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Savings and Loan Service Corporations: Regulations in Ohio

Ronald E. Alexander

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SAVINGS AND LOAN SERVICE CORPORATIONS:
REGULATION IN OHIO*
RONALD E. ALEXANDER†

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IN RECENT MONTHS the service corporation subsidiaries of savings associations have been subjected to intense scrutiny by Federal authorities. In June of 1978 the Comptroller General of the United States issued his report to Congress concerning the operation and regulation of these savings association subsidiaries. The report recommended several problem areas for further Congressional attention: 1). inability of the Federal Home Loan Bank Board (FHLBB) to satisfactorily police insider transactions between savings associations and their subsidiary service corporations; 2). insufficient sanctioning authority of the FHLBB to penalize associations for investing more in their subsidiaries than lawfully authorized; and 3). uncertainty concerning whether the FHLBB has statutory authority to regulate transactions between savings associations and their subsidiary service corporations.

On August 10, 1978, the Chairman of the FHLBB responded to the Comptroller General’s report to Congress by submitting the FHLBB’s own report to the Senate Committee on Governmental Affairs. In his accompanying cover letter Mr. Robert H. McKinney, the Chairman of the FHLBB, stated that “[t]he Bank Board shares the GAO’s concern about certain improvident high-risk ventures undertaken by a relatively few service corporations . . . and the impact the resulting losses have had on the safety and soundness of their parent savings and loans.” While expressing his belief that recent Bank Board actions had helped mitigate this problem, he also agreed with the Comptroller General’s conclusion that the FHLBB lacked sufficient authority at that time to adequately cope with the problems within the service corporation industry.

At the time of Chairman McKinney’s letter the Financial Institutions Supervisory Act Amendments of 1977 were still pending in the 95th Congress. Included in the measure were amendments sought by the Bank Board to enable it to more effectively supervise service corporations. If those amendments had passed, they would have extended the Bank Board’s cease and desist power and its removal authority to reach the directors, officers and employees of service corporations. This legislation would also have extended the Bank Board’s jurisdiction to include service corporations of state-chartered savings associations. Although these measures failed, their importance cannot be over emphasized. Without that legislation the FHLBB continued to lack jurisdiction to supervise the service corporation subsi-
aries of FSLIC insured state-chartered associations. As noted in the Report of the Comptroller General:

[O]ne . . . aspect of intra-industry competition is the flexibility available to State versus Federal Association Service Corporations. State-chartered associations receive their authority from several sources. Most States have ‘tie-in’ regulations with Federal laws. These regulations authorize State associations to do whatever Federal associations may do. However, State associations are permitted more flexibility to invest in service corporations. . . . Despite these differences, a State association may be a member of the Federal Savings and Loan Insurance Corporation and pay no more for insurance than its rigorously regulated Federal counterparts.³

Both the GAO and the FHLBB share this concern that the service corporations which remain outside the FHLBB’s jurisdiction pose a potential threat to the financial integrity of their parent associations. That threat is perceived to emanate from two sources: 1). the breadth of business activities permitted to these service corporations by the various states; and 2). inadequate supervision by those states. The Comptroller General also expressed concern that the states will continue to broaden the range of business activities permitted to service corporations, thereby pressuring the FHLBB to grant parity to federal associations and their subsidiaries.

From a competitive perspective . . . the Board is in the position of being unable to totally control either [the state’s] service corporation activities or association investment [by state-chartered associations] in service corporations. Lack of these controls allows state-chartered, federally insured associations to influence and even accelerate the expansion of Federal service corporations’ operations. Once state-chartered associations became involved in new activities, Federal associations may also want the same powers to remain competitive. Consequently, state-chartered associations may influence the future direction of Federal associations’ service corporation activity.⁴

While it is not entirely clear that an increasing range of business activities might alone threaten the financial integrity of parent associations, the concern that increasing risks can accompany inadequate state supervision is obviously well founded.

Nor were the bases for those concerns entirely removed in 1978 when Congress finally expanded the FHLBB’s jurisdiction to include limited supervision of the service corporations of FSLIC insured state associations.⁵ That added supervisory authority did not include the ability to limit di-

³ Savings and Loan Associations: Changes Needed in the Regulation of their Service Corporations (Report to the Congress by the Comptroller General of the U.S.) at 39 (June 14, 1978).
⁴ Id. at 40.
⁵ See supra note 2.
rectly the business activities of these service corporations. Those decisions still remain within the exclusive bailiwick of the individual states. One such state is Ohio. This state both permits its associations to operate service corporations and determines the scope of the service corporations’ business activities. Unlike many other states Ohio has a substantial number of associations that are not FSLIC insured. Their service corporations remain outside the FHLBB’s jurisdiction, even as recently expanded by the Congress. Most of the Ohio associations that are not federally insured are instead members of the Ohio Deposit Guarantee Fund (ODGF). A few Ohio associations are neither members of FSLIC nor ODGF.

The purpose of this article is to examine Ohio’s scheme for regulating service corporations. This examination includes the history of service corporation regulation in Ohio, the scope of permissible business activities of these corporations, investment limitations for parent savings associations and the supervisory authority of the Ohio Division of Building and Loan Associations [Division]. Perhaps this article will also provide a useful vehicle for judging whether the risks perceived by the GAO and FHLBB can arise from a single state’s regulatory scheme for service corporations. It must be remembered that any such risks inherent in Ohio’s scheme threaten not only the FSLIC system, but also this state’s separate Ohio Deposit Guarantee Fund. A brief review of the history of service corporations of both the federal and Ohio associations is necessary before beginning this examination of the Ohio service corporations.

I. SERVICE CORPORATION HISTORY

The Comptroller General’s concern that the states will influence the future direction of the federal associations has not proved to be the case in Ohio. Just the opposite has occurred. Many actions by the Ohio General Assembly and the Division have been a direct result of earlier initiatives by Congress or the FHLBB. Indeed, it is fair to depict the Ohio experience as a mirroring of earlier federal developments. The significant exception concerns investment limitations. Much higher ceilings are placed upon Ohio savings associations’ investment in and lending to service corporations than are applicable to federal associations.

A. Federal Associations

Congress first authorized federal associations to invest in service corporations in 1964. That enactment permitted a federal association to invest up to one percent of its assets in “any corporation.” In ad-
dition to the one percent limitation, "[T]he entire capital stock of such [service] corporation . . . [must be] available for purchase only by savings and loan associations of that state, district, commonwealth territory or possession and by federal savings and loan associations having their home offices therein." When promulgating regulations to flesh out this statutory scheme, the Federal Home Loan Bank Board has consistently taken the position that "[A]lthough it would appear that the language of the statute contemplated a broad scope of activities in which a service corporation of a federal association might engage, the legislative history of this provision strongly suggests that Congress did not intend that such corporations be permitted to engage in an unlimited range of activities."

The legislative history of that enactment may be briefly summarized as follows. Legislative authority for federal associations to invest in subsidiaries was initially sought by the United States League of Savings and Loan Associations. 2 During congressional hearings on their proposals the League stated that:

[s]avings and loan associations have many of the same needs for co-operative data processing as do commercial banks. Like commercial banks, they should be authorized to establish a nonprofit service corporation. Also, they should be permitted to invest in service corporations such as the Centrol [sic] Corp. of New Jersey. 13

The FHLBB agreed that savings associations ought to be permitted to acquire subsidiary corporations that would provide complementary services to savings associations. The Bank Board disagreed, however, with the League's position that federal associations ought to be permitted to invest in the Central Corporation of New Jersey 14 or similar corporations. The Bank Board preferred that the business ventures of these savings association subsidiaries be more limited. For that reason the Bank Board proposed that service corporation activities be restricted to only those approved by

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10 Id.
11 Letter from Robert H. McKinney to the Honorable Abraham Ribicoff, Attachment No. 2 Legislative History of the Service Corporation Investment Authority of Federal Savings and Loans Association and the Regulatory Implementation of Such Authority, at 1 (on file with the AKRON LAW REVIEW).
12 That organization has since changed its name to the United States League of Savings Associations.
14 The Certificate of Incorporation for the Central Corporation of New Jersey cited by the Federal Home Loan Bank Board permitted that corporation "to carry on any or all of its operations and businesses, and without restriction or limitation as to amount, to purchase, lease, or otherwise acquire, hold or own, and to mortgage, sell, convey, lease, or otherwise dispose of, real or personal property of every class or description, in any of the states or territories of the United States and in the District of Columbia, in and in all foreign countries subject to the laws of such state, district, territory, or country."
the Bank Board. This was to be accomplished by amending the proposed legislation to subject service corporations to the "rules and regulations of the Board." The bill as ultimately passed by the Senate included this amendment sought by the Bank Board and a further provision that limited an association's investment in a service corporation to two percent of the association's assets.

The legislation introduced in the House contained both the provisions passed by the Senate. Both quickly came under fire when the bill was referred to Committee. Congressman Widnall from New Jersey, home state of the Central Corporation, introduced amendments to change both provisions. He sought to permit investment in the New Jersey Central Corporation (and similar subsidiaries, if formed in other states) by removing the FHLBB's language to limit service corporations' activities to those approved by Bank Board rule. Congressman Widnall's quid pro quo for this amendment was reduction of the maximum allowable savings association investment in service corporations from two percent to one percent of an association's assets. The Congressman argued that any additional investment risk for parent associations resulting from his proposed expansion of permissible business ventures of service corporations would be adequately mitigated by this reduction in the amount of an association's assets that could be placed at risk. Both of Congressman Widnall's amendments were adopted by the Committee over the objection of the FHLBB. The measure ultimately enacted by Congress also contained both of Congressman Widnall's amendments.

This portion of the legislative history suggests that Congress intended to permit these service corporations to engage in a broad range of business activities. Militating against such an interpretation is the more restrictive approach evidenced in both the House and Senate committee reports on this measure. The sentiment of both reports is fairly represented by the House Committee's statement that it did "not contemplate that an association would be permitted to invest in ordinary profit-making corporations or corporations not closely related in purpose to the savings and loan business."

When the Bank Board's amendment expressly subjecting service corporation investments to rule-making by the Bank Board was removed from the legislation the Bank Board immediately adopted a fall-back position.

15 1964 Housing Act, § 807(e), the version passed by the Senate (S 3049).
16 Id.
17 Housing Act of 1964, § 905.
18 H.R. REP. NO. 1703, 88th Cong., 2d Sess., 28 reprinted in (1964) U.S. CODE CONG. & AD. NEWS 3416, 3444. The Senate Report noted that "[t]he committee does not contemplate that an association would be permitted to invest in corporations which do other than provide such services to savings and loan associations." S. REP. NO. 1265, 88th Cong. 2d Sess. 55 (July 29, 1964).
That argument was based upon the Bank Board's existing plenary authority contained in section 5 of the Home Owners' Loan Act: 19

In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal Savings & Loan Associations ..." 20

The Bank Board has recently noted that this "historic position" was concisely restated by a Bank Board general counsel to be as follows:

Although the Widnall Amendment deleted the words "Subject to rules and regulations of the Board," the statutory authority would still be subject to the limitations imposed by the Bank Board's regulations as provided in subsection (a) of section 5 of the Home Owner's Loan Act of 1933.

Thus, the deletion affected by the Widnall Amendment must be regarded as the removal of surplus language, having no effect on the Bank Board's power to regulate such investments. 21

Undeterred by the Widnall Amendment, the FBLBB thus proceeded to adopt its first service corporation regulation on September 8, 1965. 22 That initial regulation provided the skeletal framework which today supports the more comprehensive regulatory scheme for service corporations. A brief overview of some important elements of that scheme follows.

The initial regulation authorized federal associations to invest in two types of service corporations, commonly referred to as type A and type B service corporations. 23 These labels were derived from the paragraph numbering scheme within the regulation itself. Type A service corporations are also more descriptively referred to today as "jointly-owned service corporations." As the name suggests, the Bank Board's rule provides that the stock of this type service association must be owned by several savings associations. 24 Type B service corporations are more properly labeled "whol-
ly-owned service corporations.”25 Ownership of the stock of this type of service corporation may be limited to a single savings association.

In addition to this scheme of stock ownership, the other important difference between these two types of service corporations in the Bank Board’s initial regulation was the procedure for investment. Federal associations were permitted to invest in jointly-owned service corporations without the prior approval of the Bank Board, whereas investment in a wholly-owned service corporation was not permitted until the association first secured the Board’s approval. This difference in investment procedure was explained primarily by the fact that the FHLBB rule contained a list of pre-approved activities for jointly-owned corporations.26 The rule contained no approved activities for wholly-owned service corporations, but instead provided that “[e]ach application for approval to invest in a [wholly-owned] service corporation . . . shall contain a statement setting forth the need for such corporation, [and] the services to be performed by the corporation . . . .”27

In 1967 the Bank Board expanded the range of permissible business activities allowed to jointly-owned service corporations.28 These service corporations were now permitted to broker and warehouse real estate loans, and to engage in transactions involving loan participations.29 The Board also permitted these service corporations to expand their “clerical, bookkeeping, accounting, statistical, . . . [and] similar functions” to include providing savings associations with data processing services, accounting services, auditing services, bulk purchasing of certain office materials, and disaster storage of duplicate records.30 Additionally, included on this expanded list of preapproved activities were credit information services for

State, District, Commonwealth, territory, or possession in which the home offices of less than fifteen savings and loan associations are located, not more than 33 1/3 percent of the outstanding capital stock of such service corporation is, or may be, owned by any savings and loan association . . . .” 12 C.F.R. 545.9-1(a)(2) (1979).

25 Currently, besides the type mentioned supra note 24, a federal association may also invest in a service corporation if: “The entire capital stock of such corporation is held by one or more savings and loan associations or Federal associations with a home office in that State, District, Commonwealth, territory or possession. . . .” 12 C.F.R. § 595.9-1(b)(1) (1979).

26 These activities were restricted to “originating, purchasing, selling and servicing loans upon real estate, and participating interest therein, and/or clerical, bookkeeping, accounting, statistical, or similar functions performed primarily for savings and loan associations, plus such other activities as the Board may approve.” FHLBB Report to the U.S. Committee on Governmental Affairs (Aug. 10, 1978), Attachment 2 at 12 (on file with the AKRON LAW REVIEW).

