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Joseph M. Lynch Jr.

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THIRD PARTY PAYMENTS FOR THRIFT ASSOCIATIONS— THE LATEST ROUND*

INTRODUCTION

FOR YEARS commercial banks and thrift institutions¹ have been engaged in a battle for competitive equality. One of the hardest fought skirmishes has been the attempt by the thrift industry to offer their customers the convenience of third party payments, or checking accounts. The weapons have taken many strange forms and have been given a variety of code names. The first attack by the thrift industry was by way of the Negotiable Order of Withdrawal Account (NOW). Congress, however, limited this type of account to only seven states.² Since savings associations, except in the named states, were prohibited from allowing withdrawals from interest bearing accounts by negotiable order, the next weapon developed was the non-interest bearing Negotiable Order of Withdrawal (NINOW). This account bears no interest in order to get around the restrictions of the law. Not yet ready to concede, the Federal Reserve Board authorized the use of Automatic Funds Transfer (AFT) by commercial banks.³ This permitted automatic transfer of funds from a customer's savings account to his checking account. This weapon was a *de facto* NOW account in disguise. In the latest round of fighting, federal savings associations have been permitted to offer Payment Order Accounts (POAs).⁴ This account allows withdrawals from a special sav-

*This article is an outgrowth of the research and paper done by the author while a student in the Seminar on Select Problems in the Regulation of Financial Institutions. The author is indebted to Professor Ronald E. Alexander for his counsel and assistance.

¹ The term "thrift institution" refers to a variety of institutions: savings and loan associations, savings banks, building societies and building and loan associations. They are similar in many respects and have as a common goal the promotion of thrift and the encouragement (funding) of home ownership. For the purpose of this article, the main similarity is that these institutions are only permitted to offer "savings" as opposed to "checking" accounts. In Ohio, the savings and loan is the primary thrift institution, so for the sake of convenience, reference will be made mainly to this type of institution.

² 12 U.S.C. § 1832(a) (as amended by Pub. L. No. 95-360, Nov. 10, 1978). This section provides:

[No depository institution shall allow the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties, except that such withdrawals may be made in the States of Massachusetts, Connecticut, Rhode Island, Maine, Vermont, New York and New Hampshire.

Section (b)(6) defines "depository institution" to include "any building and loan association or savings and loan association organized and operated according to the laws of the State in which it is chartered or organized"

³ 12 C.F.R. § 217.5(c)(2) (1978).

⁴ Proposed amendments to 12 C.F.R. § 545.4-1(a) (1978) and 12 C.F.R. § 526.1 (1978). These amendments would permit an account-holder of a federal association to withdraw funds from a new category of account (paying 5% interest) for payments to third parties by a form of payment order which is not a check or other form of negotiable instrument. These amendments to the Rules for the Federal Savings and Loan System were proposed on November 1, 1978, and as yet have not become effective.

ings account by a non-negotiable, non-transferable order. Until Congress gives NOW account authority to savings associations nationwide, it appears the battle will rage on.⁵

This article will look at the state of third party payment systems. First, it will review the history of the NOW account and some problems which have arisen as to negotiability. Second, it will examine the experiences of state-chartered associations that have offered NINOWs. Third, AFT and POAs will be examined in light of recent developments. Finally, the Ohio scheme will be examined to determine if an Ohio-chartered savings and loan could offer a type of NOW account.

I. NOW ACCOUNTS — FEDERAL ASSOCIATIONS

A. *Judicial and Statutory Background*

NOW accounts first received judicial approval in the case of *Consumers Savings Bank v. Commissioner of Banks*.⁶ The Supreme Judicial Court of Massachusetts ruled that its state law authorized savings banks to allow savers to issue NOWs to transfer funds from their saving accounts. The court based its decision on two main factors. First, the statutes did not have any provisions that restricted the power of savings banks to allow NOW accounts. Second, there was explicit authority for savings banks to honor withdrawals in accordance with their by-laws.⁷ The by-laws of the Consumers Savings Bank provided that "[w]ithdrawals may be made by presentation of deposit book, other evidence of deposit, or other written instrument, by depositor, his legally appointed representative, or another on a written order." The court decided that a NOW account draft qualified as an "other instrument" evidencing deposit.⁸

The court also cited as "most persuasive" the decision in a 1968 Maryland case which upheld the authority of a savings bank to offer checking accounts. There the court observed that a savings depositor, when making a withdrawal, usually has three options: he can request cash or a treasurer's check, or can purchase a money order. The court observed that "[a]ccording

⁵ Legislation for financial reform that would allow savings associations to offer NOW accounts has been before Congress for the past several years. Due to intense opposition, a law is yet to emerge. Some people feel that the Federal Reserve Board, by authorizing automatic funds transfer, may be forcing Congress to act. See 2 SAV. AND LOAN REP. No. 41 (Feb. 6, 1978).

⁶ 361 Mass. 717, 282 N.E.2d 416 (1972).

⁷ MASS. GEN. LAWS ANN. ch. 168 § 26, (West Supp. 1979) (as amended by St. 1971, ch. 354 § 2) provides that "[t]he deposits in such corporation may be withdrawn at such time and in such manner as the by-laws direct"

⁸ 361 Mass. at 718, 282 N.E.2d at 417.

him a fourth option of drawing a check on his own account . . . is a distinction without a difference."⁹

Following this case a struggle ensued in Congress. The legislation that emerged,¹⁰ with its most recent amendments, prohibits the use of negotiable instruments against accounts on which interest or dividends are paid for all savings and loan associations, state and federal, except in the seven states listed.¹¹ The rules applicable to federal associations parallel the legislation.¹²

B. *NOW Account v. Checking Account*

What are the differences between a NOW account at a thrift institution and a checking account at a commercial bank? It may be that the differences are more theoretical than real.

