Federal Credit Union Share Drafts: Will Congress Default?
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I. INTRODUCTION

Economic adversity spawned the concept of cooperative consumer credit and the credit union institution as it is known in America today. Cooperative credit had its modern origin in Germany in the mid-1800's and was brought to America in the early 1900's as a means of relieving those of modest means, with little access to credit, from paying usurious interest rates to loan sharks. The first credit union in the United States was organized in Manchester, New Hampshire, in 1909. During that same year the Massachusetts Legislature enacted the first credit union law in this country.

Throughout the early 1900's the American credit union movement proliferated so that by the early 1930's the concept came to the attention of federal legislators. On June 26, 1934, Congress enacted the Federal Credit Union Act. No less than forty-one states had already passed legislation allowing for the state charter of credit unions. A dual chartering system was thus established that closely resembles the chartering system for banks and other financial institutions in this country.


3. R. BERGENGREN, COOPERATIVE BANKING 53 (1923). The first credit union in the United States, La Caisse Populaire Ste. Marie (St. Mary's Bank), is currently operating under its original New Hampshire state charter which was authorized by Special Act of the New Hampshire Legislature in 1909.

4. 1909 Mass. Acts ch. 419 (codified at MASS. GEN. LAWS ANN. ch. 171 (West 1971)).


6. J. DUBLIN, CREDIT UNIONS 149 (2d ed. 1971). Mr. Dublin further points out that by 1934 over 3,000 credit unions were operating among all kinds of groups, and mass-production techniques had been perfected. And finally in a memorable 5-day meeting at Estes Park, Colorado, 52 credit union leaders from 22 states held a constitutional convention to form a national union. On August 10, 1934, they signed the constitution and bylaws of the Credit Union National Association.

Id. Today only Alaska, Delaware, South Dakota, Wyoming, and the District of Columbia are without state credit union legislation. These states have only federal credit unions.

7. Under a dual chartering system a financial institution may be chartered by either the federal government or a state government.
As credit unions have grown in number they have broadened the scope of their financial services. This trend has been met with increasing antagonism and opposition by the banking world. Consistent with this opposition, the American Bankers Association in 1977 filed suit against the Administrator of the National Credit Union Administration seeking to prevent credit unions from using share drafts, a third-party payment device similar to a bank check. This Comment will explore the creation and purpose of federal credit unions in order to examine the controversy concerning the credit union share draft. After some conclusions are reached regarding the legal and policy arguments surrounding share drafts and other methods of third-party payment, the Comment will make some basic recommendations designed to alleviate the pressure mounting between institutional members of the financial community as a result of third-party payment devices.

II. FEDERALLY CHARTERED FINANCIAL INSTITUTIONS

The federally chartered financial world consists of three basic types of institutions, each regulated by at least one government agency. This general grouping consists of commercial banks, savings and loan associations, and credit unions.

A. Commercial Banks and Savings and Loan Associations

The commercial bank system makes up the largest network of American financial institutions. Commercial banks, like credit unions and savings and loan associations, can be chartered by either the federal or state governments. The Federal Reserve Board and the Federal Deposit Insurance Corporation control the activities of federally chartered commercial banks and state-chartered institutions that choose to become members of the Federal Reserve System. Commercial banks are also supervised by the Comptroller of the Currency within the Department of the Treasury due to their close relationship with the money market in the United States. Perhaps because they are the oldest financial institution in America—and the most closely linked with

8. This third-party payment device is utilized by credit union members to make payments out of their interest-bearing share (savings) accounts.
9. At the close of 1975, commercial banks in the United States reported total assets of $958 billion. Savings and loans and credit unions reported assets of $330 and $38.3 billion respectively. See BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, POCKET DATA BOOK 345-46 (1976).
American monetary policy—they are also the most heavily regulated.

Savings and loan associations also operate on both the federal and state level. The Federal Home Loan Bank Board regulates the activities of federally chartered savings and loans and state-chartered institutions that are members of the Federal Home Loan Bank system. The Home Owners' Loan Act of 1933 is the federal legislation applying to federally chartered savings and loans. As their regulatory agency's name implies, these organizations operate primarily for the purpose of providing loans in the mortgage market.

B. Credit Unions

In drafting the Federal Credit Union Act its authors drew upon what they judged to be the best of the state credit union statutes then in existence. An examination of the House debates over this piece of legislation reveals that the federal credit union, similar to its state-chartered counterpart, was intended to supply consumer credit to people of modest means who had been unable to obtain small, short term loans from state-chartered or federally chartered banks. The poor had been forced to turn to loan sharks for their short term credit needs, resulting in the payment of over two billion dollars annually in interest on usurious loans. The Federal Credit Union Act therefore provides for the establishment of cooperative lending institutions operated on a volunteer basis by individuals who are united by an occupational, residential, or associational bond (generally called the common bond requirement). The term "credit union" is defined by the federal law as "a cooperative association organized ... for the purpose of promoting thrift among its members and creating a source of

11. Id. §§ 1461-1470.
12. From an economic standpoint it is easy to see why banks were generally unwilling to make small, short term loans. Banks could keep their funds loaned out to commercial customers who borrowed much more than small consumers. Making a few large loans carried a much lower administrative cost than making many small ones. This was especially true during the computerless age of the early 1900's when accounting and bookkeeping were much more time consuming and expensive than today. The need credit unions filled during this period in history has been described as follows:

The credit union is based on the theory that the banking system needs supplementing by the development of a plan which will specialize in the smallest individual units of saving and, at the same time, concern itself with problems of small credit, collectively of great importance, but individually so small that existing banking facilities cannot cope with them except at substantial loss.

