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THE SALE OF CREDIT LIFE INSURANCE: THE BANK AS FIDUCIARY

MARK BUDNITZ†

Banks and savings and loans recently began expanding significantly the services available to their customers. This development could alter drastically the legal relationship between the two parties. Professor Budnitz focuses on a well-established and prevalent service, the sale of credit life insurance, as a prototype for exploring the potential rights and obligations of the bank and its customer when involved in transactions other than the traditional loan agreement. Banks sell credit life insurance as part of nearly every consumer loan not involving real estate. When a customer requests that the bank procure credit life insurance but the bank fails to do so, courts determine whether to impose fiduciary obligations on the bank by applying one of three theories of fiduciary law. Professor Budnitz critically analyzes these theories and concludes that the bank should be considered the agent of the customer and that the transaction should be governed by traditional agency law.

Substantial disagreement and confusion exist among judicial decisions over who bears the risk of loss in transactions between banks and their customers. One cause of this inconsistency among the courts is the failure of most courts to consider seriously the legal relationship between the two parties. At the other extreme, some courts define the legal relationship, but do so by squeezing the transaction into a doctrinal mold that does not fit. As banks offer new financial services¹ and institutions that are not banks offer banking services,² the need to establish clearly the legal relationship between customers and these various institutions becomes crucial.

The case law is in disarray in part because the legal relationship between the parties varies depending upon the type of transaction and the particular stage of the transaction at which a dispute occurs. This Article focuses on one stage of the consumer loan transaction, the sale of credit life insurance. This is an important area because this type of insurance is sold as part of nearly every consumer loan other than those involving real estate,³ and every year billions

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1. See generally *Thriffs Look to Insurance to Boost Profits*, Am. Banker, Feb. 28, 1983, at 1, col. 1; Arvan, *Merrill Forges Creative Partnership With Banks*, Am. Banker, Feb. 22, 1983, at 1, col. 2; McMurray, *Chase Manhattan Set to Buy Fourth Biggest Discount Firm*, Am. Banker, Feb. 14, 1983, at 1, col. 3.

2. See generally *Sears Will Sell Financial Services Worldwide*, Am. Banker, March 2, 1983, at 1, col. 2; *New Hampshire Lets Fidelity Establish Bank*, Am. Banker, Feb. 10, 1983, at 1, col. 1.

3. R. SABLE & W. OGBURN, *LIMITATION AND REGULATION OF CREDIT PROPERTY INSURANCE* 19 (1978); Sheffey, *Credit Life and Disability Insurance Disclosures Under Truth-in-Lending: The Triumph of Form Over Substance*, 8 FLA. ST. U.L. REV. 463 n.2 (1980).

of dollars⁴ worth of credit life is sold to millions of consumers. In addition, examining decisions involving credit life insurance provides valuable insights in developing an approach to legal relationships between banks and customers in other types of banking transactions.

Focusing on the legal relationship between the parties provides a helpful neutral ground for wrestling with the emotion-laden problems courts confront when dealing with consumer-creditor disputes. Consumer representatives point to cases involving sick, illiterate, helpless debtors who were victimized by rapacious, overreaching, deceitful creditors.⁵ They often urge enactment of statutes and regulations to protect consumers. Creditors claim they are being strangled by excessive regulation even though most creditors engage in reasonable practices. In addition, creditors claim that competition in the marketplace ensures that consumers will not be exploited.⁶ Needed is an approach that will enable courts to assess the social and economic realities of the transaction, consider the needs of each side, and decide on the rights and liabilities of each within the framework of a neutral legal doctrine. In reviewing the current state of the law on the sale of credit life insurance, this Article will show how identifying the appropriate legal relationship between the parties can provide this framework and satisfy consumer needs without further regulation.

This study focuses primarily on cases that have addressed the legal relationship between the parties to determine if the bank is in the position of a fiduciary when it sells credit life insurance. To provide necessary background, this Article describes the credit life insurance industry and summarizes the general fiduciary law. Cases in which fiduciary duties have been imposed on banks are then examined. These cases have been decided in apparent isolation, with each court seemingly unaware of the approaches most other courts have adopted. As a result, no consistent analytical framework has emerged. The decisions are best understood and evaluated by examining them within the general framework of fiduciary law. From this perspective, the cases fall into three categories to which fiduciary obligations may apply: (1) contract to procure insurance and entrusting of premiums, (2) trust and confidence, and (3) agency.

In the first category of cases, after the bank fails to obtain insurance, consumers often contend that a contractual relationship, imposing an obligation on the bank to procure insurance, arose when the consumer signed a Truth in Lending disclosure statement. In addition to the contractual obligations, fiduciary obligations may arise if the consumer has paid the premium. The

4. In 1980, 78,446,000 credit life insurance policies were in force in the amount of \$165,215,000,000. AMERICAN COUNCIL OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 34 (1981).

5. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965); *Imperial Discount Corp. v. Aiken*, 38 Misc. 2d 187, 238 N.Y.S.2d 269 (1963); *Arthur Murray Studio, Inc. v. FTC*, 78 F.T.C. 401, 439-41 (1971), *aff'd*, 458 F.2d 622 (5th Cir. 1972).

6. See generally NAT'L COMM. ON CONSUMER FIN. REP., CONSUMER CREDIT IN THE UNITED STATES, 2-3 (1972) [hereinafter cited as NCCF REPORT]; Muris, *Rules Without Reason: The Case of the FTC*, REG., Sept.-Oct. 1982, at 20.

courts are divided on this issue, and a contractual analysis alone cannot resolve all of the questions that these transactions present.

In the second group of cases, other courts impose on the bank the duties of a fiduciary as a result of the trust and confidence that the consumer has reposed in the bank. This approach provides a far more encompassing framework for analyzing credit life insurance issues, but rests on unproven assumptions, does violence to fiduciary principles, and is unfair to banks.

The third line of cases examines the features of the transaction to determine if the bank has acted as the borrower's agent during the sale of the insurance. If it has, certain fiduciary duties follow. This approach provides the most appropriate framework for analyzing the relationship between the parties in the sale of credit life insurance. It treats these transactions primarily as insurance transactions, and subjects banks to the same rules as those governing other agents procuring insurance. It imposes fiduciary duties upon banks, but only if they conduct themselves in ways that create the agency relationship. Far from creating a radical new theory which saddles banks with new responsibilities, this approach imposes fiduciary duties within the well-established traditional framework of agency law.

I. THE CREDIT LIFE INSURANCE INDUSTRY

Credit life insurance is designed to protect the lender. In the event the borrower dies, the insurance company will pay the outstanding obligation and discharge the obligation. Ordinarily credit life is sold as group insurance in transactions that do not involve real estate.⁷ The policy is issued to the lender, not the borrower, and the insured group is designated as those consumers who borrow money from the lender. The lender, as policyholder, pays the premium, but most lenders pass the cost on to the consumer.⁸

In most instances the purchase is an unwise investment for the consumer. The cost of the insurance is high; the profit for the banks is great.⁹ The banks earn substantial income from the sale of this insurance.¹⁰ The cost of the insurance is high because of "reverse competition."¹¹ Reverse competition re-

7. NCCF REPORT, *supra* note 6, at 83. Extensions of credit that do not involve real estate are too small in amount and too short in duration for insurers to make reasonable profits by selling individual policies.

8. NCCF REPORT, *supra* note 6, at 84. Many credit unions do not impose an explicit charge on consumers for credit life insurance. *Id.*

9. *Credit Life Insurance: Hearing Before the Subcomm. on Antitrust, Monopoly and Business Rights of the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. 2, 8 (1979) [hereinafter cited as *Senate Hearing*]; NCCF REPORT, *supra* note 6, at 89. The income derived from the sale of credit life insurance is so significant and the potential for abuse so great that bank regulatory officials have imposed substantial restrictions upon it. *See, e.g.*, Distribution of Credit Life Insurance Income, 12 C.F.R. § 2.4 (1983). The purposes of the regulation and need for it are discussed in 41 Fed. Reg. 29,846 (1976); 42 Fed. Reg. 48,518 (1977) (codified at 12 C.F.R. § 2.4) (proposed July 20, 1976). The regulation was upheld in *Independent Bankers Ass'n. v. Heimann*, 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied*, 419 U.S. 823 (1980).

10. Sheffey, *supra* note 3, at 466.

11. R. SABLE & W. OGBURN, *supra* note 3, at 18; NCCF REPORT, *supra* note 6, at 85; *Senate Hearing*, *supra* note 9, at 247-48.

fers to the competition between insurance companies to offer the most expensive policies rather than the least expensive. Creditors prefer the former because the higher the premium, the greater the creditor's profit. In addition, the cost of the total premium is charged up front, but the consumer pays the premium in installments, incurring a finance charge on the insurance premiums as well as on the loan principal.¹² Because there is no individual underwriting, everyone is charged the same rate regardless of age or life expectancy.¹³ Thus, the insurance is more costly for younger borrowers than for older and more costly for women than for men. Many consumers purchase unneeded coverage.¹⁴ They already are adequately insured, or if they die, the unpaid debt will not adversely affect anyone except the bank. If they do need or want insurance protection, purchasing regular long-term life insurance from an independent agent provides greater coverage at a more economical rate.¹⁵

If credit life insurance is an unwise purchase, why do almost all borrowers obtain it? Many are not even aware they have bought it because it is sold as part of a loan package.¹⁶ Others believe it is required although usually it is not.¹⁷ Still others mistakenly believe it is a sound investment. The cost per month is quite small and since it is incidental to the loan, which is their principal focus of attention and concern, they do not engage in comparative shopping to determine its true value.¹⁸

For some, credit insurance is advisable. For example, credit life may make sense if the household's wage earner is using the loan to purchase a necessity such as a car, the bank has taken a security interest in the car, the deceased's estate will be small, and he or she wants the nonworking spouse to be able to own the car free of the security interest. The purchase of credit life insurance from the bank may be prudent in this case if the borrower cannot obtain regular insurance for health reasons or if the borrower is elderly and resides in a state that has imposed somewhat reasonable limits on credit insurance rates.¹⁹ The consumer always benefits from credit insurance when borrowing from the many credit unions and far fewer banks that do not charge the consumer any fee for the insurance.

In the typical case the spouse of a deceased borrower alleges that the borrower desired credit life insurance and believed the bank had purchased it. The bank actually had not purchased insurance or had purchased a kind different from that which the borrower understood would be purchased. When insurance is not procured, the situation is replete with ironies. If the borrower

12. *Senate Hearing, supra* note 9, at 6-7.

13. *Id.* at 12, 109.

14. *Id.* at 55.

15. *Id.* at 6; *Credit Insurance: The Quiet Overcharge*, CONSUMER REP., July 1979, at 415, 417.

16. *Senate Hearing, supra* note 9, at 41, 47-48; R. SABLE & W. OGBURN, *supra* note 3, at 19; E. WILLIAMS, *CREDIT INSURANCE: A HANDBOOK FOR CONSUMERS* 6 (1977).

17. R. SABLE & W. OGBURN, *supra* note 3, at 19.

18. *Id.*; NCCF REPORT, *supra* note 6, at 86.