A checking account is a demand account upon which a member bank of the Federal Reserve System is prohibited from paying interest.¹³ This prohibition is also applicable to nonmember banks which are FDIC insured.¹⁴

A savings deposit is not a demand deposit, and thus is not subject to Regulation Q's prohibitions against payment of interest on demand accounts.¹⁵ Savings accounts of federal associations are subject to the statutory right of the association to require not less than thirty days notice prior to payment of a withdrawal.¹⁶ In reality, most savings accounts are treated like demand accounts, with the association permitting withdrawal upon request. Due to the statute, the Federal Home Loan Bank Board (FHLBB) would not be able to authorize NOW accounts which would not be subject to the right of the association to require thirty days notice before honoring a

⁹ *Savings Bank of Baltimore v. Bank Comm'r of Md.*, 248 Md. 461, 475, 237 A.2d 45, 53 (1968).

¹⁰ 12 U.S.C. § 1832(a) (1978).

¹¹ This scheme is a grant of authority to *federal* associations in the seven states only. It would appear that the corporate authority of state-chartered associations in the named states would have to derive from state law since Congress lacks the power to grant corporate powers to state-chartered entities. The *prohibition* against offering NOW accounts *would apply* to such state institutions in the other forty-three states. See Pfeiler, *NOW Accounts: A Legal Prognosis*, 42 LEGAL BULL. 149 (1976).

¹² 12 C.F.R. 545.4-1(a)(1) (1978) reads: "Savings accounts in a Federal Association shall not be subject to check or to withdrawal or transfer on negotiable or transferable order or authorization to the association." 12 C.F.R. 545.4-1(a)(3) (1978) exempts federal associations in the seven New England states.

¹³ 12 U.S.C. § 371(a) (1970).

¹⁴ 12 U.S.C. § 1828(g) (1974).

¹⁵ 12 C.F.R. § 217.2(a) (1978).

¹⁶ 12 U.S.C. § 1464(b)(1) (1978).

payment order.¹⁷ Thus, it appears that although a NOW account functions like a checking account, the notice requirement keeps it from being classified as a demand deposit.¹⁸

C. *Problems with NOW accounts*

1. Negotiability

The statutory right of the association to require notice before withdrawal has raised questions as to the negotiability of the NOW draft. Does this notice provision prevent the NOW draft from being payable on demand and thus make it non-negotiable within the meaning of the Uniform Commercial Code?¹⁹ There are several reasons why this is unlikely.

One commentator argued that as long as the NOW account withdrawal order resembles a check, this reserved right of notice should not defeat its negotiability.²⁰ He based this conclusion on two observations. First, in the vast majority of cases, the institution is highly unlikely to impose such a requirement; most savings associations permit withdrawal from savings accounts upon request. Second, according to the U.C.C., the negotiability of an instrument is always to be determined by what appears on the face of the instrument alone.²¹

Another writer concluded that the ability of the drawee institution to pay was more important than a theoretical right of an association to require notice.²² If a savings institution has sufficient funds to pay a NOW account draft when presented, it will probably do so. If it does not have the funds, it would not matter whether it is drawn on a demand account or a notice account. This is also true at a commercial bank; if the bank has insufficient funds when presented with a check for payment, it makes no difference that the check is drawn on what is defined as a demand account. The writer concluded that the crucial element for an instrument to be payable on de-

¹⁷ The prohibition of the payment of interest on demand accounts applies to member banks of the Federal Reserve System or non-member FDIC insured banks. But one commentator has asserted that the broad prohibition of 12 U.S.C. § 1832(a) (1978) would apply to any other financial institution which might obtain authority to issue demand accounts. Pfeiler, *supra* note 11 at 156 n.28.

¹⁸ Comment, *The Negotiable Order of Withdrawal (NOW) Account: "Checking Accounts" for Savings Banks*, 14 BOST. COLL. IND. & COMM. L. REV. 471, 487 (1973).

¹⁹ To be negotiable within the meaning of U.C.C. § 3-104(1), the writing must: "a. be signed by the maker or drawer; and b. contain an unconditional promise or order to pay . . . ; and c. be payable on demand or at a definite time; and d. be payable to order or to bearer."

²⁰ Comment, *supra* note 18 at 495. The NOW draft fits the definition of a check since it is a draft drawn on a bank and payable on demand. U.C.C. § 3-104(2)(b).

²¹ U.C.C. § 3-119, comment 5.

²² Pfeiler, *supra* note 11 at 159.

mand was the order as written, rather than requiring that the order be written on a demand account.²³

A negotiable instrument can be payable on demand *or* at a definite time.²⁴ If the NOW draft were to bear language which referred to the notice requirement, it is at least arguable that this would state a definite time for payment, and the instrument would, therefore, still be negotiable within the meaning of the U.C.C.

These appear to be problems in theory only. In states where NOW accounts are permitted they function as negotiable drafts. They are treated the same as checks and appear to meet the U.C.C.'s requirements for negotiability.

2. Check Clearing

By putting the reserved right of notice on the face of the instrument, an association adds weight to the argument that this is not a demand account.²⁵ But by so doing, the association may create other problems. If the association contemplates using the check collection mechanism of the Federal Reserve System, this legend may cause the clearing bank to treat this as a "noncash" rather than a "cash" item.²⁶ If this were the case, the NOW draft would be processed slower, and it would leave a greater uncollected balance in the account of one who accepted the NOW.²⁷ Whether this becomes a real problem is yet to be seen.