R. BERGENGREN, COOPERATIVE BANKING 53 (1923).
credit for provident or productive purposes." The Act also enumerates the powers of federally chartered credit unions.

I. Powers and supervision

By express statutory authorization a federal credit union may, *inter alia*, make contracts, make loans to members, receive payments on shares from members, pay dividends on shares, invest its funds in a number of ways, and, most importantly, "exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated." In 1959 the Federal Credit Union Act was amended to place the Bureau of Federal Credit Unions within the Department of Health, Education, and Welfare. This Bureau served as the regulatory body responsible for the operation of the federal credit union program until 1970. In that year Congress placed the program under the auspices of an independent agency, the National Credit Union Administration (NCUA).

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16. Id. § 1757(1).
17. Id. § 1757(5).
18. Id. § 1757(6).
19. Id.
20. Id. § 1757(7).
22. Act of Sept. 22, 1959, Pub. L. No. 86-354, § 3, 73 Stat. 628 (current version at 12 U.S.C. § 1752a(a) (1976)). Prior to 1959 the Bureau of Federal Credit Unions was regulated by the Farm Credit Administration within the Department of Agriculture. Act of June 29, 1948, ch. 711, § 2, 62 Stat. 1092 (current version at 12 U.S.C. § 1752a (1976)). This original placement resulted because "those who were interested in framing the bill thought the best place to put it was under the Farm Credit Administration for the reason that that branch of the Government is the most experienced branch in the matter of cooperative credit." 78 Cong. Rec. 12224 (1934) (remarks of Rep. Steagall).
agency is headed by an administrator who serves by appointment of the President, by and with the advice and consent of the Senate.24

2. Organization

Any seven or more natural persons are eligible to apply for a credit union charter.25 Applications for a charter are evaluated by the NCUA based upon criteria enumerated in the Federal Credit Union Act. Among these criteria are the economic advisability of establishing the proposed corporation and the common bond requirement.26

Federal credit unions are democratically controlled and governed by an unpaid board of directors duly elected from among the general credit union membership.27 The loan activities of the corporation are controlled by a credit committee,28 while a supervisory committee oversees other internal administrative policies.29 These committees are composed of unpaid volunteers appointed by the board of directors from among the general membership.

The treasurer, who in most cases serves as a full-time manager of the credit union, is the only executive officer of the organization allowed compensation for his services. The Federal Credit Union Act also provides for the credit committee to delegate its loan approval authority to one or more loan officers who are also compensated for their services.30 Under the incidental powers provision of this Act,31 federal credit unions have found no difficulty in staffing other full-time, compensated positions for loan, collection, administrative, and accounting departments.

The American credit union movement has experienced tremendous growth since its inception. As credit unions have grown to command larger portions of the financial services market, amendments to their enabling legislation have made some of their unique characteristics less apparent, making them appear increasingly similar to other types of lending institutions. There

24. Id. § 1752a(b).
25. Id. § 1753.
26. The Federal Credit Union Act limits credit union membership to "groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district." Id. § 1759.
27. Id. § 1761.
30. Id. § 1761a.
31. Id. § 1757(15).
remain, however, some fundamental distinctions between credit unions and other types of lending institutions. An understanding of the differences that affect third-party payment systems and grant competitive advantages to one institution over another is essential to the analysis in this Comment.

C. Distinctions Affecting Competition

Among Financial Institutions

State and federal law requires commercial banks and savings and loan institutions to pay income tax. By contrast, credit unions enjoy an income tax exemption on both the federal and state levels. Taxing authorities justify this favorable status by noting that credit unions maintain no capital stock.32

The amount of interest payable by commercial banks is currently limited to 5% per annum on passbook savings,33 while savings and loan associations are allowed to pay 5.25% on similar accounts.34 This interest differential represents an attempt to draw a higher percentage of the savings dollar into the mortgage market through savings and loan associations. Credit unions operate under no interest payment ceiling; the amount of dividends paid is governed by individual boards of directors.35 As a result, credit unions generally pay a higher return on share deposits than do banks or savings and loan associations on savings accounts.36 This of course serves as an important incentive for saving in credit union share accounts rather than in savings accounts provided by banks and savings and loans.

The competitive advantages given credit unions are tempered somewhat by other relative disadvantages. Credit union services are only available to credit union members, who must meet the "common bond" requirement.37 This effectively limits loan and savings portfolios to natural persons, thus restricting

33. Regulation Q, 12 C.F.R. § 217.7(c) (1978).
34. 12 C.F.R. § 526.3 (1978).
36. For the quarter ending Dec. 31, 1978, the Federal Employees Credit Union (the largest state-chartered credit union in Utah) paid share dividends at the rate of 7.11% per annum. Telephone interview with James J. Dawson, Treasurer and General Manager of the Federal Employees Credit Union, Ogden, Utah (Jan. 12, 1979). For that same quarter the Navy Federal Credit Union (the largest federally chartered credit union in the United States) paid on its share accounts 7% per annum. Telephone interview with John Henderson, Director of Education and Information, Navy Federal Credit Union, Washington, D.C. (Jan. 12, 1979).
credit union ability to compete with other financial institutions for the business dollar. In addition, credit unions, as well as savings and loan institutions, are not expressly authorized to offer demand deposit service.38 Commercial banks that are members of the Federal Reserve System are the only group of financial institutions with direct access to a national check-clearing facility; they have therefore traditionally enjoyed a monopoly in the area of third-party payment accounts. Since banks are prohibited by federal law from directly or indirectly paying interest on demand deposits,39 these accounts, although subject to a reserve requirement,40 represent free money to commercial banks. After meeting the reserve requirements, banks can lend out demand deposit money and thus realize a much higher return than if they were to pay interest on these accounts.