19. *Credit Insurance, supra* note 15, at 417.

really wanted the insurance, he or she was probably making an unwise decision. The bank, far from seeking intentionally to frustrate the borrower's wishes, would have been only too happy to sell the insurance to the debtor since the bank profits so handsomely from the sale. Nevertheless, for some reason the transaction was not completed and the borrower was not covered. Although most consumers would be better off if banks frequently failed to obtain and collect premiums for this insurance, the cases analyzed in this Article involve those relatively rare instances in which the borrower dies and the surviving spouse now claims the bank violated its duty by not obtaining proper coverage. The legal source of that duty is crucial. If the duty arises from a fiduciary relationship, banks may have to alter substantially their business practices in the sale of credit life insurance.

II. THREE SOURCES OF THE FIDUCIARY RELATIONSHIP

This Article explores three lines of credit life insurance cases in which courts have found a fiduciary relationship may exist between the consumer-borrower and the bank at the time of procurement of the insurance. A review of fiduciary law relevant to these three approaches will provide the necessary doctrinal framework in which to analyze these cases.

The "most traditional"²⁰ fiduciary relationship exists when one person "entrusts" another with his money or property²¹ with the understanding that the latter will use the money for the benefit of and consistent with the desires of the former. Although the latter now has title and control of the money, the former is the beneficial owner. Consequently, the person possessing the money must act consistent with the owner's interests. This approach is attractive because in the typical case it will not be too difficult to determine whether there has been an entrusting of money.²² In credit life insurance transactions, however, entrusting applies only to cases in which the customer has paid the premium to the bank. In addition, in order for the bank entrusted with the money to be held to fiduciary standards of conduct, it must bind itself in some way.²³ This requirement is met when there is a contractual relationship between the bank and the borrower. Courts are divided on when such a relationship exists. Even if there is a contract, the entrusting theory does not

20. J. SHEPHERD, *THE LAW OF FIDUCIARIES* 52 (1981). Although fiduciary law has been examined in the context of specific types of transactions, there have been few attempts to treat the topic as a whole. See Jacobson, *Essay—Capturing Fiduciary Obligation: Shepherd's Law of Fiduciaries*, 3 CARDOZO L. REV. 519 (1982).

21. P. FINN, *FIDUCIARY OBLIGATIONS* 89-90 (1977); Sealy, *Fiduciary Relationships*, 1962 CAMBRIDGE L.J. 69, 75. The fiduciary obligation is based on many trust principles, but has been defined in a way that is broader than the formal trust and has been applied to circumstances well beyond traditional trust situations. See generally P. FINN, *supra*, at 89; Jacobson, *supra* note 20, at 520.

22. *E.g.*, Hamby v. St. Paul Mercury Indem. Co., 217 F.2d 78, 80 (4th Cir. 1954); Commissioner v. Owens, 78 F.2d 768, 773 (10th Cir. 1935); Manufacturers' Casualty Ins. Co. v. Mink, 129 N.J.L. 575, 578, 30 A.2d 510, 512 (1943).

23. J. SHEPHERD, *supra* note 20, at 65; P. FINN, *supra* note 21, at 107.

address many issues that arise in these transactions. When it does apply, it is unclear what responsibilities fiduciary status imposes on the bank.

A second basis for imposing fiduciary status arises when one party reposes trust and confidence in another. The cases that find a fiduciary relationship based upon this theory require that there be an unequal relationship between the parties,²⁴ that one party dominate the other, that the weaker party rely on the stronger, and the stronger have the discretion to exploit his power and take financial advantage of the weaker.²⁵ The theory has been applied in many instances in which the dominant party acts as an adviser.²⁶ Since the banker often is an adviser in the sale of credit life insurance, this approach could be fruitful. This theory has been criticized, however, as being descriptive rather than analytical:²⁷ "[T]his is a principle taken out of the air, an ethical or moral imperative."²⁸ It involves applying "a moral rule, *as if it were a legal rule*, to determine legal rather than moral consequences."²⁹ It has been recommended that the better approach is to "identify a *legal* rule that furthers this moral imperative"³⁰ In addition, often it is difficult to determine from the facts whether trust and confidence have been reposed because the theory is so vague.³¹ It has been applied in cases in which the weaker party has not actually placed trust and confidence in the other.³² Finally, the theory can be criticized for not providing guidance about what responsibilities flow from the fiduciary status.³³

Courts often have rejected arguments that a fiduciary relationship exists by finding that there was an arm's length relationship between the parties,³⁴ that the plaintiff failed to prove both parties understood a special trust or confidence had been reposed,³⁵ or that neither party reasonably could expect that the alleged fiduciary would act "solely or primarily" on behalf of the party claiming breach of a fiduciary duty.³⁶

The credit life insurance cases relying on the trust and confidence ap-

24. See *Umbaugh Pole Bldg. Co. v. Scott*, 58 Ohio St. 2d 282, 287, 390 N.E.2d 320, 323 (1979); J. SHEPHERD, *supra* note 20, at 61; Wolinsky & Econome, *Seduction in Wonderland: The Need for a Seller's Fiduciary Duty Toward Children*, 4 HASTINGS CONST. L.Q. 249, 266 (1977).

25. J. SHEPHERD, *supra* note 20, at 84; Wolinsky & Econome, *supra* note 24, at 266.

26. J. SHEPHERD, *supra* note 20, at 28-32.

27. *Id.* at 63.

28. *Id.* at 57.

29. *Id.* at 57 n.36; but see Shepherd's acknowledgment that "in all fiduciary situations we are, whether we intend to or not, making a moral judgment." *Id.* at 60. See also Wolinsky & Econome, *supra* note 24, at 265.

30. J. SHEPHERD, *supra* note 20, at 57 n.36.

31. *Id.* at 59. Because it is difficult to determine whether trust and confidence have been reposed, some courts impose a heavy burden of proof upon the party seeking to establish the fiduciary relationship. See, e.g., *Vargas v. Esquire, Inc.*, 166 F.2d 651, 653 (7th Cir. 1948).

32. J. SHEPHERD, *supra* note 20, at 58.

33. *Id.* at 63.

34. E.g., *Umbaugh Pole Bldg. Co. v. Scott*, 58 Ohio St. 2d 282, 287, 390 N.E.2d 320, 323 (1979).

35. *Id.* at 286, 390 N.E.2d at 323.

36. *Id.* at 287, 390 N.E.2d at 323; accord *Cranwell v. Oglesby*, 299 Mass. 148, 152, 12 N.E.2d 81, 83 (1937).

proach provide a testing ground for the criticisms of the theory and illustrate the extent to which some courts have departed from the traditional application of this theory.

Finally, the third basis for imposing a fiduciary status arises when the facts indicate two parties are in certain relationships, such as attorney-client, guardian-ward, executor-heir, and principal-agent. The principal-agent relationship will be described and explored at length in this Article because of its applicability to the sale of credit life insurance. Finding fiduciary status on this basis has several advantages. Because objective facts determine whether a person was an agent,³⁷ there is less uncertainty about when the relationship exists than under the trust and confidence approach. If the relationship is present, a well-developed body of law delineates the duties that are imposed upon the fiduciary. The agent's powerful position justifies imposing these duties. Courts impose fiduciary duties upon agents because the agents have the discretion to take actions on behalf of their principal that may affect the legal position of the principal.³⁸ The imposition of stringent responsibilities prevents the agent from abusing his discretion. Although the laws of agency and trust and confidence are separate and distinct, commentators have noted the commonality of the two.³⁹ In a sense, the principal has put his trust or confidence in his agent. In contrast to the trust and confidence approach, however, agency law provides a set of legal rules, not just a moral imperative.

III. THE FAILURE TO PROCURE INSURANCE: CONTRACT AND ENTRUSTING AS BASES FOR THE FIDUCIARY STATUS

The entrusting theory of fiduciary law applies when there is a contract between the borrower and the bank to procure credit life insurance and the borrower has paid all or a portion of the premium to the bank. The contract is the vehicle by which the borrower transfers powers to the bank.⁴⁰ Some courts, however, have never reached the fiduciary issue because they have found that no contractual relationship exists because the customer and the bank never signed a formal agreement in which the bank promised to purchase the insurance.

On the surface one would assume that this question could be resolved easily by judicial application of neutral contract rules. The courts are divided, however, because along with other documents most consumers are presented not only with a Truth in Lending disclosure statement explaining that credit life insurance is not required but also are provided a statement such as "I

37. See *infra* notes 128-36 and accompanying text.

38. Weinrib, *The Fiduciary Obligation*, 25 U. TORONTO L.J. 1, 4 (1975); see J. SHEPHERD, *supra* note 20, at 98. One commentator has noted that the grant of power by the principal to the agent is analogous to a trust. Seavey, *The Rationale of Agency*, 29 YALE L.J. 859, 863 (1920).

39. E. HUFFCUTT, *THE LAW OF AGENCY* 7 (2d ed. 1901); J. STORY, *COMMENTARIES ON THE LAW OF AGENCY AS A BRANCH OF COMMERCIAL AND MARITIME JURISPRUDENCE* 12-13 (9th ed. 1882).

40. See generally J. SHEPHERD, *supra* note 20, at 99.

desire credit life insurance," under which they place their signatures.⁴¹ Consumers have contended that the disclosure and the signature created a contract obligating the bank to procure the insurance. The bank's failure to do so could constitute a breach of contract for which the bank may be liable. While some courts accept this argument and will impose fiduciary duties when premiums have been paid, others have rejected it. The decisions illustrate very different judicial approaches toward the relationship between customers and banks and demonstrate the need for a general conceptual approach that looks beyond the narrow question whether a contract to buy insurance existed.

Some courts have refused to find the bank liable even though the borrower signed the disclosure. The opinion of the district court in *Burgess v. Charlottesville Savings and Loan*⁴² typifies this approach. In *Burgess* a widow sued on a contract theory because of the lender's failure to purchase credit insurance when her mortgage was approved. Pursuant to the credit transaction, the lender presented to the borrowers a Truth in Lending disclosure statement that informed them of the cost of credit life and disability insurance. The statement said, among other things: "No charge is made for such insurance and *no such insurance is provided unless the borrower signs the appropriate statement below.*"⁴³ The "appropriate statement," "I desire Credit Life & Disability Income insurance coverage," was signed by the widow and her husband.⁴⁴ No formal application for credit insurance was filled out.

The court rejected the widow's contention that the signed Truth in Lending statement constituted an agreement by the bank to procure credit life insurance. The court found no agreement because the bank was not authorized by the insurance company to procure insurance unless the borrower completed an application.⁴⁵ The borrower was "charged, at law" with notice of the bank's incapacity to purchase insurance under these circumstances.⁴⁶ The role of the Truth in Lending statement was limited. It was not "intended to form a contract to procure insurance."⁴⁷ Rather, it merely notified the lender of the borrower's interest in credit insurance and as such is "part of the preliminary negotiations leading to a contract to procure insurance rather than a contract

41. To increase the attractiveness of the loan, creditors keep the finance charge as low as possible. The Federal Truth in Lending Act and accompanying Regulation Z provide that the lender need not include the cost of credit insurance in the finance charge, provided two conditions are met. First, purchase of the insurance must be voluntary. Second, the lender must provide a written statement disclosing that insurance is not required and indicating its cost. 15 U.S.C. § 1605(c) (1976); 12 C.F.R. § 226.4(d) (1983). In addition, the consumer must "give specific affirmative written indication of his desire" to purchase the insurance. 15 U.S.C. § 1605(b)(2) (1976). For transactions entered into prior to Oct. 1, 1982, the consumer also had to give a specifically dated and separately signed indication of his desire for insurance. 12 C.F.R. § 226.4(a)(5)(ii), *repealed by* 46 Fed. Reg. 20,848 (1981).