3. Reserve Requirements

The emphasis of a checking account is on withdrawal to meet instant needs, while the emphasis of a savings account is on accumulation of deposits. The Federal Reserve Board recognized this, and imposed higher reserve requirements on demand deposits. A NOW account permits a "checking" withdrawal from a "savings" account, without the requirement of a higher reserve. This has the potential of reducing the safety of deposits in a savings institution. Where NOW account authority is granted,

²³ *Id.*

²⁴ U.C.C. § 3-104(1)(c).

²⁵ See *Pennsylvania Bankers Assoc. v. Secretary of Banking*, Pa. 392 A.2d 1319 (1978).

²⁶ 12 C.F.R. § 210.2(j) (1978) defines a noncash item as:

[a]ny item which the receiving Federal Reserve Bank, in its operating letters, shall have classified as an item requiring special handling and any item normally received by the Federal Reserve Bank as a non-cash item if such bank determines that special conditions require that it be handled as a noncash item.

²⁷ Comment, *supra* note 18 at 497.

some provision should be made to raise the applicable reserve requirements to better protect the depositors.²⁸

II. NINOW's AND CHECKING ACCOUNTS — STATE ASSOCIATIONS

As mentioned earlier, the power of a state-chartered savings and loan to offer NOW accounts (authorized in seven states), or NINOWs (in the other forty-three states) is derived from state law. However state-chartered associations, if insured by the Federal Savings and Loan Insurance Corporation (FSLIC), are still subject to federal regulation. State-chartered FSLIC-insured savings and loans are prohibited from offering any demand securities.²⁹ However, they are permitted to offer checking accounts on a non-interest bearing basis where otherwise authorized by statute, regulation, or judicial interpretation.³⁰ The result is that where "authorized," state chartered associations can offer NINOWs.

At least nineteen states, including Ohio,³¹ have statutes which would prohibit negotiable withdrawal orders.³² In seven states NINOWs are possible, at least in theory.³³ Currently, savings institutions in Wisconsin, Illinois and Pennsylvania are offering this type of account. It is also interesting to note that the state of Massachusetts, where NOW accounts got their start, outlawed NINOWs in late 1978.³⁴

Perhaps the most liberal statute is found in Connecticut. Savings associations there were granted the authority in 1973 to offer personal checking accounts to their depositors.³⁵ Connecticut thus became the first

²⁸ See Kaplan, *Federal Legislation and Regulatory Treatment of NOW Accounts*, 91 BANKING L.J. 439, 456 (1974).

²⁹ 12 C.F.R. § 563.6 (1978).

³⁰ 12 C.F.R. § 561.11(a) (1978).

³¹ OHIO REV. CODE ANN. § 1151.23 (Page 1968). The Statute states:

A building and loan association may permit withdrawal of deposits upon such terms as it provides *except by check or draft*; but no such association shall carry for any member or depositor any demand, commercial, or checking account. Sections 1151.02 to 1151.55, inclusive, of the Revised Code do not prevent members from withdrawing funds by nonnegotiable orders (emphasis added).

³² Pfeiler, *supra* note 11 at 152 n.13.

³³ The states are Connecticut, Florida, Illinois, Maine, Minnesota, Vermont, and Wisconsin. News and Comment, *Legislation on NOW and NINOW Accounts*, 44 LEGAL BULL. 394 (November 1978).

³⁴ MASS. GEN. LAWS ANN. ch. 167 § 16B (West Cum. Supp. 1979). "No cooperative bank, savings bank, or trust company shall authorize non-interest bearing savings accounts that would allow withdrawals by negotiable or transferable instruments, for the purpose of making payments to third parties."

³⁵ CONN. GEN. STAT. ANN. § 36-182(a) (West Cum. Supp. 1979) provides that "[t]he provisions of section 36-104c., with respect to savings banks shall apply to building and loan associations." (Section 36-104c. gives savings banks authority to offer personal checking accounts.) Section 36-104b.(a) defines a personal checking account as "[a] demand deposit

state to give such authority to its savings institutions. Although the statute calls the account a checking account, it is the same as a NINOW account because it bears no interest. It is interesting to note that the statute provides a means by which the Commissioner can terminate the right of an association to accept such accounts, if he finds that it is a threat, or likely to become a threat, to the solvency of a commercial bank.³⁶

In the recent case of *Pennsylvania Bankers Association v. Secretary of Banking*,³⁷ the court upheld the authority of mutual savings banks in Pennsylvania to offer NINOWs. The Pennsylvania Department of Banking promulgated regulations which allowed savings banks to offer this type of account and which permitted the savings banks to exercise their option to require fourteen days notice before making payment.³⁸ Such accounts were not specifically prohibited, but were primarily left to the by-laws of the individual association.

The bankers argued that the promulgation of these regulations was outside the statutory powers of the Department. They argued that the regulations tended to distort the functions of savings institutions. But the Department of Banking had the discretionary power to make such rules, subject to the standards provided by the legislature in the Banking Code. Among other things, rules and regulations were to be promulgated to serve the convenience and needs of depositors and to give savings banks the flexibility to adapt to the changing and expanding requirements of the community.³⁹

held in the name of one or more individuals, solely for personal purposes and not for the purpose of, or in connection with, the carrying on of any trade, business, occupation or profession."

³⁶ The right of the Commissioner to terminate the authority of an association to offer checking accounts is based solely upon his finding that it has caused or is *likely* to cause "a diminution of earnings of a commercial bank . . . so substantial as to jeopardize that commercial bank's solvency or ability to continue to do business." CONN. GEN. STAT. ANN. § 36-104j (West Cum. Supp. 1979). This procedure is initiated by an individual commercial bank and the inquiry is how the situation affects an individual bank. It would be more appropriate to consider the impact on the banking community in whatever is defined as the relevant geographic market. With the aid of a sympathetic commissioner, a bank in a small community could effectively prevent competition in this type of account.

