provisions to include other offenses the violation of which would be subject to forfeiture under the Savings Association Law. This bill also provides 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 also provides 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 provides that the balance of any forfeited funds shall also be distributed to the victim of specified crimes committed by the defendants. This bill was signed by the Governor on September 30 (Chapter 1280, Statutes of 1992).

ABX 45 (Peace), which would have prohibited 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, and **SB 1396 (Marks)**, which would have required financial institutions which assemble, evaluate, or disseminate information on the checking account experiences of consumer customers of banks or other financial institutions to give specified notices to new customers, died in committee.

LITIGATION

On July 10, in one of the numerous lawsuits stemming from the failure of Lincoln Savings and Loan, a federal jury ordered financier Charles Keating, Jr., and three co-defendants to pay over $3 billion in damages for conspiring to defraud investors; specifically, the jury awarded the 20,000 class action plaintiffs $600 million in compensatory damages and $1.5 billion in punitive damages from Keating, and $1.4 billion in compensatory damages and $900 million in punitive damages from Keating's co-defendants. *[11:1 CRLR 105]* However, U.S. District Court Judge Richard Bilby had instructed the jury that it could not award punitive damages against any defendant other than Keating; it is unclear whether Judge Bilby will allow the $900 million award. Keating, already in prison on California criminal convictions stemming from the same activities, sent no lawyers to defend him in the damages phase of this civil proceeding, claiming that he could not afford to. Keating was scheduled to go on trial in Los Angeles in October on federal criminal charges of fraud, conspiracy, and racketeering stemming from the 1989 collapse of Lincoln.

On June 24, former Columbia Savings and Loan Chief Executive Thomas Spiegel was indicted on 55 criminal counts; the federal charges allege that Spiegel misappropriated millions of dollars from the now-defunct S&L. Among other things, federal officials contend that Spiegel made misrepresentations to federal regulators and Columbia's board of directors regarding his compensation; used $1 million of the S&L's money to buy a vacation condominium in Palm Springs for his family; and used the S&L's money to buy tens of thousands of dollars worth of firearms and accessories. If convicted, Spiegel faces up to 275 years in prison and $13 million in fines. Columbia failed in January 1991, largely due to losses on its huge holdings of real estate and risky, high-yield junk bonds; the total cost of the S&L's failure to taxpayers is estimated at $1.2 billion. *[11:2 CRLR 128–29]*

In ***Statesman Savings Holding Corporation and Glendale Federal Bank v. United States***, Nos. 90-773C and 90-772C (July 24, 1992), both plaintiffs acquired failing savings and loan institutions prior to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA); in both cases, plaintiffs negotiated certain terms, such as capital standards, with the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation. Following FIRREA's enactment, Statesman and Glendale were no longer afforded the favorable terms that had been part of their agreement with the federal government. Plaintiffs claimed that FIRREA's enactment breached their contracts with the government and effected a taking in violation of the fifth amendment of the U.S. Constitution.

Relying on its previous ruling in *Winstar Corporation v. U.S.*, 21 Cl.Ct. 112 (1990), the U.S. Claims Court granted plaintiffs' motion for summary judgment as to liability, finding that the agreements between plaintiffs and the federal government constituted contracts, and that the enactment of FIRREA breached those contracts in light of the sovereign acts doctrine. As a result of its finding, the court deferred consideration of plaintiffs' constitutional claim. Although the court found that plaintiffs are entitled to restitution, it did not set that amount; instead, anticipating an appeal by the federal government, the court certified its decision for interlocutory appeal to the U.S. Court of Appeals for the Federal Circuit. (For a summary of a related case, see *12:1 CRLR 129–30.*)