42. 349 F. Supp. 133 (W.D. Va. 1972) *vacated and remanded with instructions to dismiss*, 477 F.2d 40 (4th Cir. 1973).

43. *Id.* at 135-36 (emphasis added).

44. *Id.* at 136.

45. *Id.* at 137.

46. *Id.* This presumption that consumer borrowers know the law was rejected in *Hutson v. Wenatchee Fed. Sav. & Loan Ass'n*, 22 Wash. App. 91, 100, 588 P.2d 1192, 1197 (1978).

47. *Burgess*, 349 F. Supp. at 140.

itself.”⁴⁸ Its function is merely to “exchange information.”⁴⁹ Consequently, any agreement to procure insurance would arise from an offer and acceptance that might occur after the disclosures in the statement.⁵⁰ The court found that the statement could not constitute the meeting of the minds necessary to form a contract because the statement omitted many of the terms that a contract to procure insurance must contain.⁵¹ Finally, the court found that even if the parties had made a contract to purchase insurance, the bank could not be held liable for breach of the contract since Virginia law made it impossible for the bank to perform the contract unless the borrower had submitted an application.⁵²

The precedential value of this opinion is questionable in several respects. The Court of Appeals for the Fourth Circuit remanded the case to the district court, with instructions that it be remanded to the state court from which the Fourth Circuit found it had been improperly removed. The court ruled that whether the language in the lending statement created a contractual right was a question of state law.⁵³ Furthermore, *Burgess* can be distinguished on its facts. The loan was for the purchase of a home with a payback period of twenty-five years. The court found that purchasing credit life insurance for real estate mortgages is not the usual practice. The bank did not have a group policy; rather it accepted only individual applications which it forwarded to an insurance carrier. In addition, several requirements of Virginia law made this a particularly difficult case in which to find the bank liable. A different factual setting is presented by cases arising outside of Virginia that involve loans other than real estate loans, in which the bank typically has a group policy and almost every borrower buys credit life insurance.

Finally, the district court's contractual analysis is suspect. In finding no contract to procure insurance, the court did not give due regard to well-established contract rules. For example, a party's secret intent is immaterial. If a reasonable person would understand conduct as importing a promise to perform an act, the actor will be held to the promise.⁵⁴ Whether there was a meeting of the minds is determined by whether the parties' conduct indicates an agreement.⁵⁵ Courts which believe that the parties' conduct demonstrated an intention to form a contract look with disfavor upon the argument that an agreement does not contain sufficient detail, and reject contracts for indefiniteness only as a last resort.⁵⁶

In *Burgess* certain facts indicated the parties intended to form a contract

48. *Id.*

49. *Id.* at 141.

50. *Id.*

51. *Id.* at 140.

52. *Id.*

53. *Burgess v. Charlottesville Sav. & Loan Ass'n*, 477 F.2d 40, 44 (4th Cir. 1973).

54. *E.g.*, *Hudson v. Columbian Transfer Co.*, 137 Mich. 255, 100 N.W. 402 (1904).

55. *E.g.*, *Lucy v. Zehmer*, 196 Va. 493, 84 S.E.2d 516 (1954).

56. *E.g.*, *Wedtke Realty Corp. v. Karanas*, 286 A.D. 339, 143 N.Y.S.2d 198, *aff'd*, 309 N.Y. 904, 131 N.E.2d 579 (1955).

to procure insurance. The bank presented the borrower with a document stating: "I desire Credit Life & Disability Income insurance coverage."⁵⁷ The borrower signed below that statement. The document also said the insurance would cost \$11.95 per month. The borrower completed and signed a "Statement of Loan Settlement," which itemized various charges that made up the monthly installment payment. One item was a charge of \$11.95 for "Mutual Mortgage Insurance."⁵⁸

The district court did not seriously consider these facts and the possibility that a contract had been formed. It declared that the Truth in Lending disclosure "was not intended to form a contract to procure insurance"⁵⁹ without explaining to whose intent it was referring. It did not examine the bank's intent as manifested by the paper the bank had the consumer sign, or its failure at that time to do anything to counter the borrower's reasonable expectation that the bank was agreeing to purchase credit insurance. The court found no contractual meeting of the minds because of the lack of detail in the Truth in Lending disclosure.⁶⁰

There can, however, be a meeting of the minds as long as the parties manifest the intention to form a contract to procure insurance. Although a document may be so devoid of detail that it indicates there was no intention to enter into an agreement, the complexity of insurance coupled with consumers' ignorance of insurance terms make it doubtful that any contract to procure could meet the court's requirement that the parties "achieve mutual agreement of the terms."⁶¹ The court pointed out that the disclosure statement did not indicate from which insurance carrier the bank would procure insurance.⁶² It seemed to insist that this omission constituted a fatal lack of specificity. This reasoning is contrary to general insurance law.⁶³ Moreover, most consumers probably do not know one credit insurance company from another, and do not care which one is used unless the cost and coverage varies from one to another. The district court in *Burgess*, however, implied that notice of the name of the company, regardless whether that information will have any effect on the consumer's intention to enter into an agreement, must be stated in the contract. The court failed to adhere to the general approach of courts not to find absence of a contractual relationship due to insufficient detail.⁶⁴ The court should have tested the adequacy of the disclosure by ascertaining whether the obligations of the parties were reasonably certain and the terms were definite enough to enable the court to determine whether the obligations had been or could be performed.⁶⁵

57. *Burgess*, 349 F. Supp. at 136.

58. *Id.*

59. *Id.* at 140.

60. *Id.*

61. *Id.*

62. *Id.*

63. R. KEETON, BASIC TEXT ON INSURANCE LAW 52 (1971).

64. *E.g.*, *Wedtke Realty Corp. v. Karanas*, 286 A.D. 339, 143 N.Y.S.2d 198, *aff'd*, 309 N.Y. 904, 131 N.E.2d 579 (1955).

65. *See Heldenbrand v. Stevenson*, 249 F.2d 424, 427 (10th Cir. 1957).

Rather than looking at the intention of the parties as manifested by their conduct and applying traditional principles, the court charged the borrower "with knowledge of the steps necessary to make a contract of insurance"⁶⁶ under Virginia law, and charged them with notice of the bank's lack of authority to procure insurance without an application. Apparently the consumers also were charged with knowledge of the role of the Truth in Lending statement in forming contracts to procure credit insurance and the relationship between the statement and state statutes, even though the court cited no authority to support its interpretation of the relationship.

The Maryland Supreme Court in *Peer v. First Federal Savings and Loan Association*⁶⁷ also rejected the claim that the lender was liable for failure to purchase credit insurance despite the borrowers having indicated a desire for the insurance on the Truth in Lending disclosure statement. The court, relying on *Burgess*, found no contract.⁶⁸ The facts in *Peer* were significantly different, however, and the court could have found no contract without adopting *Burgess*' myopic approach. Unlike the disclosure statement in *Burgess*, the statement in *Peer* disclosed no cost for the insurance.⁶⁹ That item was left blank. In addition, at the time of the loan commitment the S&L sent the borrowers a letter urging them to purchase credit insurance, stating the cost would be included in the monthly payment "if you adopt the plan,"⁷⁰ and informing them the S&L had arranged for a life insurance salesman to visit them and talk about the specifics since the S&L was not in the business of selling life insurance.⁷¹ The salesman never came. From these facts the court acted reasonably in finding that the borrower had no reasonable expectation of insurance coverage despite the implication of the Truth in Lending statement.

Other courts have repudiated *Burgess* by giving greater effect to the Truth in Lending disclosure statement. In *Burgess* the lender contended and the district court agreed that the function of the disclosure statement is to provide the borrower with information on the cost of credit prior to entering into a contractual relationship and that the disclosure statement could not be considered to be a contract to procure insurance. In *Sutton v. First National Bank*⁷² the Tennessee Court of Appeals adopted the Fourth Circuit's determination⁷³ that the disclosure statement could be the "basis for the creation of a contract" to purchase insurance.⁷⁴ The bank argued that it was not liable when it inadvertently failed to purchase credit insurance because the only reason it included the disclosure statement was to comply with the Truth in Lending Act, and it never intended the statement to be regarded as an offer to buy insurance. The

66. *Burgess*, 349 F. Supp. at 137.

67. 273 Md. 610, 331 A.2d 299 (1975).

68. *Id.* at 615, 331 A.2d at 302.

69. *Id.* at 612, 331 A.2d at 300.

70. *Id.* at 613, 331 A.2d at 300.

71. *Id.*

72. 620 S.W.2d 526 (Tenn. Ct. App. 1981).

73. *Burgess*, 477 F.2d 40 (4th Cir. 1973).

74. *Sutton*, 620 S.W.2d at 529.

court rejected the bank's contentions, pointing out that, unlike the situation in *Burgess*, the consumer in *Sutton* was not required to complete a separate credit insurance application.⁷⁵ The language used in the disclosure statement clearly and unambiguously constituted an offer to purchase insurance. Given this language, the bank's unexpressed intention with regard to the disclosure was immaterial. When the consumer signed below the line that read, "I do desire Credit Life Insurance," he accepted the bank's offer.⁷⁶ The bank did not deduct the insurance premium from the loan or separately bill the consumer for the premium. In fact, the loan officer failed to notice that the consumer had signed the form indicating his desire to buy insurance and the matter of credit insurance had never been discussed by the borrower and any employees of the bank. The court attached no legal significance to these circumstances. What mattered was that the bank had made an offer that the customer had accepted.⁷⁷

In *Parnell v. First Savings and Loan*⁷⁸ the borrower signed the disclosure statement and orally informed the bank officer he wanted to buy credit insurance. The borrower paid the bank the first year's premium and the cost of the second year's premium was added to the monthly payment schedule. The bank failed to purchase the insurance. A separate credit life insurance application was required but the bank employee forgot to have the consumer sign it. The omission of the consumer's signature on the application apparently was the reason for the bank's failure to purchase the insurance, but the bank not only neglected to return the money paid for the first year's premium, but also accepted four monthly payments that included a charge for the second year's premiums before the borrower died. The court distinguished *Peer* in particular because in *Peer* the papers given to the consumer never contained any charge for credit insurance and no premiums were ever paid by the consumers.⁷⁹ The *Parnell* court held that there was a contract between the parties that obligated the bank to purchase insurance.⁸⁰ In addition, the court found that the bank stood in a fiduciary capacity that obligated it to use the money paid by the consumers to buy insurance.⁸¹ Although not explained in the opinion, the court may have been applying the doctrine that a fiduciary relationship arises when one entrusts another with his property.⁸²

The wider scope of analysis employed in *Sutton* and *Parnell* provides a welcome alternative to the *Burgess* court's narrow approach. First, their analyses more appropriately recognize the elements involved in these transactions. These transactions may involve both oral representations regarding the

75. *Id.* at 530.

76. *Id.* at 531.

77. *Id.* at 532.

78. 336 So. 2d 764 (Miss. 1976).

79. *Id.* at 766-67.

80. *Id.* at 768.

81. *Id.* at 767-68.

82. See generally *Central Stock & Grain Exch. v. Bendinger*, 109 F. 926, 929 (7th Cir.) (applying agency theory), *cert. denied*, 183 U.S. 699 (1901); *Quinn v. Phipps*, 93 Fla. 805, 813-15, 113 So. 419, 422 (1927) (applying constructive trust theory); J. SHEPHERD, *supra* note 20, at 52.

purchase of insurance, papers that look like contracts to reasonable consumers, and representations and conduct after the loan was made that bear upon the question before the court. The *Burgess* court focused on the absence of an insurance application. Since the insurance company never received a completed application the court refused to hold the bank liable even though the customers had indicated their intention to acquire insurance through the bank. The court ignored the issues concerning the bank's appropriate responsibilities based on its conduct with its customer. In *Parnell* the court refused to bury its head in the sand; instead it looked at what actually happened between the bank and the borrower to decide if a greater responsibility should be imposed on the bank.