Credit unions and savings and loan institutions share at least one common advantage over commercial banks in that banks are required to maintain reserves against total deposits. Depending upon a bank's geographic location, this requirement may range from seven to twenty-two percent of its total demand deposits (checking account balances), and from three to ten percent of its savings deposits.41 Credit unions and savings and loan institutions, however, are not required to maintain any reserves against their share deposits or savings accounts. Consequently, credit unions and savings and loan institutions can loan from three to twenty-eight percent42 more of the funds on deposit than can commercial banks. This advantage is partially offset by the fact that banks can offer demand deposit services. These basic differences among American financial organizations shed light upon the disputes presently surrounding third-party payment devices.

III. The Share Draft

Prior to 1974 federal credit union members could make share account withdrawals in person, by phone, or by mailed request. On August 21, 1974, the Administrator of the NCUA published a

38. A demand account with a commercial bank is merely a traditional checking account. Money deposited in these accounts is not subject to a notice of withdrawal, but is payable on demand.
40. Id. § 461.
41. Id.
42. One hundred dollars (representing the loanable funds, from a $100 deposit, available to credit unions or savings and loan institutions not subject to a reserve requirement) is 28% greater than $78 (representing the loanable funds from a similar $100 deposit with a commercial bank that is subject to a 22% reserve requirement).
regulation permitting interested parties to submit recommendations for pilot programs relating to electronic funds transfer systems. As a result of the recommendations received, the NCUA approved a pilot plan allowing credit unions to offer third-party payment services in the form of share drafts.

The approved share draft system was designed to provide credit union members with an alternative method of share withdrawal. As defined by the NCUA, a share draft is

a negotiable or non-negotiable instrument which directs a federal credit union to withdraw funds from a member's share draft account and pay those funds to either the member or a third party designated by the member. A share draft is payable through a bank and is similar to other forms of payable through drafts drawn against other nonbank institutions such as money order companies and insurance companies.

A share draft therefore has essentially the same function as a commercial bank check. It provides credit union members with a system of third-party payment from deposited funds.

Although a share draft looks and works much like a commercial bank check, some very important technical differences exist. Since a share draft is paid out of a member's share account, any money on deposit is subject to dividend payments. The demand deposit accounts from which commercial bank checks are paid, however, do not bear interest. The Federal Credit Union Standard Bylaws provide that a sixty-day notice of withdrawal power be retained by credit unions upon share accounts. As long as credit unions maintain this notice requirement, even though it is not generally exercised, the account cannot technically be classified as a demand account.

43. 12 C.F.R. § 721.3 (1978).
44. The experimental share draft programs were approved by the NCUA on Oct. 1, 1974. 42 Fed. Reg. 11,247 (1977).
45. Id.
46. A credit union share account is the equivalent of a passbook savings account at a commercial bank. Technically, however, a credit union member is buying shares in a mutual organization at the rate of five dollars per share (par value) when he deposits his money.
47. Dividend payments on share accounts are the equivalent of interest on passbook savings accounts with other financial institutions. Dividend payments from credit unions do not qualify for the $100 federal income tax exclusion available to taxpayers receiving dividends from corporations. I.R.C. § 116(b)(1).
49. A "demand deposit" is defined as "every deposit which is not a 'time deposit' or 'savings deposit.'" 12 C.F.R. § 217.1(a) (1978). This definition limits demand deposits
Share drafts are payable through a commercial bank, thus permitting credit union access to the national clearing facility operated by the Federal Reserve System. The credit union upon which the bank makes presentment of the draft may dishonor it for a number of reasons, including insufficient funds in the member's share account, exercise of the sixty-day notice requirement, or a stop payment order made by the issuer of the draft.

By February 1, 1977, the Administrator of the NCUA reported that 4.6%, or a total of 585 federal credit unions were operating some form of share draft program.50 His report indicated that during the quarter ending December 31, 1976, approximately 3,642,408 drafts totaling $199,272,045 had been cleared through banks.51

IV. SHARE DRAFT LEGALITY

On September 7, 1976, as the pilot share draft programs were rapidly growing in number, the American Bankers Association filed a lawsuit in the Federal District Court for the District of Columbia against the Administrator of the NCUA.52 The suit challenged both the Administrator's authority to establish pilot share draft programs and the legality of the share draft program itself under the Federal Credit Union Act.53 The complaint was dismissed without prejudice when the Administrator agreed to issue a final regulation concerning share drafts.54 On February 28, 1977, the Administrator published a proposed share draft regulation.55 Following a hearing on the proposal, the final regulation with amendments was published to be effective as of February 6, 1978.56 On December 9, 1977, the day following the official pronouncement of the final share draft regulation, the American Bankers Association refilled its suit against Lawrence B. Connell, Jr., Administrator of the NCUA.57
The court in American Bankers Association v. Connell considered two issues. The first was "whether, consistent with the terms of the FCU [Federal Credit Union] Act and the general statutory scheme controlling federal financial institutions, the NCUA can authorize FCUs to utilize share drafts as a means of accessing members’ accounts." The second issue concerned "whether the manner in which NCUA promulgated its regulation comports with the standards of the Administrative Procedure Act." After a review of the arguments for both questions the court ruled that "no genuine issues of material fact" existed and granted the defendant’s motion for summary judgment.