³⁷ 481 Pa. 332, 392 A.2d 1319 (1978).

³⁸ PA. STAT. ANN. tit. 7, § 503(a) (Purdon 1967). "deposits may not be accepted which are legally subject to withdrawal within a period of less than fourteen days."

³⁹ The Code provided for "[a] delegation to the department of adequate rule making power and administrative discretion . . . in order that the supervision and regulation of institutions subject to this act may be flexible and readily responsive to changes in economic conditions and to changes in banking and fiduciary practices . . ." PA. STAT. ANN. tit. 7, § 103(viii) (Purdon 1967).

In the official comment to § 103, the Code provides:

[t]he policies for banking legislation and regulation may create a *progressive rather than restrictive atmosphere* [B]anking faces . . . a high degree of competition, not

In light of this wide statutory grant of discretion, the court held that the Department did not exceed its statutory authority and that mutual savings banks in Pennsylvania can offer NINOW accounts on two grounds. First, there is no express prohibition against them in the Banking Code. Second, the notice provision, in the view of the court, kept the NINOW from being payable on demand, as a check, which would have been prohibited.

In New York, a 1975 case held that the Superintendent of Banks had no statutory authority to promulgate regulations that would allow savings banks to offer checking accounts.⁴⁰ Here the court held that the provision of the Banking Law that authorized savings banks to accept deposits without the issuance of a passbook and to issue some other evidence of its obligation to repay, was not intended to allow them to offer a demand type of account. The court felt that the statute authorized only "true" savings accounts for the accumulation of reserves. The court also saw problems of negotiability with this type of NOW account since payment of such a draft could be delayed for up to sixty days.⁴¹

Evidently the New York legislature did not agree with the court's interpretation of the Banking Law. 1976 amendments to the law authorized both savings banks and savings and loans to accept demand deposits, with such accounts no longer subject to the association's right to require notice before withdrawal.⁴² These accounts were non-interest bearing, and, by regulation, the superintendent had prohibited the use of any transfer arrangement to move funds from an interest bearing account to such demand accounts.⁴³ The accounts were not for the use of a municipal corporation or partnership, corporation, association, or organization for profit.⁴⁴

only from other banks, but also, in virtually all principal functions from a large number of other financial organizations [B]anking should have the leeway to adapt itself to changing and expanding requirements of the community [W]ithin the confines of appropriate restrictions to protect depositors and the public, the *private business judgment of management should be free to guide the development of banking institutions* [B]anking legislation should not be overly detailed but should permit supervisory authorities to shape regulation . . . in order to meet changes in banking and economic conditions *without repeated, detailed legislative amendment* (emphasis added).

⁴⁰ New York State Bankers Ass'n v. Albright, 38 N.Y.2d 430, 343 N.E.2d 735, 381 N.Y.S.2d 17 (1975).

⁴¹ N.Y. BANKING LAW § 238, subd. 2 (McKinney 1971).

⁴² N.Y. BANKING LAW § 238(6) (McKinney 1971). "Subject to any regulations and restrictions prescribed by the superintendent of banks, a savings bank may accept deposits, including demand deposits" Section 390(5) has identical wording, with "savings and loan" inserted in place of "savings bank."

⁴³ 3 N.Y.C.R.R. 301.6 (1969).

⁴⁴ *Id.*

In Minnesota, based on a reading of the statute, associations may offer NINOW accounts. The statute allows withdrawal by written order, payable to the order of a particular person, or to the "order of others as directed."⁴⁵ Since the language of the Florida statute⁴⁶ is almost identical to that of Minnesota's statute, the same conclusion can be reached. At least in theory, these associations have the statutory authorization to offer NINOWs.

Illinois savings associations are prohibited from offering any demand or checking account, but the statute allows the Commissioner to issue regulations regarding the establishment of NOW accounts.⁴⁷ The Commissioner has acted to authorize such accounts⁴⁸ which are currently offered on a non-interest bearing basis to comply with federal law. Apparently, associations have been rather slow to jump at the opportunity to offer NINOWs, since only a small number of Illinois associations have applied for such authority.⁴⁹

Several reasons were offered by the Chicago Federal Reserve Bank as to why savings and loans have been reluctant to get NINOW authority.⁵⁰ First, the associations are reacting slowly to this totally new concept, since they have little, if any, expertise in the area of third party instruments. Second, many savings and loan managers perceive the NINOW account as inconsistent with the policy of balancing long term mortgage assets with long term deposit liabilities. Third, the consumer views the NINOW as having no more to offer than a commercial bank checking account. This consumer may account for the fact that as of December 1977, NINOW accounts held only \$21.5 million of the \$11 billion in statewide savings.⁵¹ It appears that the approach in Illinois has been to go after existing customers who may have no relation with a commercial bank, rather than to "raid" the banks' checking account customers.

⁴⁵ MINN. STAT. ANN. § 51A.33 (West 1970). "Any savings account member or his authorized representative may at any time present a written application for withdrawal of all or any part of his savings accounts . . . Upon receipt of a withdrawal request . . . an association shall pay the amount stated thereon in the form of cash or one or more checks or similar instruments payable to the order of such person or persons, or to the order of others as directed . . ." (emphasis added).

⁴⁶ FLA. STAT. ANN. § 665.341 (West Cum. Supp. 1979).

⁴⁷ ILL. REV. STAT. ch. 32, § 709(a) (1973 and Cum. Supp. 1979).

⁴⁸ *Rules and Regulations, Office of Savings and Loan Commissioner*, Art. VIII, §§ 1-7 (January 1, 1976).