27 Id., Attachment 2 at 13.


29 Id. § 556.3(b)(1).

30 Id. § 556.3(b)(2).
associations; administration of certain life, health, and pension benefit programs; tax consulting services; and advertising services.\textsuperscript{31}

The Bank Board also made a significant change that year in its policy regarding wholly-owned service corporations. It announced that henceforth it would “consider for approval applications in which the [wholly-owned] service corporation . . . has authority to act as an insurance agent, escrow agent, or trustee under deeds of trust primarily for the benefit of the service corporation member.”\textsuperscript{32}

The Bank Board implemented its next substantial change in service corporation policy in 1970.\textsuperscript{33} It again enlarged the pre-approved activities for jointly-owned service corporations. They were permitted to originate, purchase and sell mobile home loans and real estate loans secured by first liens (as well as participations in such loans.)\textsuperscript{34} Educational loans were also now permitted.\textsuperscript{35} In addition, these service corporations could acquire unimproved real estate for development into areas suitable for housing construction;\textsuperscript{36} develop real estate for sale or rental;\textsuperscript{37} purchase improved real estate or mobile homes for rental;\textsuperscript{38} and purchase improved real estate to renovate for rental or for sale.\textsuperscript{39} Finally, these service corporations were authorized to maintain and manage the rental property of other persons.\textsuperscript{40} At that same time a formal list of pre-approved activities was first announced for wholly-owned service corporations.\textsuperscript{41}

In 1971 both types of federal service corporations were granted pre-approval to serve “[a]s insurance broker or agent, primarily dealing in policies for savings and loan associations, their borrowers and account holders, which provide protection such as homeowners', fire, theft, automobile, life, health, and accident, but excluding title insurance and private mortgage insurance.”\textsuperscript{42} In 1973 this insurance activity was expanded by permitting service corporations to serve as brokers or agents of title insurance companies.\textsuperscript{43}

\textsuperscript{31}Id. § 556.3(b)(3).

\textsuperscript{32}Id. § 556.3(c)(1).

\textsuperscript{33}See generally Address of FHLBB Chairman Preston Martin “Second Thoughts on the Service Corporation.” (Apr. 16, 1970).


\textsuperscript{35}Id. § 545.9-1(a)(4)(ii).

\textsuperscript{36}Id. § 545.9-1(a)(4)(v).

\textsuperscript{37}Id. § 545.9-1(a)(4)(vi).

\textsuperscript{38}Id. § 545.9-1(a)(4)(vii).

\textsuperscript{39}Id. § 545.9-1(a)(4)(viii).

\textsuperscript{40}Id. § 545.9-1(a)(4)(ix).

\textsuperscript{41}The resolution stated that the “activities of such corporations, performed directly or through one or more wholly-owned subsidiaries, [may] consist solely of one or more of the activities specified in subdivisions (i) through (xi) of paragraph (a)(4). . . .” Id. § 545.9-1(b)(2).


\textsuperscript{43}38 Fed. Reg. 24200 (codified in 12 C.F.R. § 545.9-1(a)(5)(ix) (1979)).

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In 1975 the Bank Board designated consumer lending to be a pre-approved activity. A “consumer loan” was any “loan to one or more individuals which is either unsecured or which is secured by consumer goods”; while consumer goods were “goods used or bought primarily for personal, family or household purposes.” In that same year, the Board designated as a pre-approved activity for jointly-owned service corporations the preparation of tax returns for most customers of savings associations. Another important activity pre-approved by the Bank Board in 1975 concerned office buildings for savings associations. The Board dispensed with its prior procedure to only approve this activity on a case-by-case application basis. Service corporations could now purchase and manage office buildings for any association that owned stock in the service corporation without application for Bank Board approval.

The federal statute, initial Bank Board rule, the subsequent amendments to that rule, and statements of policy provided the continuing model for Ohio’s service corporation regulatory policy. The most recent amendment to the federal scheme occurred on March 31, 1980. On that date President Carter signed the “Depository Institutions Deregulation and Monetary Control Act of 1980.” The measure, which will no doubt soon effect substantial changes in the Ohio scheme, expanded the authority for federal associations’ investment in service corporations. Section 5(c) of the Home Owners’ Loan Act of 1933 was amended to permit:

Investments in the capital stock, obligations, or other securities of any corporation organized under the laws of the State in which the home office of the association is located, if the entire capital stock of such corporation is available for purchase only by savings and loan associations of such State and Federal associations having their home offices in such State, but no association may make any investment under this subparagraph if its aggregate outstanding investment under this subparagraph would exceed 3 per centum of the assets of the association, except that not less than one-half of the investment permitted under this subparagraph which exceeds one per centum of assets shall be used primarily for community, inner-city, and community development purposes. (Italics designates the 1980 amendment.)

B. Ohio Associations

1. House Bill 21

Less than five months after Congress authorized federal associations

45 Id.
49 Id.
to invest in service corporations, similar legislation was introduced in the Ohio House of Representatives. The stated purpose of that legislative proposal was to provide Ohio chartered savings associations with additional investment and lending authority, authority already possessed by federal associations. The enactment included authority: 1). to make loans secured by building lots and building sites; 2). to make real estate loans outside the borders of Ohio; 3). to make education loans; 4). to make loans secured by multifamily residential property; 5). to participate in certain urban development building programs; 6). to lend greater maximum amounts in certain loan categories; and, finally 7). authority to invest in “service corporations.” The latter was couched in the following terms:

Such associations may invest no more than two percent [sic] of the association’s assets in the capital stock, obligations, and other securities of service corporations organized under the laws of this state to provide domestic associations as defined in Section 1151.01 of the Revised Code, services compatible with the purposes, powers, and duties of such domestic associations. Such service corporations may also provide mechanical, clerical and recordkeeping services for other corporations, other persons, or governmental units subject to the written approval of the state superintendent of building and loan associations. The capital stock of such service corporations shall be available for purchase only by such domestic associations and no association stockholder shall hold more than fifty percent of the capital stock of such service corporations.

Although Ohio legislation is generally effective ninety days after enactment, this particular measure was declared to be an “emergency measure” with the consequence that it became effective immediately. The reason for seeking immediate effect for these new lending and investment powers was “[t]hat federal savings and loan associations in this state currently are exercising the authorities this bill would confer upon state-chartered associations; therefore, making the amendments effective at the earliest possible time will

50 See Housing Act of 1964, supra note 8.
52 The title of H.B. 21 stated that the purpose was “[t]o provide building and loan associations organized under the laws of this state investment and lending powers comparable to such powers currently authorized for federal savings and loan associations . . .” Id.
58 Ohio Rev. Code Ann. §§ 1151.29(B), 1151.29(C), 1151.295(A), 1151.297(A) (Page 1968).
60 Id.
61 “[E]mergency laws necessary for the immediate preservation of the public peace, health, or safety shall go into immediate effect” Ohio Const. art. II, § 1(d).
permit all Ohio savings and loan associations to move together on these programs which are in the public interest." In less than ten months after the Congressional enactment, Ohio associations thus received authority to form and invest in service corporations.

In many respects, Ohio's statute was a mirror image of the federal statute. The Ohio statute contained a limitation on total assets that might be invested in a service corporation by a savings association, but raised that limit to two percent of an association's assets, as in the House version of the federal statute, not the one percent as finally adopted by Congress. While only the legislative history suggested that Congress intended to limit the services that might be performed by service corporations, the Ohio statute expressly limited service corporations to "services compatible with the purposes, powers, and duties of . . . domestic associations." Ohio service corporations were also permitted to provide services to entities other than savings associations, but the statute limited those services to "mechanical, clerical, and record keeping." As if in anticipation of the type of service corporation in the yet to be promulgated FHLBB service corporation regulation, the Ohio statute provided that no savings association could own more than fifty percent of the capital stock of a service corporation. This limitation in the statute permitted formation of only jointly-owned service corporations and effectively prohibited the formation of wholly-owned service corporations. Several events which were to have significant impact upon the present Ohio scheme began occurring very soon after the June 21, 1965, effective date of this Ohio statute.

In September of 1965 the FHLBB promulgated its initial service corporation rule. This rule was to be followed by the series of subsequent FHLBB actions discussed above. Ohio's ability to quickly adopt those federal developments was significantly aided by a 1967 legislative enactment of the Ohio General Assembly.

2. Superintendent's Regulation 70-5

In 1967 the Ohio legislature enacted the "parity regulation" statute. This statute permitted the Ohio Superintendent to promulgate rules which grant Ohio chartered savings associations any "right, power, privilege, or benefit" possessed by federal associations doing business in this state. In

62 1965 Ohio Laws 1643, AM. H.B. 21, § 3.
64 Id.
65 See text accompanying note 21-58 supra.
66 See Tie-in Statutes and Parity Regulations and their Constitutionality, 11 Akron L. Rev. 503 (1978) for a discussion of these types of statutes.
67 The statute requires only those rights, powers, privileges and benefits enjoyed by virtue of a federal "statute, rule or regulation, or judicial decisions" may be so conferred upon state-chartered associations by the Superintendent. Ohio Rev. Code Ann. § 1155.18 (Page 1968).

Having secured enactment of this statute, the savings association industry of Ohio has performed a commendable job in continuing to protect this authority for its Superintendent.
this way the legislature delegated to the Superintendent its power to grant Ohio-chartered associations any additional lending or investment authority, but only to the extent that similar authority had been secured for federal associations by Congressional enactment, FHLBB regulation or judicial decision. This delegation of legislative authority was further limited by the proviso that these Superintendent's rules remain effective for only thirty months. Before the expiration of that period, a parity rule must be enacted into statute by the legislature in order to permanently secure this additional authority for Ohio associations. If the legislature fails to enact a parity rule into statute within that thirty months period, that temporary authority automatically expires.68

Enactment of this parity regulation statute laid the foundation for the next significant step in Ohio's regulation of service corporations. That step was taken in 1970 when the Superintendent promulgated a service corporation parity regulation, Regulation 70-5. On August 24, 1970, the Superintendent authorized Ohio associations to invest in a new type of service corporation for the stated reason "that federal savings and loan associations, the home offices of which are located in this state, currently possess certain rights, powers, privileges, and benefits by virtue of section 545.9-1 of the Rules and Regulations of the Federal Savings and Loan System not possessed by building and loan associations organized under the law of this state."69 The effect of this new regulation was to permit Ohio savings associations to organize wholly-owned service corporation subsidiaries. The rule did not mandate that these service corporations be wholly-owned by a single association however, but only that a single association own more than fifty percent of the outstanding stock of the service corporation. The rule thus permitted service corporations very similar in ownership structure to the type B service corporations authorized by the Bank Board's initial service corporation rule. Interestingly, while the federal rule limited ownership of service corporations exclusively to savings associations (state or federal), this Regulation 70-5 did not so restrict the ownership of the remaining minority stock interest.

Under the Superintendent's parity regulation an Ohio savings association could now invest up to one percent of its assets "in the capital stock, obligations or other securities" of this new type of subsidiary service corpo-

Not only is he accorded carte blanche in expanding their investment and lending authority via these rules, he is also exempted from compliance with the normal rule-making procedures prescribed for him by the Ohio Administrative Procedure Act. Indeed, the Ohio Administrative Procedure Act has been amended to define the term "agency" as expressly not including the Superintendent when exercising his rule-making power under this parity regulation statute. Ohio Rev. Code Ann. § 119.01(A) (Page 1978).


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This one percent investment authority was not in addition to the statutory two percent investment permitted in jointly-owned service corporations, but was to be included when computing that two percent investment ceiling. Thus, if a savings association chose to invest one percent of its assets in the capital stock of a wholly-owned service corporation, it could additionally invest no more than one percent of its assets in the capital stock of a jointly-owned service corporation. Nor was it necessary for a savings association to restrict its “investment” in wholly-owned service corporations to the purchase of an equity interest. These investment ceilings could also be met through loans by the savings association to the service corporation.

The savings association could either purchase stock in the service corporation, lend to it, or do a combination of both; so long as the percent-of-asset limitations of the statute and rule were not exceeded.

Although the enabling statute for jointly-owned service corporations was silent concerning borrowing by those corporations, Regulation 70-5 implicitly authorized borrowing by imposing debt ceilings for wholly-owned service corporations. These debt ceilings were stated for two categories, unsecured and secured debt. The ceilings were applicable only to debt incurred from lenders who owned no equity stock in the service corporation. No limits were imposed upon debt owed to stockholders of the service corporation. The debt ceiling for nonstockholder lenders was as follows. In the case of unsecured debt, the ceiling imposed upon these wholly-owned service corporations was the lesser of: (a) one percent of the assets of its equity shareholders, or (b) an amount equal to its stockholders’ combined investments in the service corporation’s equity and debt securities. Secured debt could not exceed an amount equal to the lesser of: (a) four percent of the assets of the equity stockholders of the service corporation;

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70 Id.
71 This investment limitation was reiterated in the Rule in the following manner: “An association may make any investment under this regulation if its aggregate outstanding investment in the capital stock, obligations, or other securities of service corporations and subsidiaries thereof (including all loans, secured and unsecured, to service corporations, or any subsidiaries thereof, and to joint ventures of service corporations or subsidiaries, whether or not the association is a stockholder of such service corporations) would not thereupon exceed the limitations specified in the first paragraph of this regulation.” Id. at ¶ (D).
73 Superintendent’s Reg. 70-5(D). Although not artfully drafted, this provision is the source of authority for savings associations to lend to wholly-owned service corporations without also purchasing stock in that borrower.
74 Superintendent’s Reg. 70-5(C)(1). The regulation also provided that “secured debt” owed to its stockholders by the subsidiary corporation was not to be included in arriving at the amount computed in (b) above. Id.
or (b) four times the investment by the stockholders in the equity and debt securities of the service corporation.\textsuperscript{75}

Investment activities permitted to these wholly-owned service corporations were specifically delimited by this 1970 parity regulation. For example, these service corporations could originate, purchase, sell and service both loans and loan participations secured by mobile homes or by first mortgages in real estate.\textsuperscript{76} They could also originate, purchase, sell and service educational loans,\textsuperscript{77} and make certain investments authorized by statute for Ohio savings associations.\textsuperscript{78} Those investments included obligations secured by the full faith and credit of the United States,\textsuperscript{79} bonds and other interest-bearing obligations of various units of state and local government and government agencies,\textsuperscript{80} bonds and other securities issued by the Home Owners' Loan corporation,\textsuperscript{81} loans secured by real estate located within certain urban renewal areas and loans to certain community urban redevelopment corporations.\textsuperscript{82} and certificates of deposits issued by "any financial institution . . . subject to inspection by the United States or by this state."\textsuperscript{83}

Regulation 70-5 also allowed wholly-owned service corporations to acquire unimproved real estate and develop that real estate for use as residential home sites and mobile home sites.\textsuperscript{84} As a complement to this acquisition authority, the service corporations were granted authority to develop, subdivide and construct all necessary improvements on such real estate necessary to perfect that real estate for resale as sites for residential housing or mobile homes.\textsuperscript{85} Nor were these service corporations limited to acquisition of unimproved real estate for the purpose of development and

\textsuperscript{75} Superintendent's Reg. 70-5(C)(2). As in the instance of the computation of shareholders investment in equity and debt securities of the service corporation for the purpose of determining the limitations on unsecured debt, this paragraph (b) limitation based upon the stockholders' investment in these same securities was arrived at without the inclusion of "secured debt owed such corporation to [its shareholders]."

\textsuperscript{76} Superintendent's Reg. 70-5(B)(2).

\textsuperscript{77} Superintendent's Reg. 70-5(B)(2).

\textsuperscript{78} Superintendent's Reg. 70-5(B)(3).

\textsuperscript{79} OHIO REV. CODE ANN. § 1151.34(A) (Page 1968).

\textsuperscript{80} Id. § 1151.34(B).

\textsuperscript{81} Id. § 1151.34(c).