The court summarily treated the second issue in American Bankers by relying upon guidelines established in the Administrative Procedure Act. The Act provides that courts may only set aside an administrative agency’s action if it is found to be "[a]rbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." The court held that the NCUA’s authorization of a share draft program did not violate this standard.

A. Lack of Express Statutory Authority for Share Draft Programs in the Federal Credit Union Act

The court in American Bankers directed the bulk of its analysis toward considering whether the lack of express statutory authority was fatal to the operation of share draft programs. Because the Federal Credit Union Act does not expressly authorize share account withdrawals, the court reasoned the authorization must derive from the incidental powers provision of the Act and therefore the mechanics for withdrawal should be left to the discretion of the NCUA. The court pointed out that an administrative agency’s interpretation of its enabling legislation should be upheld if it has a reasonable basis in law and is not "plainly erroneous." Further, it is not required that a program be “necessary” to the continued existence of an agency in order for the program to be authorized under the incidental powers provision of that agency’s enabling act.

59. Id. at 298.
60. Id.
61. Id. at 297.
63. 447 F. Supp. at 298.
64. Id.
65. Id.
In defining the parameters of a federal agency's interpretation of its enabling law, the court relied upon *Arnold Tours v. Camp,* the leading decision treating the scope of an agency's incidental powers clause. In *Arnold Tours,* a travel agency brought an action against the Comptroller of the Currency seeking declaratory and injunctive relief from an administrative ruling that permitted national banks to engage in the travel agency business by virtue of their incidental powers. The plaintiff argued that an agency's incidental powers only authorize activities that are necessary to allow that agency to perform its intended purpose, and that "necessary" should be interpreted as meaning indispensable. The court held that the term "necessary" does not mean that which is indispensable, but that if a "connection between an incidental activity and an express power does not exist, the activity is not authorized as an incidental power." The court struck down the Comptroller's ruling on the grounds that it could find no logical connection between an expressly authorized banking function and the operation of a full-scale travel agency business.

The court in *American Bankers* pointed out that it did not find share draft programs inconsistent with the Federal Credit Union Act or the general legislative scheme surrounding federal credit unions. Share drafts were considered merely a "variation on established methods of accessing members accounts." Relying upon a form of the reenactment doctrine, the court found that congressional silence concerning the programs could well be interpreted as "an implied ratification . . . of NCUA's approval of FCU share drafts." By contrast, however, the court recognized the fact that Congress has declined passing measures that would have expressly given federal credit unions the authority to implement third-party systems. Aware of the dichotomy presented above, the court simply declared share draft programs legal by virtue of the incidental powers provision of the Federal Credit Union Act, and deferred to Congress the policy considera-

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66. 472 F.2d 427 (1st Cir. 1972).
67. Id. at 432.
68. Id. at 438.
69. 447 F. Supp. at 299.
70. The theory of the reenactment doctrine was stated as follows by the Supreme Court: "[T]he reenactment by Congress, without change, of a statute, which had previously received long continued executive construction, is an adoption by Congress of such construction." United States v. Cerecedo Hermanos y Compania, 209 U.S. 337, 339 (1908) (citing United States v. Falk, 204 U.S. 143, 152 (1907)).
71. 447 F. Supp. at 300.
72. Id.
tions surrounding any possible proscription of the share draft programs. The American Bankers case is currently on appeal to the Court of Appeals for the District of Columbia Circuit.

B. State Action

Although American Bankers represents the first judicial treatment of the legality of share draft programs on the federal level, state courts have faced a similar problem with respect to their own credit union laws. In Florida Bankers Association v. Leon County Teachers Credit Union, a Florida district court of appeals also held share drafts legal under that state's enabling legislation. The Florida law is quite similar to the Federal Credit Union Act, and the incidental powers provisions contained within them are almost identical.

The court struck down an order of the Florida Department of Banking and Finance that had found as a matter of law that state credit unions were prohibited from making share account withdrawals by means of third-party payment drafts. As in American Bankers, the Florida court recognized that the share draft program presented complex policy questions of great importance to credit unions and commercial banks. It likewise refused to become involved as a judicial entity in such policy choices, but instead held share draft programs legal as an appropriate exercise of the credit union's incidental powers. In language echoing a thought set forth in American Bankers, decided just two and one-half months earlier, the court stated that "'[i]n legal effect a share draft is nothing more than another method of withdrawal of savings from a credit union by a member, albeit a sophisticated method and one which, by its very sophistication, is new to the credit union industry.'"