⁴⁹ See *Illinois Associations Slow to Implement NINOW Account Power*, 98 SAV. AND LOAN NEWS 22 (December 1977). Only 55 of the 260 state chartered associations sought approval to offer NINOWs in the period January 1976 through December 1977.

⁵⁰ *Id.*

⁵¹ *Id.* at 23.

In New Jersey, a 1965 case⁵² upheld the authority of savings banks to accept deposits which were subject to withdrawal by check. The New Jersey statute allows withdrawals according to the "usual custom" of savings banks.⁵³ At the time the statute was enacted, a number of savings banks had already been offering checking accounts. The court reasoned that the statutory language was intended to recognize this existing practice. If the legislature had intended to prohibit the offering of such accounts, it could have done so with explicit language.

The statute in Maryland⁵⁴ provides that withdrawals can be made in such ways as the by-laws of the association provide, subject to the right of the association to require up to ninety days notice of the intent to withdraw. *Savings Bank of Baltimore v. Bank Commissioner*⁵⁵ was a case challenging the right of an association to offer checking accounts. The by-laws allowed a non-interest bearing checking account, subject to the right of the association to require thirty days notice. Since the court felt this negated any assertion that this was a demand account, it upheld the offering of the account.

The most recent NINOW "victory" occurred in Wisconsin.⁵⁶ In May 1976, Mutual Savings and Loan Association introduced "Supreme Account," a new savings account service that allowed the use of a negotiable order of withdrawal to transfer funds to a third party. This account was very similar to the NINOW account offered by savings and loans in Illinois. Any savings and loan that offers "checking" account services will meet with opposition from the commercial banking community. This case was no exception, and the action was promptly challenged by the Wisconsin Bankers Association. The trial judge, confronted with a voluminous record,⁵⁷ upheld the right of the association to offer this type of account. Recently, his decision was affirmed by the Wisconsin Court of Appeals.

⁵² *Hudson County Nat'l Bank v. Provident Inst. for Savings*, 44 N.J. 282, 208 A.2d 409 (1965).

⁵³ N.J. REV. STAT. § 17:9A-26(1) (1936) gave savings banks power to "[r]eceive money on deposit, to be repaid, upon such terms, not inconsistent with this Act, as may be agreed upon between the depositor and the savings bank, according to the usual customs of savings banks" (emphasis added).

⁵⁴ MD. ANN. CODE art. 11, § 41(a) (1976).

⁵⁵ 248 Md. 461, 237 A.2d 45 (1968).

⁵⁶ In a yet unpublished opinion, the appellate court affirmed the decision of the Circuit Court of Milwaukee County. The trial court upheld the right of the association to offer NINOWs in the Case of Wisconsin Bankers Ass'n v. Mutual Sav. and Loan Ass'n, Case #442-840 (Cir. Ct. Milwaukee County, August 17, 1977).

⁵⁷ The trial took six days and thirteen witnesses testified. The transcript was 752 pages, with 183 exhibits presented. In addition, the judge had to deal with 300 pages of written briefs submitted by the parties.

It is important to examine the various arguments advanced by *Mutual* for three reasons. First, Senator Proxmire, Chairman of the Senate Banking Committee, is from Wisconsin, and he obviously is involved with any legislation that would grant authority to federal associations to offer NOW accounts. Although such legislation has been before both the House and the Senate for years, it never seems to get anywhere.⁵⁸ The Wisconsin decision should give Senator Proxmire the opportunity to see firsthand what happens when state-chartered associations get a significant competitive advantage over federally-chartered associations. Perhaps this will give added weight to the argument for nationwide NOW account authority. Second, the decision is a good example of how a court can deal effectively with a statute that on its face appears to restrict the right of an association to offer NINOWs.⁵⁹ Finally, the same arguments could be used by an Ohio association seeking authority to offer this type of account, especially in light of the restrictions imposed by Ohio.⁶⁰

Mutual argued that the focal point of the examination should be on the nature of the account, not on the form of the withdrawal. Since most savings associations permit withdrawals from savings accounts upon demand, the method of withdrawal does not affect the nature of the deposit. In reality, the *sole legal distinction* between demand and savings deposits lies in the reserved right of any association to require notice before allowing a withdrawal from savings. *Mutual*, as part of its deposit contract, reserved the right to require prior notice of withdrawal. Although the NINOW draft was a *demand instrument*, it was still a withdrawal from a *savings account*, not a demand (or checking) account.

Since savings and loans have traditionally allowed demand withdrawals from savings accounts by various means, the NINOW draft is just a more modern method of conducting business as it has been conducted for years. *Mutual* examined the various types of customer access to savings accounts permitted in Wisconsin and concluded that since it was no longer necessary for a customer to be physically present in an office to have access to his funds, the NINOW draft was consistent with the current practice.

A customer can withdraw money from his account and get it in the

⁵⁸ 12 U.S.C. § 1832(a) (1978). The latest amendment added New York to the list of states where NOW accounts are permitted.

⁵⁹ WIS. STAT. ANN. § 215.17(1) (West Cum. Supp. 1978) states that: "[t]he association may pay withdrawals on its savings accounts at any time upon receipt of written withdrawal requests therefor, and may pay to the . . . owners of such savings accounts the withdrawal value thereof" Section 215.17(4)(a) continues, "[u]pon receipt of the written withdrawal requests, the association shall . . . pay the saver the withdrawal value"

⁶⁰ OHIO REV. CODE ANN. § 1151.23 (Page 1968).

form of the association's check (drawn on its commercial bank), payable to him, which he can, by endorsement, negotiate to anyone whom he chooses. A customer can also get what is known as an "accomodation check." This is a check made payable to any third party, as requested by the customer. Mutual Savings, as do many other associations, permits the customer to make this request by mail or by phone. The withdrawal can also be in the form of a money order or a traveler's check made payable to and intended for negotiation to third parties. Recurring bills can be paid from savings by a "Transmatic" program, which is a pre-authorized payment system. *Mutual* also permitted customers access to their accounts at various retail establishments through an Electronic Funds Transfer System. Through this System customers may obtain cash from a merchant by communicating with his savings and loan via computer and having a withdrawal from his account used to pay or reimburse the merchant for cash received by the customer.