\textsuperscript{82} Id. § 1151.34(F) Savings associations making loans under the authority of this paragraph were not permitted to exceed five percent of their assets in loans to any single such redevelopment or renewal venture, and could loan no more than twenty percent of its assets through a diversified program of renewal or redevelopment lending projects. That is, an association could lend no more than five percent of its assets to each of four separate urban renewal projects, for a total investment of twenty percent in such projects. No such percent of asset limitation was imposed upon service corporations by the Superintendent's service corporation regulation.

\textsuperscript{83} Id. § 1151.34(D).

\textsuperscript{84} Superintendent's Reg. 70-5(B)(5).

\textsuperscript{85} Superintendent's Reg. 70-5(B)(6). This authority also permitted service corporations to make improvements to be used for commercial or community purposes when incidental to a housing project.
resale as home construction sites. They were also permitted to acquire improved residential property and mobile homes for sale or for rental. Authority was additionally granted to manage any rental property acquired by the service corporation. Finally, these service corporations could participate in any manner with any other wholly-owned or jointly-owned service corporation or with any nonprofit enterprise in any of these pre-approved business activities.

In addition to the investment and lending activities described above, this Superintendent's regulation authorized wholly-owned service corporations to perform various services, so long as those services were performed "primarily for domestic building and loan associations." These activities included clerical services, accounting, data process, and internal auditing; providing credit information; appraising; construction loan inspections; and title abstracting. A service corporation could also conduct research and surveys for associations, and serve as a central purchasing agent for office supplies and similar material for associations. Record storage and microfilming was an additional permissible service. These service corporations were even permitted to provide advertising and marketing services, so long as the purpose was to solicit either savings accounts or loan applicants for savings associations. In the area of benefits for association employees, service corporations could develop and administer life and health insurance programs, as well as pension and other retirement programs. To conclude this lengthy list of permissible activities, the rule permitted any other "activities reasonably incidental" to those listed above.

The regulation's final provision permitted these service corporations to engage in "such other activities . . . as the Superintendent . . . may approve in writing upon application therefore by any such corporation."
The rule contained no standards to indicate how the Superintendent would determine whether to approve such applications.\textsuperscript{99}

3. Senate Bill 442

Because this rule authorizing investment in wholly-owned service corporations was a parity regulation, it would expire thirty months after its promulgation if not enacted earlier into statute. That expiration date was February 24, 1973. Apparently cognizant of this important deadline, the Ohio General Assembly acted in sufficient time by enacting Senate Bill 442. That enactment became effective on July 10, 1972. That measure's service corporation statute remains in effect today and is discussed in detail below. For the purposes of this historical overview, it is sufficient to note that the statute incorporated verbatim the parity regulation's concept of the wholly-owned service corporation. That is, while any number of associations may own stock in a so-called wholly-owned service corporation, one association must own more than fifty percent of the service corporation's capital stock. The investment limitation of one percent of assets was also retained in the statute, as well as the parity rule's requirement that this one percent investment must be counted toward the total two percent allowable investment in jointly-owned service corporations. The legislature did not, however, choose to codify the full text of the Superintendent's parity regulation. Senate Bill 442 instead required the Superintendent to promulgate a new service corporation rule "describing the services that [a wholly-owned] service corporation may provide."\textsuperscript{100} That rule was to be promulgated by February 24, 1973.

Senate Bill 442 also permitted service corporations to continue "any or all of the services authorized" by Regulation 70-5 until the Superintendent promulgated this new regulation.\textsuperscript{101} Interestingly, while Senate Bill 442 continued the authorizations of the Superintendent's parity rule, it did not continue the various restrictions as to secured and unsecured debt, nor the following two prohibitions contained in that 1970 wholly-owned service corporation regulation:

\begin{enumerate}
\item Whenever such service corporation, including any subsidiary thereof, engages in an activity which is not permissible for, or exceeds the limitations of, a service corporation which an association may invest in, or whenever the capital stock ownership requirements of this regulation are not met, an association having an investment in such corporation, including any subsidiary thereof, shall dispose of such investment promptly unless, within 90 days following the date of mailing of written notice by the Super-
\end{enumerate}

\textsuperscript{99} The paragraph authorizing this process did state that such activities included "acting as escrow agent, and . . . a joint venture in any such activity specified in this division (b)."

\textsuperscript{100} 1972 Ohio Laws 845, Am. Sub. S.B. 442 § 1 (1972).

\textsuperscript{101} 1972 Ohio Laws 845, Am. Sub. 442 § 3 (1972).
erintendent of the building and loan associations to such investing association, the impermissible activity is discontinued, the limitation is complied with, or the capital stock ownership requirements are met.

(2) The activities which are specified in this regulation for service corporations in which associations may invest do not include their use to acquire "scheduled items," as defined by the Superintendent of building and loan associations, from another building and loan association.102

Not only did Senate Bill 442 require promulgation of this new service corporation regulation for wholly-owned corporations, it also required that this regulation be adopted in accordance with the procedures of the Ohio Administrative Procedure Act (APA).103 This was the first time in the long history of this agency that its rulemaking had to comply with the formal procedures of Ohio's APA.104 The APA prescribes what are perhaps the most formal of the states' rulemaking procedures. It mandates both notice and a formal hearing that has the attributes of an adversarial proceeding.105 Only after these steps had been followed did the Superintendent finally adopt this new service corporation rule, Superintendent's Regulation COg-03 which became effective on December 13, 1973.

Senate Bill 442 also stated the criteria which were to guide the Superintendent in fashioning his rule. The activities authorized for wholly-owned service corporations were to "be so related to the business of building and loan associations as to be a proper incident thereto."106 With that standard as his guide, the Superintendent proceeded to incorporate many of the provisions of the wholly-owned service corporation parity regulation into this new rule. There were also several significant differences, however, which deserve discussion.107

4. Superintendent's Regulation COg-03

The 1972 wholly-owned service corporation statute authorized the Superintendent to replace the temporary parity regulation with a permanent regulation for these service corporations. Regulation COg-03 became effective on April 7, 1973. That permanent regulation expanded upon the temporary rule's class of permissible activities for wholly-owned service corporations. Where service corporations had before been permitted to provide real estate management services to a limited category of realty, this new

102 Superintendent's Reg. 70-5(F); 70-5(G).
104 See Alexander, supra note 7, at 442-454, for discussion of the Superintendent's rulemaking procedure.
105 Id.
107 Id.
regulation permitted real estate management services regardless of ownership of the property.\(^{108}\)

As with the initial parity regulation for wholly-owned service corporations, Regulation COg-03 permitted these service corporations to engage in additional activities not already pre-approved, provided each such activity was first approved in writing by the Superintendent.\(^{109}\) Regulation COg-03 significantly altered the procedure for such approvals contained in Regulation 70-5. Where that initial regulation had required positive action by the Superintendent before entering into any additional proposed activity, now the service corporation could merely "file a letter of intent to engage in an activity not otherwise authorized by this regulation," and then wait for the expiration of a thirty day period. If the Superintendent did not disapprove the letter's proposal within that thirty days, then the applicant was permitted to engage in that new activity.\(^{110}\) Regulation COg-03 stated this approval would be granted in this manner if "[t]he Superintendent [was] . . . satisfied . . . that any such activity is a proper incident to the business of a building and loan association."\(^{111}\) The rule also contained a procedure to withdraw these approvals. The Superintendent was required to hold an adjudicatory hearing in the manner prescribed by the Ohio Administrative Act.\(^{112}\) Once a final order was entered in that hearing, the Superintendent had to wait an additional ninety days before his prior approval could be withdrawn.\(^{113}\) Although the regulation stated no grounds for determining whether to withdraw approval, such decision was probably to be based upon a determination that the activity was not a proper incident to the business of associations.

The most significant change wrought by Regulation COg-03 affected the limitations upon associations' investments in wholly-owned service corporations. A brief review is necessary in order to grasp the true significance of this change. The initial 1965 statute which authorized associations to invest in service corporations had provided that a single association could "invest no more than two percent of . . . [its] assets in the capital stock, obligations, or other securities" of jointly-owned service corporations.\(^{114}\) Because associations were for the first time being permitted to place assets at risk through investments in these newly authorized, jointly-owned service corporations, it was reasonable to conclude that the legislature intended for no association to place more than two percent of its assets


\(^{109}\) Superintendent's Reg. COg-03(B).

\(^{110}\) Id.

\(^{111}\) Id.

\(^{112}\) Id.

\(^{113}\) Id.

\(^{114}\) 131 Ohio Laws 1642 (1965), Ohio Rev. Code Ann. § 1151.344. (formerly Ohio Rev. Code Ann. § 1151.34(E)).
at jeopardy through the purchase of these corporations' capital stock or debt securities, through loans to these service corporations, or through a combination of both of these investment modes. Indeed, that was the apparent construction placed upon this language when the Superintendent later (1970) promulgated Regulation 70-5 authorizing additional investment in wholly-owned service corporations. Regulation 70-5 stated that:

An association may make any investment under this regulation if its aggregate outstanding investment in the capital stock, obligations, or other securities of service corporations and subsidiaries thereof (including all loans) secured and unsecured, to service corporations, or any subsidiaries thereof, and to joint ventures of such service corporations or subsidiaries, whether or not the association is a stockholder in such service corporations) would not thereupon exceed [one percent of its assets].

When the legislature enacted 70-5 in Senate Bill 442 in 1972 that statute again stated that a single association's investment "in the capital stock, obligations, and other securities of a [wholly-owned] service corporation . . . [must] be limited to no more than one percent of the association's assets." Since the Superintendent's Regulation 70-5 was expressly referenced elsewhere in that 1972 act, it is reasonable to assume that the legislature intended to continue that regulation's one percent limitation upon the aggregate of all assets placed at risk in wholly-owned service corporations. A quite different limitation subsequently found its way into Regulation COg-03, however.

As noted earlier, the same 1972 legislative enactment that authorized wholly-owned service corporations also required the Superintendent to "promulgate . . . regulations describing the services that such . . . service corporation(s) may provide." Elsewhere in that statute the legislature twice reiterated that these regulations were only to address the services which could be provided by such service corporations. Nowhere did the statute permit the Superintendent to adopt a regulation authorizing savings associations to make additional investments in these service corporations. Yet Regulation COg-03 did precisely that. It authorized associations to place money at risk in wholly-owned service corporations in excess of the investments limitations contained in the very same statute that also authorized

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115 Superintendent's Reg. 70-5(D).
117 134 Ohio Laws 848 (1972), Am. Sub. S.B. 442, § 3.
118 See text accompanying note 100, supra.
120 Id. Indeed, a full paragraph of the statute is devoted to describing the factors which the superintendent must consider and weigh before finally determining the specific services which would be permitted pursuant to that regulation.
Regulation COg-03. Regulation COg-03 stated that:

The [one percent] investment limitations of . . . [the statute authorizing investment in wholly-owned service corporations] shall not apply to real estate loans which conform to the requirements and limits of Chapter 1151. of the Revised Code and are made to any service corporation in which the lending association does not have any investment under the authority of Section 1151.34 (E)(2) of the Revised Code or, with the Superintendent’s prior written approval of such a loan, by a parent building and loan association to a service corporation.¹²¹

Chapter 1151 of the Ohio Revised Code contains all the statutes defining the full range of loans which may be made by savings associations. By excepting this category of loans from the statute’s one percent investment limitation, Regulation COg-03 permitted savings associations to invest fully that one percent of their assets in a wholly-owned service corporation and to additionally make loans to the same extent permitted to any other borrowers. The regulation permitted savings associations to make these additional loans to two categories of wholly-owned service corporations: 1). wholly-owned service corporations in which the lending association had no investment; and 2). wholly-owned service corporations in which the lending association had an investment. For example, a savings association which had invested the full one percent of its assets in the equity stock in a wholly-owned service corporation could make additional real estate loans to the wholly-owned service corporation of another savings association. A savings association could also invest the full one percent of its assets in the equity stock of its wholly-owned service corporation and then additionally make real estate loans to that same service corporation. In this latter example the association had to first secure the Superintendent’s approval before making such loans. The regulation was silent concerning whether such additional loaned monies would be aggregated in computing the statutory two percent limitation applicable to the aggregate of all investments in service corporations of both types.¹²²

The total amount of additional monies which could be placed at risk through these real estate loans to wholly-owned service corporations was not without limitation. Since the regulation provided that these additional real estate loans had to conform to “the requirements and limits of Chapter 1151” the loans-to-one-borrower provision of that chapter had a significant limiting impact. That provision specifically limits the total amount of real estate loans which a single borrower may obtain from one savings association. That amount is the lesser of: (1) ten percent of the amount of [the association’s] withdrawable accounts; or (2) an amount equal to the sum of such [association’s] nonwithdrawable accounts, surplus, undivided profits,

¹²¹ Superintendent’s Reg. COg-03(E) (emphasis added).
¹²² Id. The Regulation merely stated that the “investment limitations of § 1151.34(E)(2) of the Revised Code shall not apply [to those additional loans].”
and reserves." It should be noted that this limitation does not apply to every real estate loan. Most statutes authorizing savings associations to make specific kinds of real estate loans require that those loans comply with this loans-to-one-borrower restriction by expressly cross-referencing to it. However, there are two statutes which permit loans to be secured by real estate, but which have no similar cross-referencing to the loans-to-one-borrower statute.

It is impossible to determine today what was truly the legislative intent regarding the regulation's additional authority for associations to make these various loans to service corporations. The statute which authorized this regulation clearly stated that the regulation was to address only one subject matter: the services provided by wholly-owned service corporations. Yet, the Superintendent exceeded that jurisdictional grant by excepting these savings associations' loans to service corporations from the statutory one percent investment limitation. Setting aside this question of uncertain legality for the moment, what is certain is that none of these questions were raised when Regulation COg-03 was adopted and implemented in 1973. The consequence of that silence was to be particularly telling. This regulatory provision of questionable legal parentage soon spawned statutory progeny which further chipped away at the investment limitations initially imposed upon the savings associations industry's venture into service corporations.

5. House Bill 366

At the same time that the Superintendent was proceeding with adoption of the Regulation COg-03 for wholly-owned service corporations, the Ohio General Assembly was considering legislation to significantly expand the lending authority of savings associations. That legislative measure became effective just a few months after Regulation COg-03. Section 1151.343 of that enactment remains in effect today and is discussed below. It nonetheless deserves note at this juncture because section 1151.343 constituted another significant step by the General Assembly toward expanding savings associations' authority to invest in service corporations.