Credit union share draft programs have not always been found legal by state courts. The Iowa Supreme Court on June 28, 1978 held them to be in violation of state law. In Iowa Credit Union League v. Iowa Department of Banking, the league

73. The court stated, "If Congress eventually acts with regard to share drafts, Congress then will be making policy judgment. This Court cannot and will not indulge in such policy judgments. If accessing FCU members' accounts by means of share drafts is to be proscribed, it must be proscribed by the legislature." Id. (footnote omitted).
75. 359 So. 2d 886 (Fla. Dist. Ct. App. 1978).
77. 359 So. 2d at 891.
78. Id. at 889 (quoting an order of the Florida Department of Banking and Finance).
79. 268 N.W. 2d 165 (Iowa 1978).
sought judicial review of a decision of the Iowa Superintendent to Banking that credit unions not be allowed to operate share draft programs. The claim made by the league was similar to the claims made by the credit union interests in the American Bankers and Florida Bankers cases—that although the Iowa credit union enabling legislation did not expressly allow for share draft programs they should be found legal under the incidental powers provision of Iowa’s credit union law. The Iowa court did not accept the argument. Instead, it looked past the notice-of-withdrawal requirement and declared that “[s]hare drafts like ordinary checks are demand instruments.” The court argued that share drafts are not just another form of account access permitted as an incidental power, but are an entirely new business for credit unions—one that makes share accounts much more volatile than the founders of the cooperative credit union movement intended. Furthermore, the new system brings third persons directly into the share withdrawal process, a process that has previously involved just the member and the credit union.

The court finally observed that since share drafts are designed to circulate among the general population, a public interest in the solvency of credit unions is created. If the legislature had intended for credit unions to offer “de facto” checking services to their members, it might have protected the public’s interest by implementing safeguards such as reserve requirements on credit union deposits.

Although the Iowa court was technically incorrect when it characterized a share draft as a demand deposit, the court apparently recognized that a credit union would rarely exercise its notice-of-withdrawal requirement. To do so would decrease public confidence in the share draft system and consequently injure the credit unions offering the service.

The arguments made by the Iowa Supreme Court are very compelling. Unlike the American Bankers and Florida Bankers courts, the Iowa court stripped away from the share draft any artificial distinctions couched in incidental power jargon and exposed the program as a credit union industry attempt to offer its members interest-bearing checking accounts. Regardless of whether the court’s characterization of share draft accounts accurately reflects credit union intent, the court raises issues the

80. Id. at 172.
81. See id. at 166.
82. Id. at 172.
83. Id.
other courts did not reach and thus provides a glimpse at possible antitrust-share-draft judicial analysis.

C. NOW Accounts

The controversy surrounding credit union share drafts is not the first time in recent history that the judiciary has scrutinized third-party payment devices. In the early 1970's some mutual savings banks in the New England area introduced the negotiable order-of-withdrawal (NOW) account. NOW accounts are identical in form to credit union share draft accounts and are therefore the functional equivalent of an interest-bearing checking account. They operate by means of a pay-through draft and are distinguished from demand deposits by a notice-of-withdrawal requirement. Although Congress has not legislated with regard to share draft accounts, it has taken affirmative action in dealing with NOW accounts. At the time NOW accounts were being implemented in state-chartered Massachusetts banks, the financial institutions subject to federal regulatory control were prohibited by the Federal Reserve Board and the Federal Home Loan Bank Board from offering negotiable third-party payment privileges on interest-bearing accounts.

In 1972 the Supreme Judicial Court of Massachusetts in Consumer Savings Bank v. Commissioner of Banks declared that the state banking commission was incorrect when it ruled that a state-chartered savings bank could not legally implement a NOW account program. Using the same reasoning utilized six years later in American Bankers and Florida Bankers, the court held that the NOW account is simply another legitimate method of allowing bank customers access to savings accounts. The court adopted the rationale of a 1968 Maryland state court opinion: "If a depositor of the Bank, on making a withdrawal, has the

84. Since institutions offering demand (checking) account services are prohibited from paying interest on such accounts, 12 U.S.C. § 371a (1976) (demand account interest prohibition on members of the Federal Reserve System); 12 C.F.R. § 561.11a (1978) (demand account interest prohibition on members of the Federal Home Loan Bank Board), it can be fairly concluded that all accounts that accrue interest are not demand accounts and are therefore subject to a notice-of-withdrawal requirement.
87. Savings banks are mutually owned institutions located primarily in the Northeast. They are similar to credit unions in that they are nonprofit organizations owned by depositors. Savings banks, however, differ from credit unions because they are governed by a self-perpetuating board of trustees and the depositor-owners have no voting rights. Mutual savings banks are not chartered on the federal level. See generally G. MUNN, ENCYCLOPEDIA OF BANKING AND FINANCE 821 (7th ed. 1973).
option of requesting cash, or a treasurer’s check, or of purchasing a money order. . . according him a fourth option of drawing a check on his own account . . . is a distinction without a difference.\textsuperscript{88}

The \textit{Consumers Savings Bank} decision spurred two completely divergent pieces of legislation in Congress. The first proposal would have prohibited NOW accounts nationwide, while the second would have authorized them on the same scale.\textsuperscript{89} In the spirit of compromise, the Legislature authorized NOW accounts on an experimental basis in Massachusetts and New Hampshire.\textsuperscript{90} This law was later amended to expand the NOW program to four other New England states.\textsuperscript{91} Congress rather carefully observed the impact of the NOW account in its experimental setting in its early years,\textsuperscript{92} but has taken no action to broaden or restrict the NOW experimental area of six states.

Due to the similarity between NOW accounts and credit union share draft programs, the NOW account controversy, which preceded share draft litigation by several years, could have established some rules by which the legality of share drafts could be evaluated. Unfortunately, the NOW legislation has created ambiguity rather than clarity.