The *Parnell* court faced the easiest factual setting because *Parnell* was the only case in which the borrower paid the premium. The bank was in a difficult position—trying to argue it could avoid liability for failing to buy insurance when it charged for and collected insurance premiums. There was a potential sticking point, however, in the consumer's failure to sign the credit insurance application. The insurance company probably required a signed application before it would agree to insure the borrower. The bank officer testified he sent the borrower a letter urging him to sign the application and mentioned it to the borrower when he saw him at a meeting.⁸³ On the other hand, the borrower's widow denied the letter was received and asserted that her husband believed he was covered. The court did not attach any significance to these factual disputes. Nor did the court indicate that it would sympathize with the contention that it is the responsibility of the borrower to sign an insurance application. Instead, the court felt that it was the bank's obligation to make sure the consumer signed; having failed to do so, the bank was liable. Merely sending a letter and postponing the purchase of insurance unless and until the consumer takes the required action was not sufficient.

It is not clear, however, what the bank should have done. Although the court said the bank had a duty to purchase insurance, the bank may not have been able to do so without a signed application. Consequently, the decision may implicitly impose upon the bank the duty to obtain the consumer's signature through affirmative action beyond sending a letter. This might require sending a notice that clearly informs the consumer of the consequences of failing to sign the application; it may require sending the notice by registered or certified mail; it may even require a personal visit to the debtor's home or place of business.

If this is what the court had in mind, it obviously was imposing duties far beyond those demanded by holding that a contractual relationship existed. If the court had gone only as far as *Sutton*, and simply found a contractual relationship that imposed an obligation to purchase insurance, then a curt letter advising the borrower of the need to complete an application might be suffi-

83. *Parnell*, 336 So. 2d at 765.

cient. If the bank is a fiduciary, however, it may have the obligation to take the vigorous action suggested above.

The *Parnell* court held the bank responsible for the customer's failure to sign the application and refused to attach importance to the letter that the bank allegedly sent. In so doing, the court ignored the obstacles facing a bank charged with buying insurance when the insured has not signed the policy. Instead, *Parnell* cast the bank as a fiduciary with the responsibility of taking the necessary steps to purchase insurance for its customer.

In *Parnell* the court forced the bank to observe fiduciary responsibilities because the consumer had paid the premium. The question arises whether paying the premium should be determinative. For example, suppose the facts are the same except for payment. That is, the consumer orally informs the banker he wants to buy credit insurance. He signs the disclosure statement, which asserts that he desires credit insurance. He neglects to sign the credit insurance application. But instead of paying the first year's premium, he signs a contract requiring him to pay the premiums in monthly installments. The bank fails to purchase credit life insurance because the application is not signed; the debtor dies before the first installment is due. Under *Sutton* a contractual relationship has been created, but this would impose no extraordinary duties upon the bank in regard to the unsigned application. The *Parnell* court would reach the same result because the fiduciary relationship was dependent upon the bank having received premiums, and none were received in the situation posed here.

Should the bank's obligation to obtain a signed insurance application be any less merely because no money for insurance was paid at the time the borrower died? It is unreasonable to rest the bank's duty on whether a premium has been paid when every other facet of the bank-borrower relationship is the same. Yet exclusive reliance on the entrusting approach seems to require this distinction, for only if money is paid can the analysis break out of the limits of contract obligations and into those of fiduciary relationships. Consequently, it is necessary to examine alternative approaches to analyzing the legal relationship between banks and consumer borrowers. In addition, the cases discussed above involved the failure of the bank to purchase credit insurance. Consumers, however, face several other difficulties when purchasing this type of insurance. The cases discussed above do not provide guidance for a more general approach that would apply to these other situations.

IV. THE BANKER AS FIDUCIARY: REPOSING TRUST AND CONFIDENCE IN THE BANKER

Recent cases from Ohio and Washington have gone far beyond a contract and entrusting analysis and have radically altered the traditional legal relationship between the bank and the consumer borrower. Ordinarily, when a bank loans money it has the superior legal status of a creditor; the borrower is in the inferior position of a debtor. As a lender the bank has the minimal

duties to act in good faith⁸⁴ and to refrain from misrepresenting the terms of the loan.⁸⁵ In a few cases, the courts have upset this relationship by imposing fiduciary or quasi-fiduciary duties upon the bank for the sale of credit life insurance pursuant to a loan on the theory that the borrower placed trust and confidence in the bank. Unlike the contract and entrusting approach, application of this fiduciary doctrine is not unduly narrow. The courts that have taken this tack, however, have done violence to fiduciary concepts and imposed an onerous burden on the banks.

A. Ohio—*The Banker as Fiduciary*

As described in part II, before finding that a person is a fiduciary because another has placed trust and confidence in him, courts require proof that the parties did not deal at arm's length and that the parties knew or should have known that one party would act primarily on behalf of the other. The Ohio Supreme Court adhered to these rules in a 1979 case, *Umbaugh Pole Building Co. v. Scott*,⁸⁶ in which a financial institution provided substantial advice and counseling to the debtors. Because the parties dealt at arm's length and the borrowers should have realized the institution was acting on its own behalf, the court held that no fiduciary relationship existed.

Despite *Umbaugh's* holding, two years later the same court found a fiduciary relationship to exist between a bank customer and an institutional lender in the case of *Stone v. Davis*.⁸⁷ Judy and Danny Davis applied for a mortgage to finance their purchase of a dairy farm. The Ashtabula Savings and Loan Association approved their application and provided them with a Truth in Lending disclosure statement similar to that used by most lenders. The disclosure form included a paragraph that stated, among other things, that no credit life insurance "is provided unless the borrower signs the appropriate statement below." Further down on the form was the statement, "I desire insurance coverage," followed by two blank lines for the borrower's signature and the date. The S&L typed "mortgage" onto the blank space in the statement, and Danny Davis signed and dated on the lines provided under the statement.⁸⁸ The S&L did not purchase insurance and did not advise Davis that he would be responsible for purchasing his own coverage. Consequently, when Davis died and his wife defaulted, the loan was not insured.

The Ohio Supreme Court justified finding a fiduciary relationship in *Stone*, despite its contrary holding in *Umbaugh*, on the basis that "the facts are different."⁸⁹ While admittedly the facts are different, it appears the court may also have changed the test for finding a fiduciary relationship.

84. *Liebergessell v. Evans*, 93 Wash. 2d 881, 892, 613 P.2d 1170, 1177 (1980); *National Bank v. Equity Investors*, 81 Wash. 2d 886, 920, 506 P.2d 20, 41 (1973).

85. *See Hutson v. Wanatchee Fed. Sav. & Loan*, 22 Wash. App. 91, 588 P.2d 1192 (1978).

86. 58 Ohio St. 2d 282, 390 N.E.2d 320 (1979).

87. 66 Ohio St. 2d 74, 419 N.E.2d 1094, *cert. denied*, 454 U.S. 1081 (1981).

88. *Id.* at 75, 419 N.E.2d at 1096.

89. *Id.* at 78, 419 N.E.2d at 1097.

The court defined a fiduciary relationship as "one in which special confidence and trust is reposed in the integrity and fidelity of another and there is a resulting position of superiority and influence, acquired by virtue of this special trust."⁹⁰ The court then reiterated the *Umbaugh* test: "A fiduciary relationship . . . may arise out of an informal relationship where both parties understand that a special trust or confidence has been reposed."⁹¹

The court proceeded to apply its definition and test to the facts before it. In *Umbaugh* the court's refusal to find a fiduciary relationship was based, in part, on the parties' arm's length relationship. In *Stone* the court reaffirmed the importance of the parties' relationship by asserting that a fiduciary relationship is present when one party has a position of "superiority and influence" over the other.⁹² The court acknowledged that when a customer negotiates the terms and conditions of a loan with a bank, they can be presumed to "stand at arm's length," and no fiduciary relationship exists. The court found that once the terms and conditions are agreed upon, however, the transaction enters a new stage that it called "loan processing." One aspect of loan processing includes "advising the customer as to the benefits of procuring mortgage insurance on the property which secures the bank's loan."⁹³ The court found that during loan processing the parties no longer have equal bargaining power.

The court appears to have laid down the following rule: When credit insurance is discussed during the loan processing stage, the parties are in an unequal bargaining relationship. Speaking in general terms about a bank and its customer, the court made the bald assertion: "[I]t is unrealistic to believe that this equality of position (present when the terms of the loan are negotiated) carries over into the area of loan processing"⁹⁴ The court then sought to support its declaration that the parties were unequal by noting various factors present in the case. But the court's language strongly suggests that the customers had not presented facts that proved inequality of bargaining power. Rather, the court seems to have decided that as a matter of policy this inequality should be regarded as a question of law, not one of fact for which the customer had the burden of proof.⁹⁵

The court's difficulty in finding facts that support the reposing of trust and confidence is shared by others applying this theory.⁹⁶ Determining inequality as a question of law seems to support the suggestion that courts often apply

90. *Id.* at 78, 419 N.E.2d at 1097-98.

91. *Id.* at 78, 419 N.E.2d at 1098. Other courts have found a reposing of trust and confidence between a bank and a customer when the transaction did not involve the sale of credit life insurance. *See, e.g.,* *Pigg v. Robertson*, 549 S.W.2d 597 (Mo. 1977); *Stewart v. Phoenix Nat'l Bank*, 49 Ariz. 34, 64 P.2d 101 (1937)(dictum).

92. 66 Ohio St. 2d. at 78, 419 N.E.2d at 1098.

93. *Id.* at 79, 419 N.E.2d at 1098.

94. *Id.* at 78-79, 419 N.E.2d at 1098.

95. *See generally* *Weiner, The Civil Jury Trial and the Law-Fact Distinction*, 54 CALIF. L. REV. 1867 (1966).

96. J. SHEPHERD, *supra* note 20, at 59.

moral rules rather than legal rules in these cases.⁹⁷

The court's opinion in *Stone* is unclear about the lender's role in advising the Davises about credit insurance. The court states generally that banks customarily advise customers about the benefits of buying insurance. Later, the court states that the lender in the instant case "failed to adhere to its customary policy of informing the Davises that they must procure the mortgage insurance themselves"⁹⁸ The court's meaning is unclear. It may be saying the bank was negligent because it failed to follow its customary policy. Or it might have decided that regardless of this lender's policy, it is customary for banks to advise their customers on this topic and it was negligence for the lender not to do so. The court asserts the lender "broached the subject of mortgage insurance and elicited an expressed desire for it by Danny Davis"⁹⁹ From the specific facts recited in the opinion, however, it appears the only action taken by the lender was presenting the Davises with the Truth in Lending disclosure statement.