124 Ohio Rev. Code Ann. §§ 1151.29, 1151.291, and 1151.297 begin with a similar prescription: that the loans made pursuant to those sections are "subject to the procedures of § 1151.292 of the Revised Code."
125 Ohio Rev. Code Ann. §§ 1151.295 and 1151.311 (Page 1968). The latter of these two provisions does seem to anticipate that § 1151.292 is entirely applicable to these participation loans, however, because it contains an express exemption from division (B) of § 1151.292. (See Ohio Rev. Code Ann. § 1151.311(B) (Page 1968)).
128 See text accompanying note 170, infra.
The consequences of that enactment were twofold. First, it was the first successful attempt by the savings association industry to enter the second mortgage lending market.\(^{129}\) More importantly for purposes of this article, other provisions of that statute permitted savings associations to make additional loans to both wholly-owned and jointly-owned service corporations; and to make additional investments in the stock of wholly-owned service corporations. The formula contained in section 1151.343 computing these increased amounts which a single association could place at risk in service corporations permits those additional loans and investments to total as much as ten percent of an association’s assets.\(^{130}\)

6. 1973 Amendments to Superintendent’s Regulation COg-03

Adoption of the initial service corporation regulation and enactment of House Bill 366 were only two of the four significant service corporation developments of 1973. Twice during that fall the Superintendent amended Regulation COg-03.

The first amendment became effective on September 24, 1973. The change wrought on that date was removal of the following provision from the original regulation:

> The activities of a service corporation in which an association may invest do not include the conduct of any such activities in an office of such service corporation, or subsidiary thereof, which is located outside of this state, and any subsidiary corporation must be organized under the laws of this state.\(^{131}\)

The consequences of this amendment were two. First, service corporations could thereafter operate from offices located outside the boarders of Ohio. Second, service corporations could organize and incorporate subsidiaries in any of the fifty states.

The second set of amendments became effective on December 13, 1973. The first of these amendments deleted the provision in the original 1973 regulation which had permitted these service corporations to make wrap-around loans.\(^ {132}\) Next, a new category of loans was authorized. Typically referred to as “equipping loans,” these included any “loans for altering, repairing, improving, equipping, or furnishing any residential real estate.”\(^ {133}\)

In addition to this expanded role, these corporations were now permitted to serve as trustees under deeds of trust\(^ {134}\) and as insurance agents.


\(^{130}\) [Ohio Rev. Code Ann. § 1151.343(A) (Page Supp. 1979)].

\(^{131}\) Superintendent’s Reg. COg-03 (amendment eff. Sept. 24, 1973).

\(^{132}\) Superintendent’s Reg. COg-03 (amendment eff. Dec. 13, 1973) deleting ¶ (A)(2) of initial Superintendent’s Reg. COg-03.


\(^{134}\) Superintendent’s Reg. COg-03 (eff. Dec. 13, 1973) ¶ (A)(14).
or brokers.\footnote{Superintendent's Reg. COg-03 (eff. Dec. 13, 1973) ¶ (A)(13).} Wholly-owned corporations were also permitted, as insurance agents or brokers, to provide "homeowners', fire, theft, automobile, life, health accident, and title" insurance.\footnote{Id.} They were prohibited from providing "private mortgage insurance," however, and had to limit insurance activities to dealing "primarily . . . in policies for savings and loan associations, their borrowers and account holders."\footnote{Id.} It deserves noting that while the intent of this provision may have been to limit the service corporation insurance activities to customers of the parent savings association, the regulation simply was not restrictive. Borrowers or account holders of any savings association were permissible insurance clients. In addition insurance activities were not even restricted to this broad class of potential clients. The service corporation had only to serve "primarily" these clients, thus permitting it to direct a significant portion of its insurance activity toward persons who lacked this requisite nexus of a savings association-customer relationship. The regulation remained unchanged for almost two years.

7. Amended Superintendent's Regulation COg-03 (1975)

The next development in Ohio's service corporation regulatory scheme occurred in late 1975. In December of that year, the Superintendent again held hearings on proposed amendments to Regulation COg-03. Those hearings culminated in the adoption of amendments that became effective on January 29, 1976. The first of those amendments added a new category to the list of pre-approved loans which could be made by a wholly-owned service corporation. That category was entitled "consumer loans."\footnote{Superintendent's Reg. COg-03 Activities of Service Corporations (1976 amendment) ¶ (A)(1)(e).} The term consumer loan was defined as a "loan to one or more individuals which is either unsecured or which is secured by consumer goods used or bought primarily for personal, family or household purposes."\footnote{Id.}

Although both Regulation 70-5 and the 1973 versions of COg-03 had authorized wholly-owned service corporations to provide numerous services, those services could only be provided to "domestic" associations. The term "domestic association" is defined by Ohio statute to include both Ohio savings associations and federal associations whose home offices are located in this state.\footnote{Ohio Rev. Code Ann. § 1151.01(B) (Page 1968).} This limitation was deleted from the 1975 Amended Regulation COg-03. Thereafter wholly-owned service corporations could market their services to any association chartered by an-
other state and to any federal association, regardless of the location of its home office.

Another amendment enlarged the category of pre-approved services. Wholly-owned service corporations were now allowed to acquire, maintain, and manage improved or unimproved real estate, provided that such real estate was “to be used for offices and related facilities of a building and loan association.” 141 There was a restriction, however, which provided that the office facility could only be used by a savings association that was a stockholder of the service corporation.

Service corporations were also permitted at this time to prepare state and federal tax returns. This service could be provided to any account holders and borrowers of the parent association, as well as members of the immediate family of these customers. 142 There was one prohibition. Tax returns could not be prepared for corporations for profit. 143

Also amended was the provision which authorized savings associations to make additional real estate loans to wholly-owned service corporations and which excepted those loans from the statutory limitations placed upon investment in service corporations. That earlier provision had permitted an association to make real estate loans to both service corporations in which it owned stock and service corporations in which the association had no ownership. 144 The authority for loans in this latter instance remained unchanged by these 1976 amendments. In the former instance, before the 1976 amendments an association could make real estate loans to those service corporations only if the association first received written approval from the Superintendent. The requirement for prior approval was modified in Amended Regulation COg-03. An association could thereafter make loans totalling an amount equal to twenty percent of its net worth to service corporations in which it owned stock. 145 Loans totalling this amount could be made without the Superintendent’s prior approval, so long as the lending association had a net worth equal to “at least five percent of its withdrawable accounts.” 146 The Superintendent still had to approve every loan to such service corporations in excess of the twenty percent ceiling and all loans to such service corporations when the lending association failed to meet this net worth requirement. 147

An association that met the net worth requirement of the rule could thus invest one percent of its assets in the equity stock of the service cor-

143 Id.
144 Superintendent’s Reg. COg-03 (D) (eff. Dec. 13, 1973).
145 Superintendent’s Reg. COg-03 (E); (1976).
146 Id.
147 Superintendent’s Reg. COg-03(F); (1976).
poration; make real estate loans to that service corporation totalling an amount equal to twenty percent of its net worth, without prior approval of the Superintendent; and make additional real estate loans to this service corporation without any other limitation except that those loans had to be first approved by the Superintendent. The regulation stated no criteria for the Superintendent to apply in determining whether to render approval for real estate loans that were not otherwise pre-approved under Amended Regulation COg-03.

These amendments continued a scheme of continuing questionable legal foundation, the scheme that abrogated by rule the limitation imposed by statute upon the total amount that a single association could place at risk through investments in, or loans to service corporations. Although the enabling legislation for wholly-owned service corporations permitted the Superintendent to “review, revise, amend, or repeal” this regulation, any such action must produce a final rule that conforms to the standards outlined in this legislative delegation. That standard had remained unaltered since its initial enactment. Simply stated, the regulation was only to address the “services” that such service corporations could provide. Indeed, the legislature left this standard unchanged even in its most recent review of Ohio’s service corporation statute.

8. Senate Bill 422

That most recent legislative review of Ohio’s service corporation scheme occurred in 1978. A measure became effective on August 29 of that year “to adopt the substance of temporary regulations issued under statutory rule-making power of the Superintendent of building and loan associations granting state chartered associations powers similarly enjoyed by federal savings and loan associations within this state and to facilitate nonsubstantive code revision.”

Although the original Regulation 70-5 which permitted associations to invest in service corporations had been just such a temporary parity regulation, the 1972 legislative enactment of Senate Bill 442 negated the need for further service corporation parity regulations. The Superintendent could grant additional lending and investment authority to wholly-owned service corporations independent of any initial action by Congress, FHLBB or federal judiciary. The only service corporation regulation in effect in 1978 was thus Amended Regulation COg-03 adopted by the Superintendent in 1973 pursuant to the authority contained in that 1972 act. Yet the 1978 Senate Bill 422 listed only two categories of subject matter

149 Id. (emphasis added).
151 Service Corporation Regulations are required by Ohio Rev. Code Ann. § 1151.344(B) to be promulgated in accordance with the procedures of the Ohio Administrative
in its title; 1). the enactment of parity regulations; and 2). nonsubstantive code revision. Although parity regulations existed at that time affecting other activities of savings associations, there was no longer any parity regulation which related to service corporations. Every provision in Senate Bill 422 which affected service corporations was intended by the General Assembly to accomplish nonsubstantive code revision of the existing statutes concerning service corporations. This is, sections 1151.34(E) and 1151.343 of the Revised Code.

Indeed, a review of the specific sections of the Ohio Revised Code contained in Senate Bill 422 establishes that the legislature did adopt one nonsubstantive amendment relating to service corporations. That amendment renumbered the existing service corporation statute from former section 1151.34 to present section 1151.344. The amendment was, in fact, long overdue. Although perhaps initially well placed in 1965 as a separately numbered division of the existing Revised Code section (division (E) of section 1151.34) which contained the detailed list of investments authorized to Ohio associations, the 1972 enactment of Senate Bill 442 containing authorization for investment in wholly-owned service corporations expanded the text of the service corporation division (by adding new subdivision (E)(2) to section 1151.34) sufficiently to justify its reenactment as a separately numbered section of the Revised Code. The problem is that the statement in the title of Senate Bill 422, was at best, misleading. What was purported to be merely nonsubstantive code revision was really much more. Senate Bill 422 also enacted substantive amendments to Ohio’s primary service corporation statute, section 1151.344.

Even if one were to accept, for the sake of argument, that Amended Regulation COg-03 did constitute a parity regulation, these 1978 amendments enacted to the service corporation statute far exceeded the statement in the act’s title that the act merely adopted the substance of such regulation. For example, Ohio has never had a regulation which related to jointly-owned service corporations. Regulation 70-5, Regulation COg-03 and the 1973 amendments, and the 1975 Amended Regulation COg-03 applied solely to wholly-owned service corporations. Yet, Senate Bill 422 added one entire new paragraph which relates exclusively to jointly-owned service corporations. That new paragraph brought about a clear substantive change. It increased the former two percent investment ceiling. An association was now permitted to lend an additional amount, equal to fifty percent of its net worth, to certain jointly-owned service corporations. This change and the other
amendments as well as the entire regulatory scheme applicable today, are discussed in detail below. Before entering that discussion a final note must be made concerning the recent 1979 amendments to Amended Regulation COg-03.

9. Rule 1301:2-1-02

On September 12, 1979, the Superintendent announced proposed amendments to the service corporation regulation to “eliminate from the Rule those sections which have been enacted into statute in Senate Bill 422, effective August 29, 1978.” Those proposed amendments were subsequently adopted and became effective on December 1, 1979. The text of that rule, as amended in 1979, is discussed in detail below. However, a brief observation on the background of those 1979 amendments is in order before finally embarking upon that discussion.

The Superintendent’s cover letter announcing adoption of that amended rule stated that “there are no changes from the language set forth in Section 1151.344 of the Revised Code [the enabling statute for service corporations]. The purpose of this rule amendment is to effectuate conformity of the rule with [section 1151.344].” Section 1151.344, referred to in the Superintendent’s letter, was that same statute which had been represented to be the subject of nonsubstantive code revision in Senate Bill 422. By stating that his amended rule only conformed that rule to this newly revised Section 1151.344 he was similarly suggesting that his amendments were intended to be nonsubstantive revisions of existing law. This cover letter neither stated nor even suggested that any substantive changes were also wrought by these 1979 amendments. Yet those amendments included repeal of the rule’s provision which had permitted the Superintendent to approve, without limitation, additional real estate loans to service corporations of the parent association. That amendment went well beyond the stated objective in the Superintendent’s cover letter for nowhere did section 1151.344 address the Superintendent’s ability to except these loans from the statute’s investment limitations.

In this span of thirteen months both the Ohio General Assembly and the Superintendent initiated amendments to this state’s scheme for

152 Formerly Superintendent’s Regulation COg-03 renumbered because of the legislation creating the Ohio Administrative Code.
153 Letter from Clark W. Wideman, Superintendent of Building and Loan Associations, to all State-Chartered Savings and Loan Associations, (Sept. 12, 1979) (on file with AKRON LAW REVIEW).
155 Letter from Clark W. Wideman to all State-Chartered Savings and Loan Associations, (Dec. 5, 1979) (on file with the AKRON LAW REVIEW).
156 The original statute was OHIO REV. CODE ANN. § 1151.34(E). That statute was amended and renumbered in 1978 to OHIO REV. CODE ANN. § 1151.344. The second statute presently in effect today is OHIO REV. CODE ANN. § 1151.343. The regulation promulgated by the Superintendent was initially numbered COG-03 Activities of Service Corporations but has been renumbered to its present Rule 1301:2-1-02.
regulating service corporations. In both instances the amendments were described as nonsubstantive revisions of the existing law. Yet, both times the amending governmental body did effect substantive changes. It is quite possible that neither the legislature nor the Superintendent intended substantive revisions, but that each simply lacked sufficient understanding of Ohio's service corporation regulatory scheme to assess the real consequence of their respective revisions. If this observation is accurate, the concerns expressed by the GAO and the FHLBB become increasingly troublesome.

Both the GAO and the FHLBB expressed concern over the impact that the states may have upon the federal scheme as states permit service corporations to engage in increasingly more diverse business activities, and as they also permit their state chartered associations to place greater amounts at risk through investments and loans to service corporations. The GAO wondered whether the FHLBB might not be pressured by its federal associations to grant them and their service corporations parity with competing state associations and state service corporations. The GAO was particularly concerned that increased service corporation involvement in more diverse and risk-laden business activities, coupled with increased investments in those corporations by FSLIC-insured state associations would pose greater potential risks to the financial stability of those associations. Increased risks for insured associations means increased potential liability for FSLIC and even the possibility of jeopardy for the federal associations should significant numbers of state associations begin to announce financial instability.

Ohio has one of the largest state chartered savings association industries in the nation. It also has perhaps the most liberal policies of service corporation regulation. Not only are service corporations granted a broad range of diverse pre-approved business activities, savings associations in this state may invest more in these corporations than can any other state's savings associations. Ohio's policies may well serve to provide the testing ground for the concerns of the GAO and the FHLBB.

And yet, casting Ohio in that role poses the ultimate irony. If the legislature's and Superintendent's recent actions were truly based upon their mutual lack of understanding of this state's regulatory scheme, then this state's service corporation "policy" may be merely the product of mistake, not reasoned design.

II. Ohio's Present Scheme

Today, Ohio's service corporation scheme is found in three sources; two statutes and one regulation. The primary statute is section 1151.344 of the Ohio Revised Code. This statute contains two divisions: 1). division (A) authorizes creation of jointly-owned service corporations; and 2). division (B) contains the authority for wholly-owned service corporations.
This latter division of the statute also contains authorization for the single service corporation regulation. That rule, Superintendent's Regulation 1301:2-1-02, affects only wholly-owned service corporations. The second statute that relates to service corporations is section 1151.343 of the Ohio Revised Code. It permits expanded investments and loans by associations to both types of service corporations.