The law establishing the NOW program conspicuously fails to include credit unions in its definition of “depository institutions.”\textsuperscript{93} Parties for both sides in the \textit{American Bankers} case viewed this fact as supporting their respective arguments. The American Bankers Association adopted the position that this deletion is indicative of congressional intent to forbid federal credit unions from using third-party payment devices.\textsuperscript{94} On the other hand the Administrator of the NCUA argued that the deletion is an implied congressional approval of the program.\textsuperscript{95}


\textsuperscript{92} See generally \textit{Assessment of the Impact of NOW Accounts in Massachusetts and New Hampshire: Hearing on the NOW Account Experiment in Massachusetts and New Hampshire Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. (1975)).

\textsuperscript{93} See 12 U.S.C. § 1832(b) (1976).


\textsuperscript{95} Brief for Appellee at 44, American Bankers Ass’n v. Connell, 447 F. Supp. 296
The legal issues surrounding federal share draft programs remain unsettled. The only federal court to directly address the subject found share drafts legal, but that decision may be reversed on appeal. The two state supreme courts that have ruled on state programs closely resembling the federal government's have reached opposite conclusions. But, although it could be an overstatement to maintain that federal credit union share drafts are legal, it would be fair to say the pendulum is swinging in that direction.

V. POLICY CHOICES—THE NEED FOR CONGRESSIONAL ACTION

Rather than allow continued judicial development of the law in this field on a piecemeal basis, Congress should end the existing share draft controversy by taking affirmative measures. Indeed, most court opinions dealing with share draft legality recognize the need for affirmative policymaking action by legislatures in order to eliminate the disparity of treatment experienced by different financial institutions providing the same service. In 1971 the President's Commission on Financial Structure and Regulation (the Hunt Commission), after having completed an extensive study of the existing status of American financial institutions, stated, "The Commission regards parity of treatment with respect to taxation, reserve requirements and regulation among institutions offering third party payment and other banking services to the general public as essential."96

The basic inconsistencies between the enabling legislation of the various types of financial institutions could best be resolved by beginning anew with a clean statutory slate and creating institutions designed to serve the financial needs of modern businesses and consumers. However, since these radical changes could create severe problems during the interim between dissolution of old systems and implementation of new ones, a surgical approach to the ills of the financial world may best solve these problems.

Because the separate states provide fifty laboratories in which financial innovations can be tested, it would be a mistake to eliminate the experimentation conducted under the present

dual chartering system. The proposals that follow are therefore intentionally limited to the federal credit union share draft system.

A. Equal Treatment for Similar Services

Although some important distinctions among types of financial institutions should be preserved, Congress should provide that offering the same service will result, for purposes of that service, in similar legislative treatment.

1. Interest Payments

Commercial banks that are members of the Federal Reserve System are forbidden from paying interest either directly or indirectly on demand deposit accounts. This law was enacted in 1933 during a severe banking crisis in an attempt to stop the large number of small bank failures that was attributed to an inability to compete with larger institutions for the demand deposit dollar. The 1933 statute sought to remedy this problem by legislatively removing what was considered to be competition detrimental to the American economy. Although it is now generally believed the notion that gave rise to the interest prohibition on demand accounts was incorrect, the law has never been repealed. Of course the banking industry has not urged modification of this provision since a requirement that interest be paid on demand deposits would destroy a source of relatively free money to banking institutions. The commercial banks' concern over credit union share draft accounts is undoubtedly linked to their desire to maintain a lucrative monopoly over widely used third-party payment systems. This desire is manifested by the fact that the banks, instead of lobbying for removal of the demand deposit interest prohibition, challenged the legality of share draft and NOW programs.

Following the banking industry's defeat in American Bankers, the Federal Reserve Board removed the competitive disadvantage suffered by its member banks. On May 1, 1978, the Board approved an amendment to Regulation Q allowing commercial bank customers to authorize the automatic transfer of

99. 12 C.F.R. § 217 (1978). Regulation Q limits the rates of interest that may be paid by member banks of the Federal Reserve System.
funds from their savings to their checking accounts. The plan became effective on November 1, 1978. In view of the strong arguments made against the legality of credit union share drafts by commercial banks, this action seems somewhat ironic. The program allows a consenting bank customer to keep his demand account balance constant, zero if he so desires, write checks against it, and have the bank automatically transfer the amount of the check to his non-interest-bearing demand account for final payment of the check. While the regulation authorizing the implementation of this new program was being formulated, it was brought to the Board's attention that the proposed program had two important weaknesses. First, the new program would allow indirect payment of interest on demand deposits. The federal law prohibiting commercial banks from paying interest on demand accounts states in part, "No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand . . . ." It can be persuasively argued that the term "by any device whatsoever" easily includes and thus prohibits the program offered by the Board. It would, in fact, be difficult to conceive of a program that is a clearer violation of the indirect payment rule. As early as 1971, the Hunt Commission recommended that the interest restriction on commercial bank demand deposits not be lifted, and observed, "Some banks have experimented with devices to transfer funds from savings accounts to checking accounts as required when checks written by depositors are presented for payment. These devices generally have been ruled evasions of the prohibition of interest payments on demand deposits." The Board obliquely countered this general argument when it stated that

the distinction drawn in the Board's regulations between savings and demand deposits is that a bank must reserve the right to require at least 30 days notice prior to withdrawal from a savings deposit, while demand deposits are available on demand. The amendment does not alter this basic distinction, and member banks will continue to be required to reserve the right to impose at least a 30-day notice period on intended withdrawals of savings deposits . . . .