Nevertheless, having "broached the subject" and obtained Davis' signature, "both sides to the loan transaction must have understood that a special trust or confidence had been reposed in Ashtabula S&L to advise and assist the Davises in procuring the insurance."¹⁰⁰ As with the issue of equality of bargaining power, the court apparently decided this issue as a matter of law rather than finding certain facts had been proven. No evidence was identified that indicates how much the S&L knew of the borrower's circumstances. While the bank may have known that the couple were young and inexperienced dairy farmers, the court recited no representations made by the Davises to the effect that they were at a loss to comprehend the transaction and were relying upon the expertise of the loan officer. These dairy farmers appear similar to the bank customers in *Umbaugh*, in which the borrowers were hog farmers and unfamiliar with this kind of transaction. They put trust and confidence in, and relied upon, the expertise of the Association, a farmer's cooperative established and chartered pursuant to a federal law to assist farmers.

In *Umbaugh* the court partially based its finding of no fiduciary relationship upon the determination that the financial institution was acting primarily on behalf of itself rather than the debtor. In *Stone* the court ignored this part of its prior opinion and instead pointed to the S&L's self-interest to support its holding. The court noted that banks do not act as "disinterested experts"¹⁰¹ when they give advice on mortgage insurance. They have a financial interest in giving this advice since the purchase of this insurance protects the bank's investment and the bank is paid a commission for every policy its customers buy. The legal significance of the bank's financial interest is not clear from the opinion. The court may have considered that the bank's self-interest sup-

97. *Id.* at 57.

98. *Stone*, 66 Ohio St. 2d at 79, 419 N.E.2d at 1098.

99. *Id.*

100. *Id.*

101. *Id.* at 80, 419 N.E.2d at 1098.

ported finding a fiduciary relationship between the bank and the customer. On the other hand, the court may have referred to the bank's self-interest to support finding it fair to impose upon the bank the duty to disclose the advisability of purchasing the insurance, and procedure for obtaining it, when a fiduciary relationship exists. If the court used the bank's self-interest to support its finding that there was a fiduciary relationship, that would be in direct conflict with the standard, set forth in *Umbaugh*, that the bank act primarily on behalf of the borrower in order to establish this relationship. On the other hand, the court may have meant to reject this element as a relevant consideration in determining whether the bank is a fiduciary.¹⁰² In other words, the court may have ruled that a fiduciary relationship exists if the other characteristics of that relationship are present, regardless of whether the bank acted primarily on behalf of the borrower. In this case, the bank's profiting from the sale of the insurance supports the reasonableness of imposing fiduciary duties upon it.

The result in *Stone* is fair; unfortunately, the court's reasoning makes it impossible to discern what standards the court will apply in future cases, and which party must prove what elements. The fairness of the *Stone* result is evident from each of two perspectives. First, the transactional setting was one in which a customer could reasonably expect he had completed the steps necessary to purchase credit insurance and the bank would do the rest, and also one in which the bank should have realized the customer's expectations. Second, the result is consistent with the view that loss should fall upon the party who can prevent harm at the lower cost. Credit insurance is a complex subject for a person not familiar with credit and insurance. The customer who takes out a single loan would incur substantial transaction costs to be fully informed about the rights and obligations of each party in regard to such insurance. Bank personnel make many loans every day. Loan officers have to be knowledgeable about credit insurance in order to perform their jobs, and having obtained that knowledge once, can disclose the information customers need at no or little additional transaction costs. Consequently, the bank can prevent harm at a lower cost than the customers.

Despite the fairness of the result, the court's reasoning creates considerable confusion. First, the scope of the decision is unclear. While the holding applies only to the purchase of credit life insurance, banks may also find themselves in a fiduciary relationship when advising customers about other aspects of the loan processing stage since the court assumes customers are not in an equal bargaining position during this stage. Second, it is not clear how the court regards the advice and counseling role of banks. *Umbaugh* presented

102. Some other cases seem to agree that this element is irrelevant. See, e.g., *First Nat'l Bank v. Brown*, 181 N.W.2d 178, 182 (Iowa 1970) (Relationship of trust and confidence may be present even though trusted party does not act primarily on behalf of other party. If trusted party has superior knowledge of facts, he must "disclose all material facts of which he is aware, or at least those favorable to his own position and adverse to the other."); *Commercial Credit Plan, Inc. v. Beebe*, 123 Vt. 317, 321, 187 A.2d 502, 506 (1963) (lender in a position of trust and confidence, has a duty of full disclosure).

the question whether the giving of advice and counseling might impose on a financial institution the responsibilities of a fiduciary. Although the court refused to hold that the advice and counseling provided in that case gave rise to the fiduciary relationship, the court did not reject the possibility that advice and counseling might have this effect under other circumstances. As discussed above, it is not clear what those circumstances are. *Stone* did not clarify these matters because it involved advice and counseling in a very different context. In that case, the banks' error was in *not* providing advice and counseling, since the court held that when a financial institution is in the position of a fiduciary, one of the resulting duties is to provide that service.

This creates a dilemma for banks during loan transactions that do not involve credit insurance. If the bank advises its customers, a court may find it to be in a fiduciary relationship. If the bank does not advise its customers, the court may determine that the bank was a fiduciary and violated its duty by not giving advice. Finally, the test for determining whether the bank is a fiduciary is uncertain. *Stone* appears to reject the requirement that there be a reasonable expectation the bank would act solely or primarily on behalf of the debtor. The court's failure to refer to *Umbaugh* in that part of its opinion is unsettling. In addition, if *Stone* did reject *Umbaugh*'s test, it is not clear what test replaced it.

The Ohio Supreme Court was provided the opportunity to clarify these matters in *Walters v. First National Bank of Newark*.¹⁰³ In *Walters* a husband and wife applied for credit life insurance. The wife alleged that the loan officer told them the insurance was effective as of the date they executed the mortgage note and filled out the insurance application. She also alleged that the monthly installment payments assessed by the bank included a premium for the insurance. The insurance application provided that the insurance would not go into effect until a policy was issued. No policy was ever issued; the insurance company returned the application to the bank because the Walterses had failed to indicate the husband's occupation. The day before the policy was returned the husband died. The court of appeals upheld the trial court's denial of the Walterses' motion for summary judgment and allowance of the bank's motion for judgment on the pleading.

The state supreme court reversed, remanding the case to the trial court. Because of the procedural posture of the litigation, the court merely held that the wife had a legally cognizable cause of action. In the course of making this holding, however, it shed some light on the questions raised by *Stone*. In *Walters* the court quoted the following passage from *Stone*: "The facts surrounding and the setting in which a bank gives advice to a loan customer on the subject of mortgage insurance warrant a conclusion that, in this aspect of the mortgage loan process, the bank acts as its customer's fiduciary"¹⁰⁴ The court went on to declare: "The fiduciary nature, at least in this respect, of the bank-customer relationship is predicated upon the bank's superior conver-

103. 69 Ohio St. 2d 677, 433 N.E.2d 608 (1982).

104. *Id.* at 679, 433 N.E.2d at 610 (quoting *Stone*, 66 Ohio St. 2d at 78, 419 N.E.2d at 1098).

sance with the area of loan processing, of which mortgage insurance is a component."¹⁰⁵ It appears from the foregoing that the court found, as a matter of law, that in any loan application in which credit insurance is involved, the bank is a fiduciary. The court next referred again to *Stone* for a description of the bank's duty as a fiduciary. The court declared that once a customer has indicated his desire for immediate insurance coverage, the bank must advise the customer "how to proceed" to obtain the coverage.¹⁰⁶

It seems all the customer must prove on remand is that she and her husband applied for credit life insurance and told the loan officer they wanted the insurance to be effective on the date of the loan, or were told by the officer that it would be effective on that date. This will be sufficient to establish the fiduciary status of the bank. Next, she need only show that the bank: (1) did not purchase insurance that was effective on that date, and (2) did not advise them of its failure to make the purchase. Having shown these facts, she will have proved the bank breached its fiduciary duty by acting negligently. The customer does not have to prove that the bank had superior knowledge of, and experience with, credit insurance, or that both parties understood or should have understood a special trust or confidence had been reposed in the bank. The customer does not also have to show that she and her husband reasonably expected the bank would act solely or primarily on their behalf.

While the *Stone* and *Walters* opinions may look like radical departures from traditional doctrine, future Ohio decisions may limit the scope of *Stone* and *Walters* even in transactions involving credit insurance. In both cases the court arguably could have found the bank liable in its normal creditor status, based on a theory of misrepresentation. This was explicitly acknowledged in *Walters* when the court pointed out that the wife's complaint alleged misrepresentation and that an action would lie on this theory.¹⁰⁷ If so, the bank's "duty of fair disclosure" is triggered only when the bank has made a misrepresentation upon which the customer may rely to his detriment.

On the other hand, *Stone* can be read much more expansively. Unlike *Walters*, it did not treat the transaction as one involving misrepresentation. The court required fair disclosure of the mechanics of purchasing insurance whenever insurance is mentioned in the bank's written documents, or by the bank's employees, and the customer expresses a desire for the insurance. The bank is obligated to do this regardless of whether it has misrepresented any aspect of the transaction. The court imposed this duty because it determined that the bank was a fiduciary. When *Stone* is viewed from this perspective, it is a significant departure from tradition.

B. *Washington—The Banker as Quasi-Fiduciary*

In *Hutson v. Wenatchee Federal Savings and Loan Association*¹⁰⁸ the

105. *Walters*, 69 Ohio St. 2d at 679, 433 N.E. 2d at 610.

106. *Id.*

107. *Id.* at 680, 433 N.E.2d at 610.

108. 22 Wash. App. 91, 588 P.2d 1192 (1978).

Washington Court of Appeals also faced a case involving a savings and loan association selling credit insurance to a married couple. The court in *Hutson* was unwilling to find that the lender acted in a fiduciary capacity, but did hold the institution to the disclosure obligations of a quasi-fiduciary.¹⁰⁹ Larry and Joyce Hutson went to the bank to obtain a home improvement loan. The lender's officer suggested it would be easier to finance construction of a new home, and the Hutsons followed his advice. Mrs. Hutson alleged that, pursuant to taking out a loan from the savings and loan association, she specifically asked for credit life insurance and the bank's employee "impliedly agreed"¹¹⁰ to purchase it. In addition, Hutson claimed she relied on the loan application, prepared by the lender, which provided that \$39.22 was to be paid each month for "taxes, fire insurance, assessments, and life insurance."¹¹¹ The bank never bought credit life insurance. Instead it obtained "mortgage insurance." Credit life insurance would have paid off the mortgage when Mr. Hutson died one year after the loan was obtained. Mortgage insurance, as that term is used by savings and loan associations, insures the bank, not the borrower. If the borrower defaults, the insurer pays the lender and assumes the burden of foreclosing on the debt.¹¹² Hutson claimed that the term "mortgage insurance" had a specialized meaning in the savings and loan industry, the lender had a duty to define that term for her, and it was negligent in failing to do so. The trial court instructed the jury that the lender had no duty to define the term and did not allow Hutson to present evidence that the term has a meaning in the commercial banking industry that is different from its meaning in the savings and loan industry.

The court of appeals found that the lender did not fit within the traditional definition of a fiduciary since "it profits from the business transaction."¹¹³ This is similar to the determination in *Umbaugh* that the lender could not be a fiduciary because it was not acting solely or primarily in the borrower's interests. In addition, both the *Umbaugh* and *Hutson* courts found that whether the parties dealt at arm's length was crucial. While the *Umbaugh* court found the lender's provision of advice and counseling did not affect the arm's length nature of the parties' negotiating postures, the *Hutson* court pointed to several factors that significantly shortened the arm's length distance between the parties. The court examined both general banking practices and the actions of the lender. The court noted that lenders dealing with "individual customers like plaintiff . . . often give financial advice about how much debt a person with any given income will be able to carry. Lenders also may explain the legal requirements applicable to any particular loan to the bor-

109. Courts have found quasi-fiduciary relationships to exist in several other contexts. See, e.g., *In re Penn Cent. Transp. Co.*, 351 F. Supp. 1348, 1350 (E.D. Pa. 1972) (carrier's duty to shipper); *Johnston v. Livingston Nursing Home, Inc.*, 282 Ala. 309, 314, 211 So. 2d 151, 156 (1968) (duty of corporate directors to corporation and its stockholders); *Gross v. J & L Camping & Sports Center, Inc.*, 270 Md. 539, 546, 312 A.2d 270, 275 (1973) (real estate broker's duty to lessor).