A. Types of Service Corporations

The term "service corporation" is not statutorily defined in Ohio. That entity has been traditionally viewed to be a corporation owned by savings associations and engaged primarily in providing services that were complimentary to the business of a savings association. The Ohio statute which authorizes service corporations embodies that concept. It deserves noting, however, that not every subsidiary corporation owned by Ohio savings associations and performing complimentary services for those associations is deemed to be a service corporation.

In 1976 the Ohio General Assembly authorized savings associations to acquire their own commercial bank. The intent of that statute was to permit Ohio associations to form a bank for savings associations as had occurred earlier in Illinois. Ohio associations may acquire the equity securities of a bank for savings associations only so long as that bank is "engaged primarily in the business of providing its services to [savings] associations." Although Ohio associations have not yet implemented this statute, future formation of an Ohio bank for savings associations will pose some interesting regulatory dilemmas.

The enabling statute authorizing banks for savings associations makes no mention of how such bank is to be regulated. Certainly the federal banking regulators will retain their respective jurisdiction over this commercial bank. But what then will be the jurisdiction of the Ohio Superintendent of banks over that Ohio chartered bank for savings associations? In the absence of the present savings association service corporation scheme, the Ohio Superintendent of banks would possess sole jurisdiction over this bank for savings associations. The question posed by the service corporation statute is whether the Superintendent of banks must share that jurisdiction with Ohio's Superintendent of building and loan associations, since Ohio's service corporation statute clearly grants the Superintendent of savings associations jurisdiction over every subsidiary service corporation of an Ohio savings association.

157 The section creating Service Corporations does state that the term "Service Corporation" "includes any subsidiary of a Service Corporation." OHIO REV. CODE ANN. § 1151.344(B) (Page Supp. 1979).
158 OHIO REV. CODE ANN. § 1151.344.
159 136 Ohio Laws 2866, OHIO REV. CODE ANN. § 1151.35(B) (Page Supp. 1979).
160 Id.
Even more troublesome is the question concerning investment limitations by savings associations in a bank for savings associations. The statute authorizing such a bank merely provides that an Ohio “association may acquire debt or equity securities in” \(^{161}\) any such bank. Did the legislature intend to permit savings associations to invest in such banks without limitation? Or was this statute enacted \textit{in pari materia} with the service corporation statute? If the latter were in the contemplation of the legislature, then the percent-of-asset limitations (of sections 1151.343 and 1151.344) applicable to service corporation investments would be equally applicable to a single association may invest in these banks for savings associations. Unfortunately, it is impossible to ascertain the legislative intent underlying these statutes. It may be that the absence of any investment limits indicates that the legislature intended no investment limitations upon the amount a single association may invest in these banks for savings associations. If that be the case, the concern of the GAO that savings associations may place too much at risk through investments in subsidiary service corporations has a firmer foundation in Ohio than ever imagined by the GAO. Nowhere in either the GAO or the Federal Home Loan Bank Board reports was there even any mention of the potential for investment by Ohio chartered savings associations in these “bank service corporations.”\(^{162}\)

Banks for savings associations are only a potential third type of subsidiary corporation that may be formed by Ohio associations. The other two types of subsidiary corporation that presently exist are: 1) jointly-owned service corporations and 2) wholly-owned service corporations.

Before beginning the discussion of these, the two names present some potential for confusion which must be resolved. Although “jointly-owned” service corporations must be owned by several association stockholders, a “wholly-owned” service corporation may likewise be owned by more than a single association. A wholly-owned service corporation must simply have more than fifty percent of its stock owned by a single association. Thus a single association may own the service corporation’s entire stock, or merely fifty-one percent, with the remainder held by other stockholders. In the instance of a jointly-owned service corporation, no single association may own more than fifty percent of its stock.

1. Jointly-Owned Service Corporations

An Ohio chartered savings association can invest in any jointly-owned

\(^{161}\) Id.


It is interesting to note that the appendices in the report of the Federal Home Loan Bank Board contain a description of the investments permitted Ohio-chartered savings associations and service corporations, but misses entirely the potential of this investment in a bank for savings associations in Ohio.
service corporation that is incorporated in this state. Although all the stock must be owned by savings associations, there is no requirement that all or even a majority of the stock be owned by Ohio associations. Other association stockholders may be domiciled in this or any other state.

A jointly-owned service corporation is one in which no single association owns more than fifty percent of the stock. Any service corporation that meets this ownership requirement is permitted by statute to engage in "services compatible with the purposes, powers, and duties of such associations." The statute authorizing these service corporations is self-implementing in the sense that it describes the range of permissible activities and does not require an additional Superintendent's rule listing pre-approved activities. These jointly-owned service corporations are left with the initial task of determining whether a particular business activity is permissible. This power to define "pre-approved" activities for itself is an important distinction between these jointly-owned service corporations and wholly-owned service corporations. There is one area of business activities, however, where even jointly-owned service corporations must await a decision by the Superintendent before proceeding.

While these service corporations have complete authority to decide what services to provide to savings association customers, they must first secure permission from the Superintendent before providing services to such nonassociation customers as other corporations, natural persons and government bodies. The form of this approval is not a list of pre-approved activities as in the instance of the wholly-owned service corporation rule, but is instead a case-by-case determination upon application to the Superintendent. Nor may jointly-owned service corporations provide nonassociation customers unlimited services. Those services must be restricted to "mechanical, clerical and record keeping services."

When jointly-owned service corporations were first authorized by statute, that enabling legislation limited the class of their potential customers to only domestic savings associations. That is, associations chartered by Ohio and federal associations with a home office in this state. When the statute was amended in 1978, jointly-owned service corporations were for the first time permitted to also provide services to foreign savings associations. A "foreign association" is any federal association whose home office is located in a state other than Ohio and any state association chartered by a state other than Ohio.

Two statutes contain the authority for Ohio associations to invest in

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164 Id.
165 Id.
166 Id.
167 Ohio Rev. Code Ann. § 1151.01(C) (Page 1968).

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jointly-owned service corporations. The first statute is the enabling statute that permits investment in both types of service corporations, section 1151.344. That section and the complementary section 1151.343 describe a complex scheme for association investment in the two types of service corporations. The complexity of this scheme is directly attributable to the historical development of service corporation regulation in this state. Whenever the regulatory scheme was altered, by either the legislature or Superintendent, it was always done piecemeal, with little attempt at reconciling and conforming earlier provisions with each new amendment to the scheme.

Those amendments produced many similarities in the investments provisions for both types of service corporations. Unfortunately, many common questions remain unanswered in both instances as well. This section discusses the investment scheme as it relates to jointly-owned service corporations. A similar analysis for wholly-owned service corporations is contained in the following section.

Savings associations have authority to both purchase the equity stock of a jointly-owned service corporation and to lend to these corporations. Section 1151.344(A) permits a single association to invest two per cent of its assets “in the capital stock, obligations, and other securities” of a jointly-owned service corporation.\(^{168}\) This amount may be distributed between equity stock purchases, purchases of debt securities, loans, or any combination of these. The second statute, section 1151.343, permits additional investment in these service corporations ranging in amount from three up to ten percent of the association’s assets.\(^{169}\) Together these two provisions allow a single association to invest at least five and up to twelve percent of its assets in jointly-owned service corporations. Whether that maximum amount may be attained is determined by the formula for determining the precise amount of investment permitted by section 1151.343 for the additional three to ten percent investment range:

A building and loan association may make additional loans and investments . . . provided that the aggregate balance of such loans and investments does not exceed three percent of its total assets, unless the sum of the permanent stock, general reserves, surplus, and undivided profits of the association exceeds five percent of its total assets. In that case, it may hold additional amounts of such assets, not to exceed in the aggregate one and one-half percent of its total assets for each percentage point by which the sum of its permanent stock, general reserves, surplus and undivided profits exceeds five percent of its total assets, but the aggregate of all assets held by any association under the authority of this section shall not exceed ten percent of its total assets. (Emphasis added.)\(^{170}\)

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\(^{170}\) Id.
An association that meets the full requirements of this formula can place an amount equal to ten percent of its assets in equity stock purchases, purchases of debt securities, or in loans to jointly-owned service corporations, or in any combination of these. Adding the two percent authorized of section 1151.344 to this amount allows a single association to increase its total commitment in a jointly-owned service corporation to twelve percent of assets.

Section 1151.344 also contains provisions that permit associations to loan additional amounts to these service corporations. There are two classes of these additional loans. Both classes share a common feature; the loans are limited to "any loan authorized by any other section of Chapter 1151 of the Revised Code." Chapter 1151 contains all the provisions that describe the various kinds of loans that may be made by saving associations. Loans that can be made to any other borrower can therefore be made to jointly-owned service corporations. Each class also possesses features unique to itself.

The first class of loans is distinguished by the definition of permissible borrowers. The loans can only be made to a jointly-owned service corporation in which the lending association owns no more than ten percent of the capital stock.171 Loans to these service corporations may total no more than an amount equal to fifty percent of the association's net worth.

The second class of loans is distinguished by the definition of qualifying lender. These loans may only be made by associations which meet Ohio's reserve and net worth requirements.172 In addition, the loans can only be made to service corporations meeting two criteria: "the [lending] association has no investment in such service corporation and . . . no association owns more than ten percent of the service corporation's capital stock."173

As noted, a ceiling is imposed upon the total amount of loans in the first class, but none is imposed upon the second class of these loans.174 Nor does the section authorizing these loans (1151.344) impose a ceiling in either instance upon the total amount that may be loaned to a single service corporation. Yet, the common characteristic that both classes of loans be "authorized by . . . [a] section of Chapter 1151 of the Revised Code," is the source of such a limitation.175

171 This provision was newly enacted in 1978. It does limit these loans to a jointly-owned service corporation in which the lending association owns no more than ten percent of that service corporation's capital stock. The form of the loans are any that are otherwise permissible for a savings association to make as authorized by Chapter 1151 of the Ohio Rev. Code Finally, these loans may be made to either the service corporations or to a joint venture of the service corporation. Ohio Rev. Code Ann. §§ 1151.344(A).
173 Id.
174 Id.
175 Id.
Not only does Chapter 1151 authorize various loans for savings associations, it also contains a loans-to-one-borrower ceiling for such loans. That ceiling is that an association’s single loan or combination of loans to a single borrower may not exceed the following amount: the lesser of 1). ten percent of the association’s withdrawable accounts, or, 2). the sum of the association’s nonwithdrawable accounts, surplus, undivided profits and reserves.¹⁷⁶

2. Wholly-Owned Service Corporations
   a. Savings Association Investments

A wholly-owned service corporation is one in which a single savings association owns more than fifty percent of the stock. This service corporation may be owned entirely by a single stockholder (as the name implies) or may be owned by several stockholders, so long as one owns more than fifty percent of the stock.¹⁷⁷ Nor must all the shareholders be savings associations. There need be only a single savings association stockholder, but in such event, that association must own the majority of the outstanding capital stock.

An Ohio chartered association can only invest in a wholly-owned service corporation that is incorporated in Ohio. The other stockholders of that service corporation, including the majority (savings association) stockholder, may be domiciled in this or any other state.

The investment scheme for wholly-owned service corporations is as complex as for association investments in jointly-owned service corporations. Today there are two related statutes that together contain the full investment authority for wholly-owned service corporations, sections 1151.344 and 1151.343. The enabling statute, section 1151.344(B), authorizes a single association to invest an amount equal to one percent of its assets in the “capital stock, obligations, and other securities” of a wholly-owned service corporation.¹⁷⁸ [The amount of this investment must then be subtracted from the total amount (two percent of assets) that was otherwise available for investment in the “capital stock, obligations, and other securities” of jointly-owned service corporations.]¹⁷⁹ This is the first component of the total amount authorized to associations for investments in wholly-owned service corporations. It should be noted that this

¹⁷⁸ Id.
¹⁷⁹ This computation is found within the enabling statute for service corporations, OHIO REV. CODE ANN. § 1151.344(B) (Page Supp. 1979). That statute permits two percent investment in jointly-owned service corporations. It must not be confused with the additional authorization of from three to ten percent of assets which are additionally authorized by OHIO REV. CODE ANN. § 1151.343 (Page Supp. 1979). That latter authority for a single association to invest from three to ten percent of its assets in jointly-owned service corporations remains unaltered by its investment of one percent in a wholly-owned service corporation, OHIO REV. CODE ANN. § 1151.344(A) (Page Supp. 1979).
is the only authority for investment in the equity stock of these service corporations. All additional authority relates solely to lending to these corporations. It should be further noted that even this one percent authorization may be in the form of loans as well as equity stock acquisition. Thus, an association may invest this one percent of assets through loans to wholly-owned service corporations, through purchases of equity stock (or debt securities), or in any combination of these.

Just as in the instance of investments in jointly-owned service corporations, section 1151.344 additionally authorizes two classes of loans with a common characteristic: "any loan (to a wholly-owned service corporation) authorized by any other section of Chapter 1151 of the Revised Code." The first class is defined as any such loan to a wholly-owned service corporation "in which an association has made an investment." A ceiling is placed upon this class of loans, that the "aggregate of all such loans shall not exceed twenty percent of the association's net worth." 

The second class of these loans can be made without a limiting ceiling on total amount, provided that the association has met Ohio's reserve and net worth requirements. Two other criteria must be met to make this class of loans: (1) that the lending association own no stock in the service corporation; and (2) that no other association own more than ten percent of the borrowing service corporation's stock.

As in the instance of the two classes of loans authorized to be made to jointly-owned service corporations, the section authorizing these loans (1151.344) places no ceiling on the amount which may be loaned by a savings association to a single wholly-owned service corporation. However, the same chapter 1151 which defines what kinds of loans may be made also contains a loans-to-one-borrower ceiling for all such loans. It prohibits an association from lending to a single borrower an amount in excess of the lesser of 1) ten of the association's withdrawable accounts; or 2) the sum of the association's nonwithdrawable accounts, surplus, undivided profits and reserves.

In addition to these two classes of loans and the one percent of assets investment authorization, an association may also utilize part or all of its section 1151.343 three to ten percent of assets authorization and make loans in that amount to a wholly-owned service corporation. Section 1151.343 provides, in the instance of jointly-owned service corporations, that this range of three to ten percent of assets may be invested in either the equity stock of a jointly-owned corporation or loaned to that service corporation. The authority is not so liberal with respect to wholly-owned service cor-

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181 Id.
182 Id.
183 See text accompanying note 176, supra.
Savings and Loan Service Corporations. This additional three to ten percent of asset amount may only be used to make additional loans to wholly-owned service corporations. It may not be used to acquire additional capital stock of a wholly-owned service corporation. 184

Hopefully, the following example will demonstrate how a single savings association could select to loan and invest the full amount possible to a combination of jointly-owned and wholly-owned service corporations. The association in this example is Perpetual Savings and Loan, an Ohio chartered stock association. It is in full compliance with Ohio’s reserve and net worth requirements. The sum of its permanent stock, general reserves, surplus and undivided profits is equal to nine percent of its total assets (thereby allowing Perpetual to invest the full ten percent permitted by section 1151.343).