The trend is definitely toward ease of customer access to their savings dollars, by allowing pre-authorized or electronic access to funds to pay for goods and services. A negotiable order of withdrawal is just another variation of the means of access that have been permitted in the past. As another court observed, allowing withdrawal by check was a "distinction without a difference."⁶¹

III. AUTOMATIC FUNDS TRANSFER (AFT) AND PAYMENT ORDER ACCOUNTS (POA)

It appears that the Federal Reserve Board and the Federal Deposit Insurance Corporation agreed with at least part of the court's reasoning in the Wisconsin case. Both agencies promulgated rules for Automatic Funds Transfer by commercial banks that created what has been called *de facto* NOW accounts. The FRB regulation applies to member banks of the Federal Reserve System,⁶² and the FDIC regulation applies to non-member banks insured by FDIC.⁶³ The effective date of these rules was November 1, 1978.

⁶¹ 248 Md. 461, 237 A.2d 45 (1968).

⁶² The FRB action amended 12 C.F.R. § 217.5(c)(2) (1978). The pertinent part reads: "[W]ithdrawals may be permitted by a member bank to be made automatically or as a normal practice from a savings deposit that consists only of funds in which the entire beneficial interest is held by one or more individuals through payment to the bank itself or through transfer of credit to a demand deposit or other account pursuant to a written authorization from the depositor to make such payments or transfers in order to cover checks or drafts drawn upon the bank [A] member bank must reserve the right to require the depositor to give notice in writing of an intended withdrawal not less than 30 days before such withdrawal is made."

⁶³ The FDIC amended 12 C.F.R. § 329.5(c)(2) in substantially the same language as did the FRB, but made it applicable to non-member, FDIC insured banks.

In practical result, these agencies authorized banks to pay 5% interest on a regular checking account. The funds remain in an interest bearing savings account and are "transferred" to cover a check drawn on the demand account. In an argument that appeared to support the position of many state-chartered savings and loan associations that have offered types of NOW accounts, the Board gave reasons why this action would not violate the prohibition against payment of interest on demand accounts:

[A]utomatic transfer service does not violate the prohibition against the payment of interest on demand deposits. Section 19(a) of the Federal Reserve Act (12 U.S.C. Section 461) authorized the Board to define the terms "savings deposit" and "demand deposit." Pursuant to Section 19, the *distinction drawn . . . between savings and demand deposits is that a bank must reserve the right to require at least thirty days notice prior to withdrawal from a savings deposit, while demand deposits are available on demand.* The [Board's] amendment *does not alter this basic distinction . . .*⁶⁴

It appears that the same basic argument used by banks to protest the offering by savings associations of NOW accounts is now being used by the banks to justify AFT. But as has been indicated, the notice requirement is seldom, if ever, enforced before withdrawal from savings is permitted. This "sole legal distinction" is being referred to by both banks and savings and loans to justify the result that both are seeking, the payment of interest on an account subject to withdrawal by check.

However, the "war" still continues to escalate. While the United States League of Savings Associations continues its suit to halt AFT,⁶⁵ the

⁶⁴ 43 Fed. Reg. 20,001 (May 1, 1978) (emphasis added).

⁶⁵ The most recent development in this suit came as a surprise to all those concerned. While this paper was being prepared for publication, the U.S. Court of Appeals for the District of Columbia Circuit consolidated three pending cases, and in one swift move ruled that Automatic Funds Transfer at commercial banks, Remote Service Units at savings and loans, and Share Drafts at credit unions were illegal. The court felt that each of these "devices" were not authorized by the relevant statutes. Specifically the court ruled: (1) In *American Bankers Ass'n v. Connel* (Civ. No. 76-0105), that the Automatic Fund Transfer system is that "indirect . . . device" prohibited by 12 U.S.C. § 37(a) (1976);

(2) In *Independent Bankers Ass'n of American v. Federal Home Loan Bank Board* (Civ. No. 76-0105), that the Remote Service Units used by many savings and loan associations violate the prohibition against checking accounts contained in 12 U.S.C. § 1464(b)(1) (1976); (3) In *U.S. League of Saving Ass'n v. Board of Governors of the Federal Reserve System* (Civ. No. 78-0878), that the Share Drafts utilized by many federal credit unions are the practical equivalent of checks drawn on interest bearing time deposits in violation of the provisions of 12 U.S.C. §§ 1751-90 (1976).

The court feels that these three separate and distinct financial institutions are becoming three separate but homogenous types of financial institutions offering virtually identical services to the public. The court stated that this should not occur without the benefit of Congressional consideration and the necessary statutory enactment. Acknowledging that

Federal Home Loan Bank Board has decided that it must act to counter the latest move by the Federal Reserve Board. The Board met in an "emergency" session on November 1, 1978, and authorized a new type of account paying 5% interest subject to withdrawal by non-negotiable, non-transferable orders for payment to third parties.⁶⁶ What this in fact created was a non-negotiable NOW account for federally-chartered associations. It is yet to be seen how these accounts will be accepted by the public because they are not negotiable. Until the first insufficient funds payment order endorsed by the payee to a nonbank fourth party is disputed, no one will know how the POA will be treated under the Uniform Commercial Code.