110. *Hutson*, 22 Wash. App. at 93, 58 P.2d at 1194.

111. *Id.* at 94, 588 P.2d at 1194.

112. *Id.* at 92, 588 P.2d at 1193.

113. *Id.* at 102, 588 P.2d at 1198.

rower.”¹¹⁴ In addition, federally mandated Truth in Lending disclosures change the relationship between the parties because “they remove certain factors from the bargaining area, limiting the amount of leeway the lender has in dealing with its customer.”¹¹⁵ In regard to credit life insurance, the defendant and many other lenders “routinely provide the service of arranging credit life insurance.”¹¹⁶

Moreover, the court pointed to specific actions taken by the defendant that showed this was not an arm’s length business transaction. The lender took the initiative of providing financial advice about a federally subsidized loan program. The court admitted that this is a “complex relationship” since the lender both advises the borrower and screens applicants for the government. Therefore, the lender does not act solely or primarily for the benefit of the borrower as *Umbaugh* required. But the court went on to recount *Hutson*’s allegation that she relied on the lender’s advice to build a new house rather than remodel her present one, and on his assurance that the loan was financially feasible for her. Finally, the court described the specific steps taken by the lender to promote its sale of credit life insurance. “This extra service, while not changing the relationship to one of fiduciary trust, does mean that the customer will rely upon the lender for one more facet of the entire transaction.”¹¹⁷

The court examined the entire pattern of the lender’s conduct in regard to this transaction, and held that the savings and loan association occupied a position of trust and confidence and was in a quasi-fiduciary relationship with the borrower.

Both the *Hutson* and *Stone* courts wrenched the bank from its traditional protected role of lender and threw it into the treacherous role of fiduciary and quasi-fiduciary. The approach of each court, however, was significantly different. The *Stone* court implicitly rejected the test that a fiduciary is one who the customer reasonably expects is acting solely or primarily in the customer’s behalf. Quite to the contrary, *Stone* referred to the bank’s self-interest to support either its finding of a fiduciary relationship or its imposition of liability. In contrast, *Hutson* refused to find a fiduciary relationship because the customer knew the bank was motivated by its interest in making a profit from the transaction. *Stone* assumed without any examination of the facts that the parties dealt at arm’s length until they entered the loan processing stage of the transaction and the issue of credit insurance arose. *Hutson* did not limit itself to that stage. Rather it looked at the “entire pattern,” including financial advice that was not directly related to credit insurance.

Having found the lender was acting in a quasi-fiduciary capacity, the *Hutson* court imposed upon it a duty of disclosure more exacting than if the court had found the bank to be a mere lender. That duty, however, did not neces-

114. *Id.*

115. *Id.* at 102, 588 P.2d at 1199.

116. *Id.* at 103, 588 P.2d at 1199.

117. *Id.*

sarily require the bank to define the term mortgage insurance. Rather, "it was a jury question whether the lender had a duty to define any ambiguous or specialized terms which might mislead unknowledgeable and uncounseled customers, members of the lay public who rely on the lender's advice."¹¹⁸ Consequently, the bank customer must prove "mortgage insurance" is an ambiguous or specialized term, and must prove he or she was an unknowledgeable and uncounseled person who relied upon the bank's advice. If the customer met her burden of proof on these facts, the bank had a duty to define the term if it knew or should have known that failure to define the term might mislead this customer.

Just as the *Walters* court could have imposed liability on the bank without conferring on the bank the status of a fiduciary, so too the *Hutson* court need not have found the lender was a quasi-fiduciary. The court stated that section 551(2)(b) of the Restatement of Torts would also apply to the *Hutson* transaction.¹¹⁹ That section imposes upon a party to a business transaction a duty to disclose information "necessary to prevent his partial or ambiguous statement of the facts from being misleading."¹²⁰ The court found that a jury could decide the lender's "mentioning mortgage insurance without defining it as such a 'partial or ambiguous statement' that it might mislead a reasonable customer."¹²¹

The Restatement section upon which the court relied does not require a finding that the party making the partial or ambiguous statement be in a quasi-fiduciary relationship with the party to whom the statement is made. This is indicated both by the failure of the section to refer to the status of any of the parties to the business transaction, and the contrast between this provision and an accompanying section that bases disclosure explicitly upon the status of the person making the statement and the relationship of the parties.¹²²

118. *Id.* at 105, 588 P.2d at 1200.

119. *Id.* at 103, 588 P.2d at 1199.

120. RESTATEMENT (SECOND) OF TORTS § 551(2)(b) (1957).

121. *Hutson*, 22 Wash. App. at 103, 588 P.2d at 1199.

122. RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1957) imposes a duty to disclose "matters . . . that the other is entitled to know because of a fiduciary or other similar relation of trust and confidence" between the parties. *Id.* Although the court quoted this section, 22 Wash. App. at 101, 588 P.2d at 1198, it did not base the decision upon it. *Id.* at 103, 588 P.2d at 1199. The court may have read the section to require a finding that the lender was acting in a fiduciary capacity or another equivalent capacity. Since the court was willing to hold that the lender acted in a quasi-fiduciary capacity, it may have found the section inapplicable. In the course of its decision, however, the *Hutson* court cites with approval a case in which the Washington Supreme Court found two parties in a quasi-fiduciary relationship. In that case the court applied section 551(2)(a), the Restatement disclosure rule applicable to fiduciaries. See *Boonstra v. Stevens-Norton, Inc.*, 64 Wash. 2d 621, 625, 393 P.2d 287, 290 (1964). In addition to holding that the section governs cases involving quasi-fiduciaries, the court in *Boonstra* implied that the rule was not limited to fiduciaries, or those in a comparable status, by deleting from its quote of the Restatement section the word "fiduciary," including only the requirement that the parties be in "a relation of trust and confidence." *Id.* at 625, 393 P.2d at 290.

In *Hutson* the court avoided interpreting section 551(2)(a) in light of *Boonstra* by basing its alternative holding on section 551(2)(b), which makes no mention of the relationship between the parties.

Financial institutions in Washington might try to limit *Hutson* to its facts or to cases involving partial or ambiguous statements, arguing that courts should avoid following *Hutson*'s approach of classifying the lender as a quasi-fiduciary since the quasi-fiduciary part of the opinion was not necessary in light of *Hutson*'s reliance on tort law as well. Banks might be tempted to do so, fearing that courts might apply the quasi-fiduciary classification to additional bank conduct, thereby imposing duties of disclosure in many more situations. Washington banks still risk being held to quasi-fiduciary duties even if subsequent decisions ignore or distinguish the *Hutson* case. These institutions are still bound by a ruling of the state's highest court that found a quasi-fiduciary relationship exists and a duty to disclose follows when one party has superior business knowledge and experience and knows the other party is relying on its judgment.¹²³ Moreover, the Restatement rule on ambiguous statements contains its own potential for expanded application since it applies to all bank-customer transactions, regardless of whether the bank is in a quasi-fiduciary role.

Banks in Washington face the possibility of attacks on three fronts. First, under *Hutson* they may have a duty to define ambiguous terms when they engage in the type of conduct that results in a quasi-fiduciary relationship. Second, courts may apply a Restatement rule that imposes a more general duty to disclose on banks found to be quasi-fiduciaries because of their relation of trust and confidence with the customers.¹²⁴ Finally, the duty to define the terms may arise from the Restatement rule on explanation of ambiguous statements.¹²⁵ This duty does not depend on a quasi-fiduciary relationship.

C. *The Failure of the Trust and Confidence Approach*

Although the trust and confidence doctrine may provide a sound basis for decisions in other banking contexts,¹²⁶ analysis of credit life insurance cases

123. *Boonstra v. Stevens-Norton, Inc.*, 64 Wash. 2d 621, 625, 393 P.2d 287, 289 (1964).

124. RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1957).

125. *Id.* § 551(2)(b).

126. Although courts have been unable to apply successfully the trust and confidence approach in credit life insurance cases, there may be other types of banking transactions to which this theory would apply without the difficulties encountered in credit insurance cases. Banks increasingly are offering comprehensive financial planning services to their customers. *See Full Majority of Banks Offer Financial Planning*, *Am. Banker*, June 7, 1983, at 6, col. 3. In some cases banks will establish relations with their customers in which trust and confidence is reposed. In addition, some advertising by financial institutions may give customers the impression that the bank wants trust and confidence to be reposed in them. Implicit is the message that the institution accepts the obligation to act primarily in the customer's best interest. For example, an advertisement for the Sears Financial Network states in part:

When people put their trust in the Sears Financial Network, they're anything but speechless . . . "I think people trust the Sears Financial Network because they know Sears." . . . Because people—even people who make a good living—need good, sound advice about their money. And they need that advice simple to understand and easy to find. . . . And perhaps most of all, they need it from people they trust.

The Atlanta Constitution, Sept. 29, 1982, at 9-D.

A commercial bank advertisement stresses the expertise of its loan officers and its interest in obtaining the best loan for the customer, implying that the customer's best interest is the primary

lends support to the criticisms of this approach.¹²⁷ Courts have developed new and uncertain standards for determining when a person will be regarded as a fiduciary. This puts banks at an unfair disadvantage. They need certain and general rules that can be applied easily to distinct types of transactions in order for them to conduct efficient operations. Whether the bank is a fiduciary under the trust and confidence doctrine depends on facts that will vary from one sale of credit life insurance to the next. In some transactions the parties will not deal at arm's length, the bank will possess superior bargaining power and experience, and both parties will realize the customer is reposing trust and confidence. In other transactions the opposite will be true; and in still others it will be difficult to determine the exact nature of the relationship. This is unsatisfactory. Both the customer and the bank need to know the legal relationship between the parties in every typical sale of credit life insurance. The courts in *Stone* and *Walters* tried to overcome this problem by finding as a matter of law that certain facts were present, whether the evidence indicated they actually were. This artificial approach does violence to traditional fiduciary concepts.

Whether a bank is a quasi-fiduciary under the *Hutson* test also depends on the facts of each case. These facts may be difficult for the banker to determine. For example, is a term ambiguous or specialized? Is the borrower uninformed? Should the bank know that failure to define a term may mislead the customer? In addition, the court does not develop standards that could be applied in a credit insurance case involving a different type of dispute.

What is needed is an approach that is consistent with the realities of the situation, in which a neutral legal concept can be applied without undue strain, to clearly guide banks.

V. THE BANK AS AGENT OF THE INSURED

Insurance case law that examines the legal relationship between the customer and the person in the position to procure insurance provides a neutral conceptual basis for analyzing the sale of credit life insurance by banks. It is surprising that the decisions reviewed thus far have not referred to that case

consideration. "Our Personal Loan Specialists will work hard to find the loan that's just right for you." *Id.*, May 13, 1983, at 2-D, col. 2.