Perpetual owns ten percent of the capital stock of “Jointly-Owned Service Corporation.” Two other Ohio chartered savings associations and three federally chartered savings associations with their home offices in Ohio each owns eighteen percent of the remaining capital stock of Jointly Owned Service Corporation. Perpetual has invested an amount equal to eleven percent of its assets in this stock of Jointly-Owned Service Corporation. 185 Perpetual has also made loans (authorized for Ohio associations by Chapter 1151 of the Ohio Revised Code) to Jointly-Owned Service Corporation in an amount equal to fifty percent of Perpetual’s net worth. 186

Perpetual has also invested an amount equal to one percent of its assets in the capital stock of “Wholly-Owned Service Corporation.” The stockholders of this service corporation include Perpetual (a five percent shareholder), Granite Savings and Loan (an Ohio chartered savings association owning fifty-six percent of the stock), and Equity Finance (a mortgage banking firm owning thirty-nine percent of the stock). Perpetual has made loans (authorized for Ohio associations by Chapter 1151 of the Revised Code) to Wholly-Owned Service Corporation in an amount equal to twenty percent of Perpetual’s net worth.

Perpetual has also made loans (authorized to Ohio associations by Chapter 1151 of the Ohio Revised Code) to the “Independent Service Corporation.” Perpetual owns none of the capital stock of Independent Service Corporation. The stock of this Ohio corporation is owned in equal amounts by eleven non-Ohio state chartered associations whose home offices are located outside of Ohio. 187 Those loans to Independent Service Cor-

185 Authorized by Ohio Rev. Code Ann. §§ 1151.344(A) and 1151.343(A) (Page Supp. 1979).
187 It should be noted that most service corporations in which an Ohio chartered savings association invest in or make loans to must be incorporated in Ohio. The exception to this
poration total an amount equal to ten percent of Perpetual's withdrawable accounts\(^{188}\) (which is less than Perpetual's total nonwithdrawable accounts, surplus, undivided profits and reserves).

The total amount which Perpetual has placed at risk in service corporations through these stock investments and loans totals an amount equal to the sum of twelve percent of Perpetual's assets plus seventy percent of Perpetual's net worth plus ten percent of Perpetual's withdrawable accounts.

b. Service Corporation Activities

The enabling legislation for wholly-owned service corporations provides that they may provide only such services as permitted by Superintendent's rule.\(^{189}\) This statute further provides that "[t]he Superintendent may authorize services which he determines to be so related to the business of building and loan associations as to be a proper incident thereto."\(^{190}\) That rule provides a detailed list of such permissible activities.\(^{191}\)

As discussed above, the legislative history for the Congressional authorization allowing federal associations to invest in service corporations is at best clouded concerning the issue of permissible activities for federal service corporations. There was substantial evidence in the committee reports that Congress did not intend for these corporations to engage in a broad range of profit making activities. The sentiment of the committees of Congress seemed to lie, instead, in favor of merely providing services complementary to the business of a savings association. Even the Bank Board's effort to subject service corporations to its rules was an apparent attempt to permit itself to limit the scope of activities by these service corporations. Whether Congress in fact intended service corporations to limit their activities to the performance of services related to the business of a savings association is certainly not clear on the face of the statute itself. That statute merely authorized the investment in "any corporation."\(^{192}\)

\(^{188}\) These loans are authorized by \textit{Ohio Rev. Code Ann.} § 1151.344(B) (Page Supp. 1979) and are in conformance with the loans-to-one-borrower restriction contained in § 1151.292 (H). The hypothetical poses a situation in which ten percent of Perpetual's withdrawable accounts is less than the sum of Perpetual's non-withdrawable accounts, surplus, undivided profits, and reserves.


\(^{190}\) \textit{Id}. The statute instructs the superintendent as follows: "In determining whether a particular service is a proper incident to a building and loan association the superintendent shall consider whether its performance by a service corporation can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound building and loan association practices." \textit{Id}.


No formal legislative history exists in Ohio to aid in determining what the Ohio General Assembly intended to be the precise range of permissible activities for jointly-owned service corporations or wholly-owned service corporations. It appears, however, that the Ohio General Assembly did a better job of evidencing its intent on the face of the enabling statute than did the Congress. When the Ohio legislature authorized investment in jointly-owned service corporations it stated that such corporations were “to provide [savings] associations . . . services compatible with the purposes, powers, and duties of such associations.” The Ohio General Assembly also stated in that legislation that its purpose was to grant to Ohio chartered savings associations the same investment powers that had recently been granted by Congress to federal associations. Although Ohio’s act did not contain an exhaustive definition of the term “services,” the range of those activities was defined to include “mechanical, clerical and record keeping services.” What the statute did not address was whether these service corporations could perform either of the essential functions of a savings association: 1). acceptance of savings deposits; or 2). lending. That is, whether jointly-owned service corporations could directly engage in either of those two traditional business activities of a savings association.

The enabling legislation for wholly-owned service corporations also does little to resolve this question. Section 1151.344(B) merely reiterates the earlier notion that this second type of service corporation must limit its activities to providing services to savings associations. Although the legislature left to the Superintendent the task of defining the parameters of this range of permissible services, it did provide him with a guide. The Superintendent may only authorize those services which he determines to be “so related to the business of [a savings association] as to be a proper incident thereto.” When fixing these services the Superintendent is instructed to “consider whether its performance by a service corporation can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound building and loan practices.” Unfortunately, this amplification of services in the enabling legislation for wholly-owned service corporations does not provide support for the conclusion these service corporations may engage in either of the traditional business activities of a savings association.

194 Id.
195 Id.
196 134 Ohio Laws, 845, OHIO REV. CODE ANN. § 1151.344(B) (Page Supp. 1979) (formerly OHIO REV. CODE ANN. § 1151.34(E)(2)).
197 Id.
To complicate matters, this legislation was not initiated by the Ohio Division of Building and Loan Associations, but was sought by Ohio’s savings association industry. The primary trade association for this state’s savings association industry is the Ohio League of Savings Associations.198 During hearings before the Financial Institutions Committees of the Ohio House of Representatives and the Senate, the League representative testified that its wholly-owned service corporations legislative proposal was intended to permit this state’s savings associations to gain experience in new lending activities.199 The trade association’s motion of “services” was that these service corporations would engage in lending activities that heretofore had not been permitted to savings associations. The League argued that parent savings associations could identify new potential lending markets in this way while also allowing savings association employees to gain the requisite business experience in making such loans. The League stated that while this activity of this new type of service corporation might pose an additional potential risk of loss for the savings association’s investment, that risk of loss would be mitigated because the savings association would have very little invested in these wholly-owned service corporations, only one percent of the two percent of assets already authorized for investment in jointly-owned service corporations.

The League’s legislative witness made these statements during the Committee hearings to consider the bill that was textually identical to the statute as ultimately enacted. That is, although the bill’s text only stated that wholly-owned service corporations could provide services to savings associations, the League’s position was that the bill permitted these service corporations to engage in lending activities that were prohibited for the parent savings association. It was with this backdrop that the Superintendent had to promulgate the initial rule detailing permissible activities for wholly-owned service corporations. His benchmarks for the substance of that rule were, at best, difficult to sight. The express language of the statute permitted only complementary services to be provided to savings associations. On the other hand, the consistent position of the trade association that had secured the introduction and passage of the bill had been that the bill authorized a much broader range of permissible activities, including lending activities.

The initial version of that Superintendent’s regulation and all subsequent amended texts have always reflected the League’s position. Today the rule continues to outline not only a full range of permissible clerical services which may be provided to savings association, but also delineates a substantial list of permissible lending activities.

198 The Ohio League of Savings Associations represents over 80 percent of Ohio associations and federal associations located in Ohio.

199 The author was legislative counsel to the Senate Committee on Financial Institutions and the House Committee on Financial Institutions during the period that the wholly-owned service corporation proposal was under consideration by the Ohio General Assembly and was therefore present during all the oral testimony on that bill.
One final point must be noted about the enabling legislation for wholly-owned service corporations before proceeding to a discussion of the permissible activities for these corporations. The present enabling statute contemplates that jointly-owned service corporations will provide their services to savings associations and other customers. Services provided to non-association customers must be limited to mechanical, clerical, and record-keeping services, and can only be provided after having secured the written approval of the Superintendent on a case-by-case basis. The enabling statute for wholly-owned service corporations neither anticipates that services will be provided to other than savings associations nor expressly limits the clientele to savings associations. The Superintendent’s regulation implementing the statute for wholly-owned service corporations, however, adopts the approach reflected in the enabling statute for jointly-owned service corporations: the regulation lists a series of services which may be provided “primarily” to savings associations, thereby implying that these service corporations can also provide their services to non-association clients.200

Wholly-owned service corporations are today permitted to offer such clerical services as accounting, data processing, and auditing.201 They may also provide appraisal services, perform construction loan inspections, abstract titles, and offer credit information.202 A wholly-owned service corporation may also serve as an office supply purchasing agent,203 provide record storage facilities,204 serve as an advertising agency to solicit savings accounts and loan accounts,205 and conduct marketing surveys, branch studies and other research.206 These corporations may administer “personnel benefit programs, including life insurance programs, health insurance, and pension or retirement plans.”207 In addition, the service corporation may serve as an insurance broker or agent and provide homeowners’ fire, theft, automobile, life, health, accident, and title insurance to savings associations, their borrowers or accountholders.208 The service corporation is prohibited, however, from serving as broker or agent dealing in private mortgage insurance.209 It is permitted to serve as an escrow agent or trustee under a deed of trust.210 The service corporation may also prepare state and federal tax returns. Clients of this service must be limited to the parent association’s

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201 Id. ch. 1301:2-1-02(A)(3)(a).
202 Id. ch. 1301:2-1-02(A)(3)(b).
203 Id. ch. 1301:2-1-02(A)(3)(c).
204 Id. ch. 1301:2-1-02(A)(3)(f).
205 Id. ch. 1301:2-1-02(A)(3)(g).
206 Id. ch. 1301:2-1-02(A)(3)(d).
207 Id. ch. 1301:2-1-02(A)(3)(c).
208 Id. ch. 1301:2-1-02(A)(13).
209 Id.
210 Id. ch. 1301:2-1-02(A)(14).
accountholders, borrowers, or immediate family members of such customers. These corporations can also maintain and manage real estate owned by its customers.

Service corporations may perform management and maintenance services for their own real estate. The real estate that a service corporation may purchase falls into four categories. First, it may purchase certain unimproved real estate. But not all forms of unimproved real estate may be purchased by the service corporation. Such purchases must be limited to one of the following three kinds of unimproved real estate: 1) unimproved real estate suitable for development into a housing subdivision; 2) unimproved real estate suitable for use as mobile home sites; or 3) unimproved real estate which is intended for resale to third parties for the development of housing sites.

Second, these service corporations may purchase improved residential real estate and mobile homes, so long as such real estate and mobile homes are intended to be used as rental property. Although the rule is not entirely clear, it is fair to assume that the service corporation may also serve as the rental agent and landlord of these rental properties. The third category of permissible real estate purchases also consists of improved residential real estate. Wholly-owned service corporations may purchase any such real estate if the purpose of that purchase is to: (1) remodel, rehabilitate, modernize, renovate or demolish and rebuild the property; and (2) subsequently sell or rent that property as so altered.

A fourth category of property which may be purchased by these service corporations consists of office facilities for savings associations. The apparent purpose of this provision of the rule is to permit service corporations to buy and lease back (or sell back) office facilities to the parent association. The property purchased for this purpose may be improved or unimproved, although the service corporation lacks the authority to develop unimproved real estate into office facilities. The only role that a service corporation could thus play vis-a-vis unimproved real estate would be to make the initial purchase and then resell that real estate to another for development into office facilities. If the service corporation instead purchases improved real estate for the purpose of leaseback to its parent savings association, it may then also maintain and manage that real estate during the period of that rental agreement.

Although these service corporations lack authority to develop unimproved real estate owned by others, they can purchase and manage such property.

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211 Id. ch. 1301:2-1-02(A)(15).
212 Id. ch. 1301:2-1-02(A)(8).
213 Id. ch. 1301:2-1-02(A)(4).
214 Id. ch. 1301:2-1-02(A)(6).
215 Id. ch. 1301:2-1-02(A)(7).
216 Id. ch. 1301:2-1-02(A)(9).
proved real estate into office facilities for savings associations, they do have some limited development authority. Once it has purchased unimproved real estate suitable for construction of housing or mobile home sites as discussed above, the service corporation can elect to retain and develop that property itself rather than resell it to some third party. The service corporation can make all improvements necessary for the subdivision and construction of housing thereon or for its utilization as a mobile home park. It may make all additional improvements that will be necessary for the construction of commercial or community facilities that will be incidental to the housing project. Once these improvements have been completed and the real estate subdivided, the service corporation may either sell the improved property or rent it. Since these service corporations may not engage in the construction of housing, any unimproved real estate developed for the purpose of housing construction would obviously be sold upon completion of that development to third persons. If unimproved property had been developed into a mobile home park, however, the service corporation would have the election of selling that property or retaining ownership and serving as the rental agent to the mobile home owners.

Wholly-owned service corporations also have broad authority to engage in joint ventures. Any activity otherwise permissible for these service corporations may also be engaged in jointly with any other third party. These wholly-owned service corporations are also permitted to engage with other wholly-owned service corporations, jointly-owned service corporations and any "non-profit organization" in joint ventures involving any of the following activities: 1) the purchase of unimproved real estate for mobile home park or housing construction development; 2) development and construction of improvements on such property; 3) the purchase of improved residential real estate and mobile homes for rental; 4) purchase of improved residential real estate for alteration and resale or rental; and 5) real estate maintenance and management services. Wholly-owned service corporations may also participate in any manner in activities of Ohio community improvement corporations, Ohio development corporations and Ohio community redevelopment corporations. Finally, these

217 See text accompanying note 213, supra.
218 Ohio Ad. Code ch. 1301-2-1-02(A)(5).
219 The rule elsewhere permits a service corporation to engage in "real estate maintenance, management, and services." This language should be sufficient to also permit the service corporation to serve as the rental agent and landlord for a mobile home park. Rule 1301:2-1-02(A)(8).
221 Ohio Ad. Code ch. 1301-2-1-02(A)(10).
222 Id. ch. 1301:2-1-02(A)(11).