In a press release accompanying this proposal, the Board gave several reasons why it felt that this action was necessary. First, until Congress grants NOW account authority to associations nationwide, POA is the only alternative available to maintain competitive equality with national banks. Second, an economist with the Federal Reserve Board predicted that AFT would cost thrift institutions \$10 billion of low rate deposits over a three year period. Third, it appeared to the Board that the banks targeted their marketing of AFT at savings and loan passbook customers. Fourth, they felt that this type of account was "in tune with the times."⁶⁷ Whatever reasons are offered, the main reason continues to be maintenance of competitive equality.

IV. THE OHIO SCHEME

In absolute terms, the Ohio statute prohibits withdrawals from savings accounts by check or draft.⁶⁸ The statute does permit withdrawals by non-negotiable order,⁶⁹ so at least Ohio-chartered associations can compete

large sums of money are at stake, the court stayed the order vacating and setting aside the abovementioned regulations until January 1, 1980.

According to an Associated Press release in the Akron Beacon Journal on May 20, 1979 at H-12, large sums are indeed involved. If Congress doesn't act by January 1, or the court's decision is not stayed or overruled, more than three million depositors and \$9 billion in balances will be affected. At stake are automatic transfer systems at 23% of the nation's 14,000 commercial banks, remote service units at 10% of savings and loans, and share draft services at 1,500 credit unions nationwide.

Congressman St. Germain, Chairman of the House Subcommittee on Financial Institutions Supervision Regulation and Insurance has introduced a bill (H.R. 3864) which would permit payment of interest on demand accounts. St. Germain introduced this measure specifically to comply with the "request" of the D.C. Circuit Court.

In effect, the court has called Congress' bluff. Hopefully this was the impetus needed to force Congress to act.

⁶⁶ Proposed Amendments to 12 C.F.R. §§ 545.4-1(a), 526.1 (1978). See note 4 *supra*.

⁶⁷ Press Release, Federal Home Loan Bank Board (Nov. 1, 1978).

⁶⁸ OHIO REV. CODE ANN. § 1151.23 (Page 1968).

⁶⁹ *Id.*

with federal associations in the offering of POAs. But beyond this, it is unclear what Section 1151.23 is intended to prohibit or allow.

This section contains some contradictions. It prohibits the use of checks or drafts. The Ohio Revised Code defines a check as a "draft drawn on a bank and payable on demand."⁷⁰ A draft is defined simply as "an order,"⁷¹ presumably an order to pay. This section goes on to say that the terms "check" and "draft," as the context requires, may refer to instruments that are not negotiable.⁷² Given this definitional framework, how can Section 1151.23 prohibit withdrawal by draft, but allow withdrawal by a non-negotiable order, also a draft? Apparently, it is intended that only drafts which are non-negotiable are to be permitted.

Checking accounts are prohibited by the Code. But if the policy is to prohibit the use of negotiable instruments to withdraw from savings, present practice may have defeated this policy. The same arguments used by Mutual Savings in the Wisconsin case to justify its offering of the NINOW account could be used by an Ohio-chartered association that wanted to offer the same type of service to its customers. Ohio-chartered associations have the authority to offer many services that appear to violate the spirit of Section 1151.23. It appears that, in light of current practice, the policy underlying this section may have been defeated.

Ohio associations have the authority to sell traveler's checks.⁷³ Once these checks are signed, they are negotiable within the meaning of the Ohio Uniform Commercial Code.⁷⁴ This would seem to allow a customer to use his savings account as a checking account, at least for very limited purposes.

Major industries are relying heavily on the use of sophisticated electronic equipment and the financial industry is no exception. In the future, the use of checks may be made obsolete by reliance upon electronic transfers of funds. This raises the question of why the use of checks should be prohibited at all.

The Federal Home Loan Bank Board, in May 1978, issued a permanent regulation authorizing Remote Service Units (RSUs).⁷⁵ An RSU is defined in part as an "information processing device . . . by which infor-

⁷⁰ OHIO REV. CODE ANN. § 1303.03(B)(2) (Page 1962).

⁷¹ *Id.* at § 1303.03(B)(1).

⁷² *Id.* at § 1303.03(C).

⁷³ Phone conversation with D. Westerfelt of the Ohio Division of Building and Loan Associations (March 28, 1978).

⁷⁴ OHIO REV. CODE ANN. § 1303.03 (Page 1962), Comment 5.

⁷⁵ 12 C.F.R. § 545.4-2 (1978).

mation relating to financial services rendered to the public is stored and transmitted . . . to a financial institution."⁷⁶ Various services can be offered to the public through an RSU; a customer can credit or debit existing savings accounts, credit payments on loans, or perform other services authorized by the Federal Reserve Board.⁷⁷ Ohio-chartered associations, to maintain parity with federal associations, have also been given RSU authority.⁷⁸ Access to an RSU is usually by plastic card, similar to a credit card. Allowing withdrawals by way of an RSU is very similar to the cashing of a check. As one federal court observed,

From this the District Court concluded that a card inserted into the CBCT [Customer Bank Communications Terminal] machine to secure money was not the cashing of a check within the meaning of the U.C.C. or in the common understanding of check cashing. We cannot agree [T]his is exulting form over substance The check is merely the means used by the bank to obtain the desired objective, *i.e.*, the payment of money to its customer. *The card serves the same purpose as a check. It is an order on the bank* The relationship between the bank and its customer is the same *CBCT withdrawal is the "functional equivalent" of a written check.*⁷⁹

Ohio associations allow customer access through the "functional equivalent of a check," despite the seemingly absolute prohibition.

Ohio associations also issue accommodation checks to their customers. The customer can go to his association and request that funds from his account be withdrawn in the form of the association's check, drawn on its commercial bank, and made payable to third parties as directed. This can also be done by phone or by a mailed request.⁸⁰ The customer can get the check payable to himself, which he can freely negotiate.