One savings and loan stresses in advertisement after advertisement that the institution is the customer's "partner." "So come and open any kind of account at Decatur Federal. By doing so, you'll have us as a Partner, vitally interested in your financial well being . . ." The advertisement closes with: "[y]our partner Decatur Federal." *Id.*, June 29, 1983, at 13-A, col. 4; July 13, 1983, 11-A, col. 3. See also *id.*, Aug. 19, 1983, at 13-A, col. 3.

Manufacturers Hanover advertised:

What business demands now is reliable credit alternatives intertwined with informational and operation services — giving access not just to a bank but to a total financial source. . . . [O]ur customers characterize Manufacturers Hanover as second to none for flexibility, accuracy and loyalty. . . . We don't take a "lend you and leave you" attitude toward our customers.

Advertising supplement, *Am. Banker*, April 16, 1979, quoted in Symons, *The Bank—Customer Relation: Part II—The Judicial Decisions*, 100 BANKING L.J. 325, 327 (1983) (emphasis added).

127. See *supra* text accompanying notes 24-33.

law. The sale is essentially an insurance transaction even though the bank's primary role is that of a lender. Insurance law provides us with a well developed body of legal rules that do not share the deficiencies of the approaches discussed above. Banks can apply these rules to determine whether they will be considered fiduciaries. If they do not wish to assume the responsibilities that status entails, they can take steps to prevent courts from designating them fiduciaries.

Those procuring insurance are held to occupy fiduciary status when they act as the customer's agent. A brief summary of agency law will set the stage for an examination of this issue. The legal relationship of agency arises when there is an agreement between two parties that one will act on behalf of another and will be subject to the other's control in regard to the specific undertaking.¹²⁸ To determine whether this relationship exists, one looks only at whether certain facts are present. It does not matter whether the parties intended to establish an agency relationship or whether they intended the legal consequences that such a relationship entails.¹²⁹ There need not be a contract between the parties.¹³⁰ The relationship exists "when the parties behaved in such a way that the rules" of agency "come into operation."¹³¹ This behavior consists of the principal consenting that the agent may act for him and the agent accepting the undertaking. It is not necessary for either of the parties to expressly manifest his consent. The required consent will be found if it can be "reasonably inferred from the conduct of the parties."¹³² The agent does not have to indicate his consent in any explicit manner. In some situations, if a person performs the undertaking to which the principal consented, that conduct is in itself "a sufficient indication of consent."¹³³ A person can be an agent even though he has an interest adverse to the principal.¹³⁴ Moreover, an agency relationship is not precluded if the agent acts on behalf of one person for part of the transaction and on behalf of another for the rest of the transaction. The agent has two principals and has duties to each, depending on which aspect of the transaction is involved.¹³⁵ It is not inconsistent with agency concepts for the agent to obtain a commission from the person with whom he is doing business on behalf of the customer-principal. As long as it is normal commercial practice for persons in the agent's position to receive a fee, such a payment is permitted since the principal was, or should have been, aware that

128. RESTATEMENT (SECOND) OF AGENCY § 1 comment (1)(a) (1954).

129. *Id.* comment (1)(b).

130. See Seavey, *supra* note 38, at 863. Agency is "analogous to a trust rather than to a contract and the mutual obligations are created by the fiduciary character of the relationship." *Id.*

131. H. REUSCHLEIN & W. GREGORY, HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIP 10 (1979).

132. W. SELL, SELL ON AGENCY 1 (1975). See, e.g., *In re Schmidt*, 210 F. Supp. 106, 113 (E.D. Wisc. 1962).

133. W. SELL, *supra* note 132, at 14.

134. Seavey, *supra* note 38, at 869-70. Contrast this adverse interest rule with the trust and confidence rule requiring that the person who has reposed trust and confidence must have reasonably expected the other party to act primarily on his behalf. See *supra* text accompanying notes 85 and 99.

135. RESTATEMENT (SECOND) OF AGENCY § 13 comment c, § 14L (1954).

this would occur.¹³⁶

Applying these rules in cases involving types of insurance other than credit life, courts have found insurance agents to be agents of the insured when they procure or are requested to procure insurance.¹³⁷ Several features present in the sale of credit life insurance indicates that banks should be considered the borrower's agent in this type of transaction as well.

In the sale of credit life insurance the customer normally engages in conduct from which one can reasonably infer that he consents that the bank act as his agent for the purpose of obtaining insurance. This occurs when the consumer signs the Truth in Lending statement in which he agrees that he desires insurance. His consent may also be manifested by conversations about the insurance between the consumer and the bank officer. The bank may agree to be an agent in a number of ways. The bank officer may expressly agree to purchase the insurance or he may have the consumer complete an application, thus "embarking on the purpose of the agency."¹³⁸ Presenting the customer with the Truth in Lending disclosure statement indicates the bank's consent to be an agent for the purpose of purchasing credit insurance, unless the bank also engages in conduct that clearly indicates to the consumer that the bank will not act as his agent.

While the bank may be the borrower's agent with respect to procuring credit insurance, it is also considered an agent for the insurer when engaging in other activities such as collecting premiums. This creates no legal difficulties. Agency law has long recognized that a person can be a dual agent.¹³⁹ This is an exception to the traditional agency rule that an agent must have undivided loyalty to his principal. The strict formulation of this exception is that the party can be both agent to the insured and the insurer when this is done with the express or implied consent of both parties and their interests do not conflict. In most insurance cases, however, courts find a proper dual agency even when it is not clear both parties consented to the dual agency and when "there would appear to be an inherent conflict of interest"¹⁴⁰ in the dual relationship.

The foregoing discussion indicates the sale of credit insurance fits neatly into the traditional law of agency as it has been applied, and somewhat modified, in insurance cases. This has significant implications for banks because an agent is in a fiduciary relationship with his principal.¹⁴¹ Nevertheless, it is not advisable to regard the characterization of a legal relationship as conclusive. That is, even if an examination of the credit life insurance transaction leads

136. P. FINN, *supra* note 21, at 212.

137. *E.g.*, Black v. Illinois Fair Plan Ass'n, 409 N.E.2d 549 (Ill. App. Ct. 1980); Hlavaty v. Kribs Ford, Inc., 622 S.W.2d 328 (Mo. Ct. App. 1981); *see generally*, G. COUCH, CYCLOPEDIA OF INSURANCE LAW § 25:101 (2d ed. 1960).

138. W. SELL, *supra* note 123, at 8.

139. RESTATEMENT (SECOND) OF AGENCY § 14L (1954); G. COUCH, *supra* note 137, at § 25:101.

140. Rokes, *Dual Agency of Insurance Agents and Brokers*, 44 INS. COUNS. J. 677, 681 (1977).

141. RESTATEMENT (SECOND) OF AGENCY § 1(1) (1954).

ineluctably to the conclusion that the bank is the customer's fiduciary because of the agency relationship, courts could justifiably resist the implications of such a finding if it led to bad policy, such as giving the borrower an undeserved advantage, or imposing too great a burden upon the bank.¹⁴² In this connection it is appropriate to note the policy of the Federal Reserve Board. The Board has "expressed the expectation" that when a bank holding company or its subsidiary sells credit insurance in a transaction subject to the Board's regulations, it "will exercise a fiduciary responsibility."¹⁴³ In addition, the National Association of Insurance Commissioners (NAIC) has suggested that banks be required to meet fiduciary standards in the sale of credit insurance.¹⁴⁴ A NAIC staff study noted the double standard that presently exists.¹⁴⁵ When bank management purchases corporate insurance to cover bank property, it seeks the best possible terms. That is, it purchases insurance from a company that is financially stable and provides adequate service at a reasonable cost. To buy insurance on other terms would be a breach of management's fiduciary duty to its stockholders. In stark contrast, when purchasing credit insurance for its customers, banks generally buy the most expensive insurance because to do so results in the greatest profit for the bank.

The pronouncements of these institutions intimately involved in the credit insurance industry suggest that regarding banks as fiduciaries is not bad policy. A sounder judgment can be made, however, if we also examine the obligations that fiduciary status entails.

An agent is a fiduciary with specific duties. These duties are "inferred" from his position as an agent.¹⁴⁶ One duty is the use of care and skill.¹⁴⁷ When a person takes on the role of an agent, he must act with "skill commensurate with the job to be done" and must "use that skill with diligence."¹⁴⁸ In addition, the agent must "use reasonable effort" to provide his principal information that the principal "would desire to have."¹⁴⁹ This duty refers both to information in regard to the transaction itself, and information about the rela-

142. Fiduciary obligations are imposed upon individuals who engage in activities that require legal regulation. "It is not because a person is a 'fiduciary' . . . that a rule applies to him. It is because a particular rule applies to him that he is a fiduciary . . . for its purposes." P. FINN, *supra* note 21, at 2 (emphasis in original).

143. 36 Fed. Reg. 15,526 (1971).

144. Letter from Richards D. Barger, President, National Association of Insurance Commissioners to Board of Governors of the Federal Reserve System (April 5, 1972) (available in the office of the North Carolina Law Review). See also Letter from Robert E. Dineen, consultant to the National Association of Insurance Commissioners, to Baldwin Tuttle, Board of Governors, Federal Reserve System (October 6, 1972) (recommending implementation of fiduciary standards) (available in the office of the North Carolina Law Review); Letter from Russell E. Van Hooser, Commissioner of Insurance, State of Michigan, to Arthur Burns, Chairman, Federal Reserve Board (April 14, 1971) (recommending imposition of fiduciary responsibility) (available in the office of the North Carolina Law Review).

145. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, A BACKGROUND STUDY OF THE REGULATION OF CREDIT LIFE AND DISABILITY INSURANCE 132-33 (1970) [hereinafter cited as NAIC STUDY].

146. RESTATEMENT (SECOND) OF AGENCY § 381 comment a (1954).

147. *Id.* at § 379.

148. H. REUSCHLEIN & W. GREGORY, *supra* note 131, at 121.

149. RESTATEMENT (SECOND) OF AGENCY § 381 (1954).

tionship between the agent and others involved in the transaction.¹⁵⁰ For example, if the agent has interests adverse to the principal, or represents another party with adverse interests, he has a duty to disclose those facts to the principal.¹⁵¹ The agent has a duty to obey the principal by following his instructions¹⁵² and also owes him a duty of loyalty.¹⁵³

In cases involving other types of insurance, courts have not hesitated to impose fiduciary duties upon agents of the insured who failed to procure the type of insurance coverage they were instructed to purchase.¹⁵⁴ Agents have been held liable even though the insured (the principal) was seemingly vulnerable to the defense of estoppel on a contract theory or contributory negligence on a tort theory because the insured failed to read the policy and discover the error or omission.¹⁵⁵ These potential defenses are to no avail because the principal is entitled to rely on the agent's use of care and skill. "Business could not be carried on" if the principal had a duty to use his own care and skill to make sure his agent employed the proper amount of care and skill in the performance of his duties.¹⁵⁶

The cases reviewed in this Article illustrate many of the problems consumers confront when credit insurance is involved and raise questions about the exact nature of the bank's duties in these transactions. Applying agency status to the bank, with the duties which accompany that status, provides far clearer guidelines than those available to the courts if other standards are used. The duty to provide information that the principal "would desire to have" requires the bank to explain the mechanics of purchasing insurance and to explain ambiguous terms, or terms, such as "mortgage insurance," that have a specialized meaning. This duty to disclose apparently would be a stricter requirement than the duty imposed in *Hutson*, which requires that a bank define terms only if the consumer could show that those terms might mislead him. The bank also would be required to disclose that it has adverse interests to the extent that it profits from the sale of credit insurance. The duties to follow the principal's instructions and to use skill and care would be violated if the bank failed to procure insurance and it appeared from all the circumstances that the customer expected it to do so.