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service corporations may join with any federal, state or local government unit in an urban renewal or low cost housing project.\footnote{\textit{Id.} ch. 1301:2-1-02(A)(12).}

The last category of approved activities for these service corporations consists of permissible loans. Ohio associations must comply with fairly stringent geographical restrictions when making loans secured by real estate.\footnote{\textit{Ohio Rev. Code Ann.} § 1151.292(B) (Page Supp. 1979) (real estate loans generally); \textit{Ohio Rev. Code Ann.} § 1151.311(B) (Page Supp. 1979) (participation loans).} Most of their lending activity must be centered within this state. No such geographical restrictions are placed upon the activities of these service corporations. Although Ohio must be the state of incorporation for these service corporations, their lending activities may be conducted on a nationwide basis. They may make any loan which is secured by real estate and made "on a prudent basis."\footnote{\textit{Id.} ch. 1301:2-1-02(A)(1)(a). This provision of the rule also permits corporations to originate or purchase participations in such loans, broker, and warehouse such loans.} The rule contains no definition of "prudent basis." Certainly any loan secured by a first mortgage in real estate and not in excess of the appraised market value for that real estate should constitute a prudent loan.

These service corporations are also permitted to make loans secured by first liens upon mobile homes,\footnote{\textit{Id.} ch. 1301:2-1-02(A)(1)(b).} home improvement loans,\footnote{\textit{Id.} ch. 1301:2-1-02(A)(1)(c).} and consumer loans.\footnote{\textit{Id.} ch. 1301:2-1-02(A)(1)(d).} The term "home improvement loan" is a generic label to represent any loan for the purpose of altering, repairing, improving, equipping or furnishing residential real estate. There is obviously overlap between these home improvement loans and what the rule designates as "consumer loans." Consumer loan is defined by the rule to mean "a loan to one or more individuals which is either unsecured or which is secured by consumer goods used or bought primarily for personal, family or household purposes."\footnote{\textit{Id.} ch. 1301:2-1-02(A)(1)(e).} Although not an artfully drafted provision, the intent is fairly clear, to permit these service corporations to loan monies with which the borrower may purchase consumer goods. Consumer goods are any goods which can be used for personal, family or household purposes. That is, such items as household furniture, the family automobile and family recreational equipment. It should be reemphasized that these loans need not be secured by any interest in the goods purchased.

Another provision of the rule concerning investment activities is couched in very interesting terms. That provision permits these service corporations to make "any investment of the types specified in section 1151.34 of the
Revised Code." That particular section of the Ohio Revised Code has become a catch-all for investment authorization over the years. Whenever the legislature wished to expand the investment authority of savings associations it often inserted that additional provision within the existing section 1151.34. Indeed, that was the section in which the legislature initially inserted the authorization for savings associations to invest in service corporations. Just as in the case of the proverbial topsy, this section has grown with too little legislative scrutiny or supervision. For example, the section imposes no uniform percent of asset limitations upon all investments that are authorized therein. This is particularly troublesome when considering that the degree of investment risk varies throughout this litany of authorized investments. When one considers that a prime reason for authorizing wholly- owned service corporations to make loans was that they might enter into areas of lending that had theretofore been prohibited to savings associations, it is difficult to fathom a rationale which would permit these very same service corporations to invest without limitation in the exact mediums permissible for savings association investment.

Those investment mediums include bonds and other interest bearing obligations issued by the United States Government. General obligations issued by any state, territory or political subdivision of the United States are a permissible investment so long as the obligation is rated at the time of investment "in one of the four highest grades as shown by the most current publication of a nationally recognized investment rating service." Additional bonds that are permissible investments include certain government-issued revenue bonds, and the obligations issued by twelve specified federal agencies. This latter provision provides that the service corporation may invest in any obligation "issued or fully guaranteed as to principal and interest by the agencies and instrumentalities created pursuant to the following acts and amendments thereto:

(2) "Farm Credit Act of 1933," 48 Stat. 257, 12 U.S.C. 131;

231 OHIO AD. CODE ch. 1301-2-1-02(A)(2). (emphasis added).
233 OHIO REV. CODE ANN. § 1151.34(B) (Page Supp. 1979). Such obligations issued by possessions of the United States or their political subdivisions are also permitted under this provision.
235 Id.
(10) "Government National Mortgage Association," created by the Act of August 1, 1968, 82 Stat. 536, 12 U.S.C. 1716(b);

The former category of revenue bonds includes any issued by a state, political subdivision of that state, public corporation or government agency.

The provision authorizing savings associations to invest in these revenue bonds contains two limitations which raise some troublesome issues for the service corporation which may wish to make these same investments. First, savings associations may invest no more than ten percent of their assets in these revenue bonds. The service corporation regulation merely authorizes investment in these revenue bonds. It neither incorporates this investment limitation nor makes it expressly applicable to service corporations. Although a single service corporation could easily avoid the issue by simply investing no more than ten percent of its assets in these revenue bonds, it certainly deserves noting that investments in excess of that limitation are arguably permissible for the service corporation.

Section 1151.34 contains a second restriction on revenue bond investments. It provides that a savings association investing in such revenue bonds must first comply with "such conditions and restrictions as the superintendent . . . prescribes by regulation." Clearly no savings association may purchase such revenue bonds without complying with this requirement, but once again the service corporation rule does not incorporate this requirement of the statute. This is even a more troublesome question than the one concerning the ten percent investment limitation, for the Superintendent has never issued such a regulation. The consequence for savings associations is that they are not authorized to purchase these revenue bonds. If the service corporation rule was intended to authorize these investments without forcing the service corporation to comply with the investment limitation and Superintendent's rule requirements, then service corporations may purchase revenue bonds even in the absence of a Superintendent's revenue bond limitation.

236 Id.
237 Id.
rule. It is more likely, however, that failure to incorporate these two statutory limitations was not intentional and that a service corporation ought not purchase these revenue bonds unless it fully complies with both of the statute's requirements. In other words, service corporations will not be able to purchase revenue bonds until the Superintendent promulgates the revenue bond regulation required by statute.

Other investments permitted by section 1151.34 include "securities acceptable to the United States to secure government deposits in national banks." Service corporations may also invest in notes and debentures issued by a deposit guarantee association of this state. Securities and other obligations issued by the Student Loan Marketing Association are also permissible investments. Bankers' acceptances of a commercial bank are permissible investments if the bank is insured by FDIC and not in receivership of that corporation. The periods to maturity for these bankers' acceptances may not exceed nine months. In addition, a savings association investing in such acceptances must limit that investment to a maximum of "one-fourth of one percent of the total deposits of such bank as shown by its last published statement of condition preceding the date such acceptances are required." As in the instance of the revenue bonds, it is unclear whether this investment limitation is applicable to service corporations.

Investments are also permitted in certain loans of federal funds to an insured bank of the federal reserve system. Service corporations are also permitted to acquire securities issued by the Federal Homeowners' Loan Corporation "in exchange for eligible real estate, home mortgages, and other obligations and liens secured by real estate."

Two final provisions of this investment statute pose the same question that arose with the revenue bond authorization. Savings associations are authorized by this statute to invest in various urban renewal and rehabilitation programs, but must comply with investment limitations for those investments. For example, the statute permits investment in real property and the purchase of loans secured by real property if that property is located within urban re-

238 Id.
239 Id. For discussion of deposit guarantee associations authorized by OHIO REV. CODE ANN. §§ 1151.81 et. seq. (Page Supp. 1979) see Alexander, supra note 7, at 416.
240 Id. The statute refers to this association as being created by "12 U.S.C. 1464(c)."
241 Id.
242 Id.
243 Id.
244 The statute provides that such loan "shall not exceed the greater of one quarter of one percent of such bank's total deposits shown by its last published statement of condition, or twenty thousand dollars, and its term shall not exceed six months." Id.
245 OHIO REV. CODE ANN. § 1151.34 (Page Supp. 1979). This provision seems to merely reiterate what is authorized by a second provision that appears earlier in the statute. See OHIO REV. CODE § 1151.34(B)(4).
Two limitations apply to these investments and purchases: 1) no more than five percent of the association’s assets may be invested in a single such purchase; and 2) the sum of such purchases may not exceed twenty percent of the association’s assets. In addition, associations are permitted to invest one percent of their assets in: 1) stock of a national corporation for housing partnerships; 2) limited partnership interests in a national housing partnership; and 3) partnerships or joint ventures authorized by the Housing and Urban Development Act of 1968. The sum of the investments in these three areas may not exceed one percent of the association’s assets. As in the instance of the revenue bond authorization, a service corporation may avoid confronting the question of the applicability of these investment ceilings by simply complying with those limitations contained in the statute.

Section 1151.34 also contains the authorization which permits service corporations to place their funds in short term investments. The provision permits deposit of any funds “in any financial institution that is subject to inspection by the United States or by this state.” Unfortunately, the statute only authorizes that these funds be deposited in certificates of deposit. It does not permit a service corporation to place funds in a checking account nor in a standard savings account. Indeed no such authorization is to be found anywhere within the enabling statute or the wholly-owned service corporation regulation. Since it is impossible to imagine that a profit-making corporation could attempt to engage in business today without utilization of at least a checking account, it is reasonable to expect that service corporations could also engage in that activity. Silence on this matter ought to be deemed mere oversight and not an intent to prohibit such activities.

The enabling statute and regulation are equally silent concerning a much more important matter for wholly-owned service corporations (and jointly-owned service corporations). That matter concerns the ability of service corporations to borrow. Certainly the enabling legislation for service corporations contemplates that a savings association may lend to a service corporation. This lending may occur by purchasing debt securities or by investment in “obligations” of the service corporation. But nowhere is there authorization for service corporations to borrow from non-association

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250 See the first sentence of both divisions ((A) and B)) of Ohio Rev. Code Ann. § 1151.344.
lenders. Any leveraging of a service corporation’s capital base must be done solely by borrowing from savings associations. Although that class of potential lenders would include both shareholders and nonshareholder savings association, this omission effectively prohibits both types of service corporations from borrowing funds from such traditional lenders as commercial banks and insurance companies.

There may be a partial answer to this problem, at least for wholly-owned service corporations. The wholly-owned service corporation regulation permits those service corporations to file a letter of intent with the Superintendent requesting his permission to engage in any activity not otherwise authorized by the rule. If the Superintendent fails to deny that request within thirty days of its filing, then the applicant service corporation is deemed to have permission to engage in that requested activity. The standard applied to determine whether to grant such request is whether that “activity is a proper incident to the business of a building and loan association.” A service corporation that would wish to borrow from a nonassociation lender would have to establish that the purpose of such loan was to engage in an activity that was incidental to the business of savings associations. Failure to establish that fact would probably result in disapproval of the request. The rule further provides that even if the Superintendent initially grants his approval, that approval may be subsequently withdrawn. Before withdrawing such approval, the Superintendent must grant the service corporation notice and hearing in accordance with the adjudicatory procedures prescribed by the Ohio Administrative Procedure Act. Even after his decision is rendered at the conclusion of that hearing the Superintendent must wait an additional ninety days before that disapproval becomes effective.

The rule also provides that failure to secure the Superintendent’s approval to engage in any activity that is not a preauthorized activity constitutes “an unauthorized practice” for the corporation. Just how the Superintendent would determine that a corporation was engaging in an unauthorized practice is part of the next topic of supervisory oversight of service corporations by the Superintendent.

III. SUPERVISORY OVERSIGHT

A. Examinations

Examinations are recognized to be the most effective means available

251 Ohio Ad. Code ch. 1301-2-1-02(B).
252 Id. The rule also contemplates that there may be instances in which the superintendent will grant written consent for such a request.
253 Ohio Ad. Code ch. 1301-2-1-02(B) (1).
254 Id. ch. 1301-2-1-02(B) (2).
255 Id.
256 Ohio Ad. Code ch. 1301-2-1-02(B) (1).
to the Superintendent for exercising supervisory oversight of service corporations. Yet, when the legislature enacted the original enabling legislation for jointly-owned service corporations in 1965, that enactment was silent concerning the Superintendent's authority to examine those service corporations. Perhaps the legislature simply assumed that the Superintendent's authority to examine service corporations was inherent in his general authority to examine the parent associations. The Superintendent's subsequent action revealed that he may have lacked complete confidence in that approach. Indeed, the legislature may have intended to leave jointly-owned service corporations free from examination by the Superintendent.

When the Superintendent promulgated Regulation 70-5 on August 24, 1970 he provided that no savings association could invest in wholly-owned service corporations until the association executed an authorization which permitted the Superintendent to examine its service corporation. The prescribed form for granting such examination authority provided that:

Pursuant to the provisions of Regulation 70-5 issued by the Superintendent of Building and Loan Associations effective August 24, 1970, the undersigned corporation agrees that it will permit (and pay the cost thereof) examination of the [wholly-owned service] corporation by the Superintendent of Building and Loan Associations as the Superintendent may from time to time deem necessary.257

Whether jointly-owned service corporations remained free from any examination by the Superintendent was finally settled in 1972.258 The enabling legislation of that year for wholly-owned service corporations expressly permitted the Superintendent to examine all service corporations. The separate division of that statute which permits formation of wholly-owned service corporations also provides that the "[S]uperintendent may at any time examine the affairs of any service corporation in which an association organized under the laws of this state owns stock."259 Unlike the original scheme of Regulation 70-5 where the parent association paid the costs of examination of its service corporation, today that cost of examination is borne by the Division's biennial appropriation, with the consequence that it is passed back on a pro rata basis to all of the Ohio savings associations in this state.

The drafting of the statute which authorized examinations by the Superintendent and the initial absence in 1965 of express authority to examine jointly-owned service corporations lead some members of the industry to argue that the Superintendent received authority in 1972 to examine

259 134 Ohio Laws 845, § 1151.344(B) (Page Supp. 1979) (formerly Ohio Rev. Code Ann. § 1151.34(F)(2)).
only wholly-owned service corporations. While the drafting of that examination authority is not a model of clarity, the intent of that examination provision is nonetheless clear. The Superintendent received authority to examine both jointly-owned service corporations and wholly-owned service corporations. Superintendents have consistently construed the section in this fashion since its 1972 enactment.

By authorizing the Superintendent to examine all service corporations, the legislature has recognized that the economic wellbeing of savings associations is intricately interwoven with and interdependent upon the wellbeing of their service corporations. Unfortunately, the statute provides little guidance for the task of defining the scope of that examination process. It simply provides that:

The [S]uperintendent may at any time examine the affairs of any service corporation in which an association organized under the laws of this state owns stock.

The authority to examine is merely that, nowhere is the Superintendent ever required to examine, let alone to do so on some regular basis. Yet examinations of service corporations are normally conducted by the Superintendent's office during the course of the annual examination of the parent savings association.

Even should an examination uncover unauthorized activities of a service corporation the Superintendent has no authority to directly penalize a service corporation, its officers or directors. The scheme instead provides for sanctioning the shareholder association:

Whenever a service corporation or a building and loan association fails to meet the requirements and limitations set forth [in the service corporation statutes or regulation] . . . , all loans or investments by [an] . . . association to or in such service corporation constitute unauthorized investments.

The bill which amended the earlier service corporation enactment to additionally permit wholly-owned service corporations was divided into two separate divisions. The initial paragraph authorizing the formation of jointly-owned service corporations was renumbered (E)(1) in this 1972 bill. The new language which authorized formation of wholly-owned service corporations and which also now granted the superintendent the authority to examine service corporations was contained in subdivision (2) of that same division (E). This numbering scheme lent credence to that argument that the legislature had only intended to permit the superintendent to examine the wholly-owned service corporations authorized within that same subdivision (2).