On April 19, 1978, the Federal Home Loan Bank Board advised federal associations that they have the authority to issue credit cards.⁸¹ In Ohio, associations have similar authority to affiliate with a credit card

⁷⁶ *Id.* at § 545.4-2(a)(4).

⁷⁷ *Id.* at § 545.4-2(c).

⁷⁸ Pursuant to OHIO REV. CODE ANN. § 1155.18 (Page 1968), the Superintendent issued Rule 1301: 2-5-15, which parallels the federal regulations.

⁷⁹ *State ex rel Lingnoul v. Continental Ill. Nat'l Bank & Trust Co. of Chicago*, 536 F.2d 176, 178 (7th Cir. 1976) (emphasis added).

⁸⁰ The manager of an Ohio association told this author that this is common practice.

⁸¹ By way of *Memorandum #R-43*, from William Sprague, Director of the Federal Home Loan Bank Board. This was in response to a request from California Federal Savings and Loan Association for an opinion concerning their authority to enter into an arrangement with Visa and/or Mastercharge. The Director stated federal associations needed no further grant of authority, but asked any associations desiring to offer credit cards to clear it with his office first. Since this plan involved a loan upon the security of a savings account, it complied with the terms of 12 U.S.C. § 1464(c)(1)(A) (1979).

company.⁸² At the present time, at least one Ohio association is offering the use of credit cards to its savings customers.⁸³ Although there is some problem in calling a credit card a negotiable instrument,⁸⁴ credit cards do perform many of the functions traditionally accomplished by check. They allow the customer, on the security of his account, to pay for goods and services without the need to go to the association in person. Through a cash advance, the credit card allows him to receive cash upon presenting the card at certain financial institutions.

Some Ohio associations also offer "Transmatic" services to their account holders, whereby a customer authorizes the association to pay certain recurring debts directly from his account. This presents a situation very similar to a checking account. Rather than withdraw funds and pay the bill in cash or by check, the saver allows the association to transfer the money to the debtor. In other words, by using "Transmatic," the saver avoids having to write checks to pay certain bills. Between billing periods, the funds earn interest; if the money were left in the saver's checking account, no interest would accrue. In many ways, "Transmatic" is the thrift industry's Automatic Funds Transfer.

Another problem is the method by which funds are currently withdrawn when a customer goes to the association's office. A customer presents a withdrawal slip and demands payment. The usual practice permits withdrawal from his savings account upon request. If the purpose behind Section 1151.23 is to prohibit demand accounts, then most associations are in technical violation of the law.

In light of this statutory framework, what options are available to an Ohio association desiring to remain highly competitive in the area of third party payments?

⁸² In a bulletin from the Ohio League of Savings Associations dated April 6, 1978, the League advised associations that the Division of Building and Loan Associations was of the opinion that there were no regulatory objections to such a plan. The line of credit for the credit card must be secured by a savings account in conformity with OHIO REV. CODE ANN. § 1151.293. The Bulletin also advised that the Superintendent is "[r]eserving his right to take a different statutory position on the issuance of such credit cards in the event that a legal determination is made to the contrary."

⁸³ The Ohio Savings Association of Cleveland began offering a Visa card to its customers in late 1978.

⁸⁴ In an opinion letter to the Ohio League of Savings Associations from the Cleveland law firm of Squire, Sanders and Dempsey, dated February 3, 1978, it was observed that "[n]either the credit card nor the merchant sales draft in general use in the United States is payable to 'order or to bearer' as U.C.C. § 3-104(1)(d) requires for an item to be negotiable. Nor in our opinion can they be considered transferable orders." But the card, when presented to a merchant accomplishes the same result as a check made payable to his order.

First, the association can offer a non-negotiable Payment Order Account to comply with the letter, if not the spirit, of Section 1151.23.

Second, the association can sit back and wait until federal associations nationwide are given authority by Congress to offer NOW accounts. At that point, in order to maintain desired competitive equality, the Ohio Superintendent of Building and Loans would probably draft a parity regulation giving the same authority to Ohio-chartered associations.⁸⁵

Third, an association could offer a type of NINOW account. This action would promptly be challenged by the Superintendent, commercial banks, or both. It is possible that a court would rule favorably based upon a critical examination of Section 1151.23, in light of current practice in the industry. Authority exists that this is not a checking account,⁸⁶ since a notice requirement keeps it from being on demand. The court could also refer to the Wisconsin case⁸⁷ and conclude that the policy reasons underlying Section 1151.23 have been defeated. Or the court could conclude that the allowance of NINOWs would be in tune with the current trends in the industry. It may only be a short time before nationwide NOW account authority is granted, so this type of decision would merely anticipate what many see as an inevitable event. Obviously this third alternative carries the most risk of any an association could choose.

CONCLUSION

Progress is often made because someone is willing to take just such a risk. If the management of Consumers Savings Bank in Massachusetts had not gambled with the NOW account, and if Mutual Savings and Loan Association in Wisconsin had not risked offering its "Supreme Account," it is unlikely that thrift institutions would have even limited ability to offer third party payment systems to their customers. The thrift industry would have lost the third party payment battle long ago. At least for now, the industry still has a fighting chance. As more and more state-chartered associations offer these types of accounts, Congress will be pressured to grant NOW account authority nationwide.

JOSEPH M. LYNCH, JR.

⁸⁵ OHIO REV. CODE ANN. § 1155.18 (Page 1968).

⁸⁶ See PA. STAT. ANN. tit. 7, § 503(a) (Purdon 1967).

⁸⁷ *Supra* note 56.