As an agent with fiduciary responsibilities, the bank also may be required to advise the client whether it is wise to purchase credit insurance from the bank at all. As explained above, although it is a sensible purchase for some consumers, for most it is unnecessary and too expensive to be a good value. The duty to provide this counseling arises from the agent's duties to be loyal,

150. *Id.* at § 381 comment a.

151. *Id.* at § 381 comment d.

152. *Id.* at § 385.

153. *Id.* at § 387.

154. See generally Rokes, *supra* note 140. In other cases the courts have imposed on insurance agents a stringent standard of commercial practice without referring to fiduciary obligations. See, e.g., *Hardt v. Brink*, 192 F. Supp. 879 (W.D. Wash. 1961).

155. *E.g.*, *Hampton Roads Carriers v. Boston Ins. Co.*, 150 F. Supp. 338 (D. Md. 1957).

156. *Id.* at 344 (quoting J. ARNOULD, *MARINE INSURANCE* 160 (13th ed. 1950)).

to provide information the principal "would desire to have," and to use skill and care.

One court has expressed support for this view. In *Browder v. Hanley Dawson Cadillac*¹⁵⁷ the consumer's complaint alleged that the car dealer who sold him credit insurance was a fiduciary, and as such had the duty to inform him that cheaper but comparable insurance was available. The court remanded the case for a determination about whether the car dealer acted as an agent of the consumer. The court went on to say that if the dealer were an agent, he had a fiduciary responsibility to disclose all material facts that might affect the transaction, including all the facts about the price and the credit insurance.¹⁵⁸ Apparently, if the consumer could show the existence of an agency relationship, the car dealer would be required to explain that less expensive insurance was available.

In a comparable vein, the court in *In re Dickson*¹⁵⁹ found that a financial institution violated its fiduciary duty when it charged about twice as much for credit insurance as considered "adequate" by the state insurance commissioner, received a 25% rebate as a commission, and failed to disclose these facts to the consumer. The court also found that the failure to disclose constituted an unfair and deceptive practice under the North Carolina statute prohibiting such practices.¹⁶⁰ The *Browder* court agreed with this analysis, asserting that if the trial court found the creditor was an agent, he violated the Illinois Consumer Fraud statute by failing to disclose the availability of cheaper insurance.¹⁶¹

These cases are consistent with a Federal Reserve policy statement which said that the Federal Reserve expected a financial institution, in the exercise of its fiduciary responsibilities in the sale of credit insurance, to make "its best effort to obtain the insurance at the lowest practicable cost to the customer."¹⁶²

It is likely that banks would object to a general duty to provide counseling or a specific duty to provide detailed price disclosures and comparisons. These duties conflict with the bank's interest in making the highest profit on the sale of credit insurance, and thrust the bank officer into the role of adviser and financial counselor. Imposing that responsibility can be justified, however, by the nature of the transaction and the conduct of the bank. As described above, many consumers believe credit life insurance is required, others believe it provides protection otherwise not available. Because of its low monthly cost, consumers do not realize its real cost and do not engage in comparative shopping.

157. 62 Ill. App. 3d 623, 379 N.E.2d 1206 (1978); *accord* Fox v. Industrial Casualty Ins. Co., 98 Ill. App. 3d 543, 424 N.E.2d 839 (1981).

158. *Browder*, 62 Ill. App. 3d at 630, 379 N.E.2d at 1211.

159. 432 F. Supp. 752 (W.D.N.C. 1977) (mem.).

160. *Id.* at 761.

161. 62 Ill. App. 3d at 631, 379 N.E.2d at 1212. Other cases holding that sale of credit insurance falls within the scope of state unfair and deceptive acts or practices statutes include Fox v. Industrial Casualty Ins. Co., 98 Ill. App. 3d 543, 424 N.E.2d 839 (1981); *Dodd v. Commercial Union Ins. Co.*, 373 Mass. 72, 365 N.E.2d 802 (1977); *Ranger County Mut. Ins. Co. v. Guinn*, 608 S.W.2d 730 (Tex. Civ. App. 1980).

162. 36 Fed. Reg. 15,526 (1971).

Therefore, the bank is the only place where credit insurance is sold. As one court has pointed out:

The critical fact is that the lending officer, by virtue of his ability to communicate with the borrower, is the only person anywhere who has a real opportunity to explain the benefits of credit life to a borrower and obtain assent to such insurance. The lending institution is uniquely situated for placement of credit life.¹⁶³

The bank is not required to purchase credit insurance. It voluntarily takes on the role of seller of insurance and profits from doing so both monetarily and in increased security for the loan. Once the bank holds itself out to the public as a seller of insurance, it is not unreasonable to impose on it fair standards of business practice. What is fair depends on the nature of the transaction. The cost, function, and need for credit insurance are not well understood by the consumer. It is incidental to the loan and it is purchased or intended to be purchased as one small part of a complex transaction filled with technicalities. The transaction is characterized by reverse competition since the bank has a strong motivation to sell the most expensive insurance. The remarkably high penetration rates vividly illustrate the effect of the above features of the transaction: almost every consumer buys the insurance whether he needs it or not. Under these circumstances, it is not unreasonable to impose a duty on the bank to provide some form of financial counseling on the cost and need for the insurance.

It is not certain how the banks might react to imposition of this duty. It would increase the bank's costs. The bank would have to train its loan officers to provide meaningful information about credit insurance. Loan officers would have to spend more time with customers to complete the loan transaction. These extra costs might be passed on to customers rather than be taken out of the bank's profits from the sale of the insurance. Providing increased information to consumers about credit insurance may result in information overload in light of all the other disclosures provided the consumer. Most troubling, banks may fear that providing counseling on the purchase of credit insurance could lead to greater risks. Consumers might complain that the information provided was incomplete or misleading. As a result of these potential costs and problems, banks might stop offering credit insurance. As noted above, this would not harm most consumers since they do not need it anyway. Presumably the free market will operate to provide it through non-banking sources for those who do need it. If banks want the loan covered by insurance for the extra security it provides the bank, they can purchase the insurance themselves and not impose an insurance charge on the consumer. A duty to counsel should not result in such a case.

If the consumer decides to purchase credit insurance after receiving advice and counseling from the bank, the bank would be obligated to provide the insurance at a charge reasonable for a fiduciary. Although such a duty would require banks to drastically alter their practices, this requirement already has

163. *First Nat'l Bank v. Smith*, 436 F. Supp. 824, 830 (S.D. Tex. 1977).

been recommended by the Federal Reserve Board¹⁶⁴ and the National Association of Insurance Commissioners.¹⁶⁵ NAIC has suggested banks could fulfill their responsibilities by obtaining competitive bids or demonstrating "a reasonable affirmative effort to obtain a fair sampling of the market."¹⁶⁶ If the bank can show it accepted the lowest bid (consistent with reasonable requirements regarding service and financial stability), it could successfully fend off customer claims of a breach of the duty to obtain credit insurance at a price consistent with the responsibilities of a fiduciary. The bank would be permitted to charge an amount for rendering the service of purchasing the insurance, but this would be limited to an amount appropriate for a fiduciary to receive. Requiring the bank to solicit bids should not be regarded as an unreasonable burden, for, as NAIC has pointed out, this is a standard practice for employers who obtain credit insurance for their employees. NAIC found that the resulting aggressive competition among insurance companies has resulted in lower prices and smaller profit margins, but the continued eagerness of insurance companies to offer group insurance to employees indicates the profit margin is adequate.

While the agency-fiduciary approach imposes significant burdens upon banks, it should also result in a substantial benefit. Imposing the duties of an agent probably will result in the establishment of a competitive market for the sale of credit life insurance.¹⁶⁷ The resulting lower premiums should lessen the pressure for government regulation to lower rates to a level comparable to that in other segments of the industry. Thus, application of agency law serves business' general objective of increasing government deregulation.

VI. CONCLUSION: THE BANK AS FIDUCIARY; THE SIGNIFICANCE OF THE CONCEPTUAL BASIS

The analysis and discussion presented in this Article illustrate the extent to which case law concerning the sale of credit life insurance has developed in a piecemeal and isolated manner. Each court appears unaware of decisions rendered by other courts. Each opinion fails properly to place itself within the general context of fiduciary law. As a result, the case law has not produced an adequate analytical framework for determining the liability of banks. The inadequacy of this body of law invites regulatory intervention to prevent abuse. The need for regulation, however, could be obviated by faithfully adhering to traditional concepts of fiduciary law.

The three lines of cases examined in this Article have placed banks in a fiduciary relationship to the borrower. If there is a contractual relationship between the parties the bank is a fiduciary when the customer entrusts it with the premium. If the customer reposes trust and confidence, the bank may be a fiduciary. Finally, if the bank is the customer's agent, fiduciary duties result.

164. 36 Fed. Reg. 15,526 (1971).

165. Letter from Richards D. Barger, *supra* note 144.

166. *Id.*

167. NAIC Study, *supra* note 145, at 135.

Although banks were labeled fiduciaries in each instance, the Article shows the substantial differences that exist depending upon the conceptual basis on which the fiduciary status is based.

The entrusting approach imposes a heavy responsibility upon the bank to engage in affirmative conduct to make certain the customer is insured. This obligation is triggered only if there was a legally enforceable agreement to purchase credit life insurance. The cases illustrate the difficulties the consumer may have in establishing such an agreement. Even if a contractual relationship existed, no fiduciary duties arise unless the customer paid for the insurance. Finally, fiduciary responsibilities arise only in regard to the duty to procure insurance. Other aspects of the sale of insurance are not covered.

The trust and confidence approach is the most problematic. Courts applying it to the sale of credit insurance have violated traditional fiduciary standards. In addition, if customers are required to show that they reposed trust and confidence in the bank, they will face substantial problems of proof. Perhaps for that reason, courts that favor this approach assume the necessary facts are present, absent proof to the contrary. In any given transaction, however, it may not be clear to the banks that trust and confidence were reposed. Consequently, banks may find fiduciary duties imposed in transactions in which they reasonably do not expect them. Because of these features, it is unlikely many courts will adopt this method of addressing credit insurance transactions.

The agency approach is the most appropriate. It is consistent with general insurance law. Agency law is based on the objective conduct of the parties, not subjective factors such as trust and confidence. Consequently, banks can look at their standard business practices and apply established principles from insurance cases in determining whether an agency relationship exists. Banks can ascertain what fiduciary duties they are responsible for by examining traditional agency law. Similarly, courts that are called upon to decide disputes can look at these sources for guidance. As a result, decisions should be relatively consistent and predictable. Additional regulation of these transactions should be unnecessary.

There are drawbacks to this approach. Whether an agency relationship exists is a question of fact, not law. Therefore, there is the potential for a disagreement in every transaction. The only alternatives, however, are for courts to rely upon one of the far more unsatisfactory approaches discussed above, develop a new body of law for these transactions, or hold that an agency relationship always exists as a matter of law when credit insurance is in any way involved. The latter mode of analysis conflicts with standard agency law. It is also too restrictive. In some instances, a bank may make it very clear that it is not acting as the customer's agent. The bank should have that option. If the bank does not exercise that option, it should be held to the responsibilities of other agents in light of the context in which the sale of credit life insurance takes place.