100. 43 Fed. Reg. 20,002-03 (1978) (to be codified in 12 C.F.R. § 217.5(c)(2) to (3)).
CREDIT UNION SHARE DRAFTS

The Board here begs the real question of whether the new program violates the indirect payment rule. Perhaps the Board should be commended for attempting to bypass an anachronistic rule and thereby promote competition for deposits by allowing members of the Federal Reserve System to pay interest on demand deposit accounts. In any event, the Board's argument closely resembles the one that the American Bankers Association opposed when the Administrator of the NCUA distinguished share drafts from checks by use of the notice-of-withdrawal requirement.105

The second possible weakness of the Board's new regulation is that the program allows commercial banks, by a two-step process, to offer NOW accounts. For all practical purposes, a customer is allowed the privilege of writing checks against an interest-bearing account. This is precisely the type of transaction that Congress in 1975 attempted to limit to six New England states through its NOW account legislation. The Board dismissed this argument by pointing out that the distinction between savings and demand accounts is preserved by its new amendment, and that it does not directly allow third-party interest-bearing accounts.106

The two issues set forth above were litigated in the Federal District Court for the District of Columbia in United States League of Savings Associations v. Board of Governors of the Federal Reserve System.107 The court ruled in favor of the Board of Governors on October 31, 1978, and the plaintiff filed a notice of appeal to the Court of Appeals for the District of Columbia Circuit on November 6, 1978.108 The appellate court has not yet made a final ruling. Since Congress has expressly forbidden the payment of interest on demand accounts, the court of appeals should give deference to that manifested intent and reverse the lower court's ruling. Form would be placed above substance by accepting the argument that the Board of Governor's regulation maintains a distinction between checking and savings accounts and only allows interest payments to be made on savings deposits. By holding the transfer program illegal as a method of indirectly paying interest on demand accounts, the court would place the burden of removing the obsolete "no interest on demand depos-

its'" rule where it belongs—upon Congress.

The problems posed by interest payment on third-party payment device accounts, whether the interest is paid directly or indirectly, are legion. The solution to these problems will involve policy choices that should be made by Congress. The demand deposit interest restriction should be legislatively removed so that banks can fairly compete for third-party payment funds without having to resort to backdoor tactics that violate the spirit if not the letter of federal law. Should Congress feel that the maintenance of an interest rate ceiling on third-party payment accounts is necessary, it should mandate that Regulation Q be amended to provide for such a restriction, and broadened so that all institutions offering such accounts are subject to the requirement.

2. Reserve Requirements

The deposit reserve requirement imposed upon commercial banks serves two functions. First, it protects the public, among whom checks are circulated, against the temporary or permanent inability of banks to pay outstanding demands on checking account funds. In short, reserve accounts ensure bank liquidity. Second, because demand deposits are considered a part of the money supply, commercial banks have the unique ability in the financial world to "create" money by loaning out demand account deposits. By raising or lowering member bank reserve requirements, the Federal Reserve Board can expand or constrict the nation's money supply and thus partially control monetary policy. Conceivably, if a large enough quantity of funds shifted from demand accounts to interest-bearing third-party payment accounts, the Federal Reserve Board's control could be lost or impaired.

If the two purposes of deposit reserves are to be accomplished, credit unions that choose to operate share draft programs should be subject to them. Since a share draft is the functional

109. The United States money supply is defined as "currency (including coin) and demand deposits." M. BURNSTEIN, MONEY 1 (1963). That being true, the phenomenon of the commercial banking industry's ability to expand the money supply can best be illustrated as follows: Suppose A has saved $1,000 and deposits it in his checking account at bank Z which is subject to a 20% reserve requirement. Bank Z satisfies its reserves with $200 and lends $800 to B. B pays C, his creditor, with the borrowed funds and C deposits that amount in his checking account at bank Y which is also subject to 20% reserve requirement. Bank Y satisfies its reserves with $160 and loans $640 to D who deposits his borrowed money in his checking account at bank Y. Assuming this simple fact situation, the country's money supply would include A's $1,000 demand account as well as B's $800 and D's $640 demand deposits. Therefore, the money supply would have expanded from $1,000 to $2,440 as a result of bank lending activities.
CREDIT UNION SHARE DRAFTS

equivalent of a commercial bank check, the public should be afforded the protection of deposit reserves. This being the case, each separate financial regulatory agency should not be allowed autonomous control over the reserve requirement ratio of the financial institutions it oversees. Permitting each agency complete independence in this area could cause the actions of one agency to frustrate the monetary policies of the other. Congressional action in this area is therefore necessary to provide the Board of Governors of the Federal Reserve System with the power in to implement an across-the-board deposit reserve requirement. A uniform reserve requirement would preserve the Federal Reserve Board’s control over monetary policy and ensure against institutional insolvency among all three types of federally chartered financial organizations.

B. Tax Exemption

Credit unions are exempt from state or federal income tax, while savings and loans and commercial banks, though not taxed as heavily as most corporations, are required to pay income tax on their corporate profits. Tax statutes justify the exemption on the basis that credit unions do not maintain capital stock. This favorable treatment is also due to the fact that credit unions are democratically controlled, subject to a common bond requirement, and created to fill the credit needs of a group of people with modest means.