The superintendent has authority to make both special and annual examinations of savings associations. (Ohio Rev. Code Ann. §§ 1155.09, 1155.10 (Page 1968)). Although the superintendent is required to make annual examination of savings associations, there is no mandate that the superintendent ever examined a service corporation. Instead, the authorization to examine service corporations is a discretionary function of the superintendent. For a further discussion of the annual examination of savings associations, see Alexander, supra note 7, at 412-414.

The same sanction is applied where the association exceeds the relevant investment and lending restrictions.

B. Supervisory Sanctions

The fiction of service corporations is that each constitutes a separate, independent corporate entity sufficiently independent from its shareholder savings associations as to insulate those savings associations from liability for the service corporation's debts. By penalizing those same stockholders for the service corporation's unauthorized activities, the legislature has effectively removed this fictional veil of corporate independence. Yet in some instances the service corporation will be effectively independent of a particular savings association shareholder. Consider for example, the instance of the wholly-owned service corporation whose stock is held eighty percent by one savings association and twenty percent by a second association. Why should that second savings association be penalized for the actions of a service corporation that is controlled by another savings association? Even more troublesome is the example of the jointly-owned service corporation. If fifty savings associations each owns two percent of the stock of a service corporation, can any of those individual savings associations be deemed to control that service corporation? Yet if that same service corporation fails to comply with the relevant restrictions on its activities, each of those fifty associations' investment in that service corporation is deemed to be an unauthorized investment. Such a determination is of no small consequence for the association holding that unauthorized investment.

When the Superintendent believes that "an association has made or is holding any [unauthorized] loan or investment," he may convene a formal adjudicatory proceeding as the first step toward sanctioning the association. At least thirty days, but no more than forty-five days, before that hearing the Superintendent must give the savings association notice of the time and place for the hearing. That notice must also contain a statement of the alleged matters which constitute the basis for the hearing. The hearing must be conducted procedurally in a manner prescribed by the Ohio Administrative Procedure Act for formal adjudications.

That Administrative Procedure Act requires that the hearing be conducted very much in the manner of a court trial. Documents and witnesses...
may be subpoenaed and produced during the proceeding. A stenographic record must be maintained containing all the testimony and evidence submitted during the hearing. The Superintendent may preside at this hearing or he may appoint a hearing examiner to serve in his place. Hearing examiners have the same authority as possessed by the Superintendent when conducting these hearings, but lack the power to make the final decision. Hearing examiners must hear all the evidence and reports, enter findings of fact, conclusions of law, and a recommendation of the action to be taken by the Superintendent. This report is filed with the Superintendent and copies are forwarded to the savings association. That report must be forwarded within five days of the date of its filing with the Superintendent. The savings association then has ten days from the receipt of that report to file written objections to the report with the Superintendent. Those written objections and all the matters and materials presented to the hearing examiner must be considered by the Superintendent before he enters a final decision in the matter. Once the Superintendent enters a final decision he must send a copy of that order to the savings association by registered mail along with “a statement of time and method by which an appeal may be perfected.”

When a savings association has been charged with making an unauthorized investment and the Superintendent determines after hearing that the investment was indeed made, he may issue one or more of three orders to that association. He may order that the association:

1. Establish a valuation reserve against [the] unauthorized loan or investment;
2. Divest itself of such loan or investment within a reasonable time of not less than ninety days; [or]
3. Cease and desist from any unauthorized lending or investing practice . . . ”

Such orders are not self-implementing. That is, the Superintendent’s primary mode for enforcement of such orders in the event a savings association refuses to comply is to request that the Ohio Attorney General petition a court of competent jurisdiction to order compliance with the order. Failure to subsequently comply with the judicial order can result in contempt citations by the court issuing that order.

268 Id. Stenographic records are not required by the statute in every instance. The statute does provide, however, that in those instances where a record is not compiled during an initial hearing, if that hearing is to serve as a basis for an appeal to court, then the appealing party may request rehearing for the purpose of compiling such a record. “The rules of an agency may specify the situations in which a stenographic record will be made only on request of the party, otherwise such a record shall be kept at every adjudication hearing from which an appeal to court might be taken.” Id.
269 Id.
These three enforcement tools provide the Superintendent with little real authority to supervise service corporations. A cease and desist order from continuing unauthorized lending or investments in a service corporation will simply force the shareholder's savings association to cease making further loans or investments. Such an order will not recapture the assets of the savings association that have already been placed at jeopardy with the service corporation, nor necessarily cause a recalcitrant service corporation to cease wrongdoing.

Nor will the order to the savings association to divest itself of these loans and investments help recapture all those risked assets. Such an order may simply mean that the savings association will, at some indeterminate time in the distant future, sell these loans or its stockholdings in the service corporation to a third party. Nor does a divestment order assure that the selling savings association will not incur substantial losses from those sales. Even after the savings association has sold its service corporation loans or stock at a severe loss, the service corporation may well continue to operate in the manner which first produced the divestment order.

Finally, the establishment of a valuation reserve alone does nothing to significantly influence the service corporation to discontinue its unauthorized activity. Such an order simply places an additional burden upon the savings association. The effectiveness of this remedy is particularly suspect when considering that the activities of the service corporation may already have significantly jeopardized the normal business operations of this savings association.

IV. RECOMMENDATIONS

A. Savings and Loan Investments in Service Corporations

The two tiered approach to service corporations is merely a mirroring of the federal scheme. No good reason exists to justify such a structure for service corporations. It makes little sense to require a so-called wholly-owned service corporation to abide by a list of pre-approved activities while permitting a second type of service corporation to determine on its own what constitutes a permissible activity. Indeed, the ownership of a wholly-owned service corporation need be little different from a jointly-owned service corporation. For example, a service corporation whose stock is owned by three savings associations will be deemed a wholly-owned service corporation if shareholder A owns fifty-one percent of the stock while the remaining two shareholders each owns twenty-four and one-half percent of the stock. That same service corporation can be very easily converted to jointly-owned status by the transfer of a mere one percent of A's stock to either of the other two shareholders. The sale of one-half percent of stock to each of two minority shareholders by A will result in the latter's ownership of fifty percent of the stock, and the other two with twenty-five percent each, a jointly-owned service corporation.
This needlessly complicated two tiered ownership scheme should be replaced with a single entity approach. That scheme should also only allow associations to invest in and loan to service corporations whose stock is owned solely by savings associations. This limitation would preclude the present possibility that a portion of the stock of a wholly-owned service corporation may be owned by a non-association investor.

The present limits upon the amount which a single savings association may place at risk through investment in the stock of service corporations and through loans to service corporations must be jointly reevaluated by the Superintendent and the legislature. This reevaluation should consider anew whether service corporations serve any useful purpose for savings associations. This task will be much easier today than it was at the inception of service corporations some fifteen years ago. Jointly-owned service corporations have existed for that entire period and wholly-owned service corporations have been authorized to Ohio savings associations for almost a decade.

The time is past due to review the performance record compiled by these service corporations with a view toward determining which activities have promoted the purposes underlying the initial enabling legislation for service corporations. If the primary purpose for wholly-owned service corporations was truly to create a vehicle for experimental lending, then review of lending activities of existing wholly-owned service corporations should aid in determining whether they fulfilled that task. Review of the various activities of both types of service corporations should aid in redefining the purposes and objectives for service corporations in the decades ahead.

This process of reevaluating the purposes to be served by service corporations will provide a useful backdrop for then fixing new investment limitations. There is no justification for continuing the present investment limitations. The formula for computing the total amount that may be placed at risk through loans to and investments in service corporations can be and must be simplified. First, the ceiling upon the amount that may be invested in equity ownership of a service corporation should be separate and distinct from the ceiling upon total lending to service corporations. Every loan to a service corporation should be treated just as a loan by an association to another borrower. That is, any loan to a service corporation borrower should comply with all the applicable requirements for that type of loan. If the savings association would have to comply with loan-to-value ratios, asset limitations and amortization periods if the loan were to be made to any other borrower, then those same loan restrictions should be equally applicable to the service corporation borrower. So also should the loans-to-one-borrower provision apply equally when associations loan to service corporations. Perhaps an additional ceiling should even be placed upon the total of loans to all service corporations by a single savings as-
sociation. That is, a "loans-to-service corporations" ceiling. This would mean that a single savings association could lend no more to all service corporation borrowers than this maximum amount fixed by statute.

The maximum amount which a single savings association may invest in the equity of either type of service corporation should be reduced from the ceilings presently in effect. This is particularly needed with respect to the possible twelve percent of assets that may be invested in jointly-owned service corporations. The two apparent reasons for allowing Ohio associations to organize service corporations were that they provide support services to savings associations and that they engage in experimental lending not otherwise permissible for savings associations. Whatever investment ceilings will be adequate to permit service corporations to fulfill this former task must be reexamined and fixed anew. Whatever that ceiling may be, it ought to limit a single association's risked investment to an insignificant amount. Though opinions will differ when defining the upper reaches of "insignificant," the present investment limits clearly allow an association to place too substantial amounts at risk.

The second rational for service corporations was to allow associations to indirectly engage in business activities that were prohibited to direct involvement by associations. Yet the era of legislative and industry promotion of the fiction of separate, noncompeting financial institutions has drawn to a close. The recent passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 brought the final demise of the dual system of commercial banks and savings associations. It is time for Ohio to also allow its savings association industry to enter the decade of the 80s. If the range of business activities is so clear as to be definable in a Superintendent's regulation for service corporations, then those same business activities ought instead to be directly permissible for savings associations. The time has arrived for associations themselves to become the vehicle for new business activities. Whether there was ever a time for service corporations to provide that vehicle, that time has passed. The total amount that a single association may presently invest in service corporations should now be reduced by whatever portion the legislature deemed necessary to finance this experimental lending function of service corporations.

Finally, some restrictions should be placed upon savings associations' investments in banks for savings associations. These banks are no less service corporations than are other subsidiaries of savings associations. The investment ceiling for service corporations should be applicable to the aggregate of investments in service corporations and banks for savings associations. Alternatively, the legislature should at least impose a separate ceiling for all investment in banks for savings associations.
B. Service Corporation Activities

Only wholly-owned service corporations are presently required to abide by the list of pre-approved activities in the Superintendent's regulation. Jointly-owned service corporations may determine for themselves what constitutes permissible activity. It is only after engaging for a period of time in such activity that the jointly-owned service corporation may come under the Superintendent's scrutiny. At that time, he may determine that the activity is not a permissible one and prohibit it for the future. A better approach will be to subject the proposed single type of service corporation to the kind of scheme presently applicable only to wholly-owned service corporations. A single Superintendent's rule should list permissible activities for the service corporation and also prescribe the geographical limitations for those activities. These latter limitations could parallel those applicable to savings associations, since there seems to be little reason to permit service corporations to do business in geographical regions where Ohio savings associations may not do business.73

If the purposes for service corporations remain to provide complementary services to savings associations and to engage in experimental lending prohibited to savings associations, then the Superintendent's regulation ought to limit its consideration to these two areas. The regulation should not permit or authorize service corporations to engage in lending activities that are already permissible for savings associations. The provisions in the present Superintendent's regulation permitting service corporations to make all the investments permissible to savings association by Ohio Revised Code Section 1151.34 ought to be deleted. The provisions authorizing educational loans, equipping loans, mobile home loans, participation in certain urban renewal and low cost housing programs, and loans secured by residential property ought to be similarly removed. Nor should the Superintendent be permitted to authorize additional activities on a case-by-case basis dependent upon individual requests from service corporations. Every activity approved for service corporations ought to be encompassed within the rule. If the petition of a service corporation to engage in a new unauthorized activity has merit and is approved by the Superintendent, then that approval should result in amendment of the rule so that all service corporations are equally benefitted by this approval.

Potential conflicts of interest pose the most serious concern in the area of service corporation activities. Savings associations can presently utilize their subsidiary service corporations to make loans to certain borrowers that would otherwise be prohibited loans for the savings association to make itself. These include loans to certain insiders and loans in excess of prescribed limits to one borrower. The enabling legislation for service cor-

corporations should be amended to add a conflict of interest provision. It should clearly prohibit loans by a service corporation to any employee, director, control person, insider or affiliate of the shareholder savings association. Loans should also be prohibited to insiders of the service corporation. These would also include the officers, directors, and all other employees of the service corporation or of any subsidiary of the service corporation. Finally, limitations should be placed upon the amount that a service corporation may lend to any single borrower.

C. Supervision

The most critical flaw in the present regulatory system for service corporations is that the Superintendent lacks jurisdiction to directly regulate service corporations. Instead, he must regulate service corporations by imposing sanctions upon the shareholder savings associations. This problem should be resolved by granting the Superintendent broad statutory authority to impose fines upon the officers, directors and employees of the service corporation or upon the corporation itself, to remove such persons from further contact with the service corporation, and to issue cease and desist orders to the employees, officers and directors of the service corporation.

Another significant omission in the Superintendent’s present authority concerns foreign service corporations. These are service corporations doing business in Ohio, but incorporated in another state. Since Ohio savings associations are not now permitted to own stock in a service corporation incorporated in any state other than Ohio, the shareholding savings associations of a foreign service corporation consist of savings associations chartered by other states and federal associations whose home offices are located in a state other than Ohio. Such service corporations frequently engage in business in this state, often in lending activities that are tantamount to the lending business of a savings association. Foreign savings associations may only conduct business in this state after securing a certificate of authority to do so from the Superintendent. They are subject to examination and may be subject to a modest penalty if they fail to comply with this provision. Yet foreign service corporations are not subject to even this cursory oversight. Foreign service corporations must also be required to comply with regulatory oversight similar to that applied to foreign savings associations.

The Superintendent should be required to conduct annual examinations of domestic service corporations and should be permitted to conduct special examinations at the expense of the service corporation examined. This

276 One condition for doing business in this state by foreign service corporation would be to consent to annual and special examinations by the Superintendent, as in the instance of foreign savings associations.
would parallel the Superintendent’s present authority to examine Ohio savings associations and Ohio deposit guarantee funds. Sufficient fees should be assessed to service corporations to underwrite the cost of all annual and special examinations. There is simply no reason why all associations in this state should bear equally the expense of examining the service corporations of other associations.

Finally, all service corporations doing business in this state should be required to submit an annual report of condition to the Superintendent. These reports should be in the format prescribed by the Superintendent and should include such matter as the kinds of business activities engaged in during the preceding calendar year; salaries of officers, directors and other employees; disclosure of any outstanding loans to insiders or affiliates of shareholder savings associations; and disclosures of any common directors who serve on the board of another financial institution, including the board of a shareholder savings association.

These steps recommended to reform Ohio’s service corporation scheme will substantially reduce the risk posed by these corporations for their parent associations, significantly enhance the regulatory oversight and supervision of these subsidiaries, and render clarity to a scheme that is complex at its best and probably more often unintelligible.

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279 Since service corporations are presently permitted to make loans to insiders and loans to affiliates, even if the legislature prohibits such loans in the future, some service corporations will continue to carry those loans on their books for a period in the future. The status of those loans should be annually updated so that the superintendent can adequately overview any new loans.