For the first few years following the enactment of the Federal Credit Union Act, credit unions commanded a minuscule portion of the financial market. Commercial banks were in fact pleased to defer to credit unions the small consumer loans in favor of more lucrative short term business loans that credit unions, due to their common bond requirement, are unable to attract except on a very small scale. However, during the past few years credit

111. The tax treatment of financial institutions is very complex and beyond the scope of this Comment. The taxation provisions are scattered throughout title 12 of the United States Code.
113. By 1940 commercial banks reported total assets of over $64 billion. [1941] U.S. DEP’T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 282-83. That same year credit unions reported total assets of approximately $252 million. U.S. DEP’T OF LABOR, OPERATIONS OF CREDIT UNIONS IN 1940, at 4 (1941).
114. In order for a business entity to become a credit union member, all of its partners or shareholders must satisfy the common bond requirement. For that reason only very small corporations and partnerships are allowed credit union privileges.
unions have expanded more rapidly than any other form of financial institution, at the rate of fifteen to twenty percent per year.\footnote{115} Some bankers now believe that credit unions pose a threat of becoming their principal competition in the future.\footnote{116} In June of 1977, William Ford, the chief economist for Wells Fargo Bank of San Francisco, stated that “[a]s credit unions offer a barrage of full financial services, the competition grows wary of the once ‘harmless’ thrift movement.”\footnote{117} Because credit unions are increasing in size and services, their favored tax status is more difficult to defend against those who claim that credit unions are gradually assuming traditional banking services.

The distinction between credit union functions and banking activities is becoming unclear, largely due to the exercise by each type of institution of its incidental powers. Since Congress and the various state legislatures granted credit unions a tax-exempt status, those legislatures should therefore now make the final determination of what a banking function is and how closely a credit union can look and operate like a commercial bank without being taxed as one. Once such a policy line is drawn, the share draft program may fall on the banking side. If this occurs, credit unions who choose to compete directly with taxed financial institutions by offering share draft services should expect to pay their portion of the income tax burden.

Should Congress recognize the need for such a policy, at least two options would be available. First, if a credit union should choose to provide banking or savings and loan association services to its members, it could be required to qualify for an appropriate state or federal charter. This would mean that such an institution would lose its credit union identity and thus its privileged tax status.\footnote{118} This policy would help eliminate the artificial distinc-

\footnote{115. U.S. DEP’T OF THE TREASURY, CONSUMER QUESTIONS ON BANKING, SAVING AND LOAN ASSOCIATIONS AND OTHER INSTITUTIONS 24 (1973). At the close of 1977 federally insured state credit unions reported a 20.2% growth in assets over the previous year. For that same time period federally insured federal credit unions reported an asset growth of 21.7%. [1977] NCUA ANN. REP. 5, 18.}

\footnote{116. Interview with J. Michael Holt, Senior Vice President and Corporate Secretary of Walker Bank and Trust Co., Salt Lake City, Utah (Sept. 10, 1978).}

\footnote{117. Address by William Ford, Chief Economist of Wells Fargo Bank, San Francisco, 16th Annual Credit Union Executives Society Conference (June 1977), reprinted in CREDIT UNION MAGAZINE, Aug. 1977, at 8.}

\footnote{118. In 1973, before the present share draft controversy arose, President Nixon made a similar proposal when he authorized the Treasury Department to submit to Congress that there are credit unions that would prefer to offer the services of “mutual saving institutions,” such an extension of powers would leave them indistinguishable from taxable institutions and their tax-free status could not be justified.}
tions between aggressive credit unions and other financial organizations and relieve those credit unions that desire to remain credit unions from the threat of an industry-wide revocation of their tax-exempt status. Thus, clear guidelines as to permissible innovations should be promoted.

Second, should Congress conclude that a complete deprivation of a credit union's tax-exempt status for offering share draft services is not warranted, it could instead impose an income tax upon the profits derived from share draft service. This may be the best and most logical approach in view of the fact that credit unions offering share draft services would presumably still preserve the reasons for their initial blanket tax-exempt status—the lack of capital stock, democratic control, the common bond requirement, and the provision of financial services to those of modest means.

VI. CONCLUSION

The credit union has proven to be a viable institution that is highly innovative and responsive to the needs of its members. The introduction of the share draft program has stirred the attention of commercial bankers who have reminded the credit union industry that its actions are felt on a competitive basis throughout the financial community.

Recent decisions demonstrate that the legality of credit union share draft programs is being favored, thus indicating a trend toward homogenization of American financial institutions. This homogenization has ripened some policy issues, has called into question traditional banking practices, and has caused the banking industry to undergo serious introspection regarding its established practices. As Congress is pressed to make policy decisions that will affect the financial community and ultimately the American consumer of financial services, it must determine whether some of the distinctions between commercial banks and credit unions remain valid or whether they should be legislatively

Credit unions that want to expand their services and assume the burdens of full service mutual thrift institutions will be permitted to do so. Procedures to facilitate an exchange of charters will be available.


119. This would create a significant administrative and accounting burden upon credit unions desiring to operate share draft programs. It would involve a total segregation of share draft funds from the time of deposit until paid out or collected with interest by member-borrowers. The inconvenience of this procedure, however, may be somewhat mitigated for the credit union if the alternative is a complete loss of its tax-exempt status.
removed. Congress should remedy the inequities resulting from the introduction of the share draft system and should not by default shift its policymaking responsibility to the courts.

_Kent H. Collins_