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The Legality of Credit Union Share Draft Accounts Under Federal Law

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COMMENTS

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I. INTRODUCTION

Credit unions are cooperative thrift and lending institutions owned and operated on a volunteer basis by individuals united by an occupational, residential, or associational bond. First established in the United States in 1909,2 these financial institutions were developed as self-help associations whose members, by pooling their small savings together, could create a source of credit from which they could borrow money.3 Today, credit unions can be formed under either a federal or state charter.4 On the federal level, these associations are chartered under the Federal Credit Union Act of 1934 (Act).5

Under that Act, federal credit unions are empowered to receive the savings of their members for deposit into share accounts.6 Traditionally, these savings

1. D. Harless, Nonbank Financial Institutions 69 (1975); see D. Melvin, R. Davis & G. Fischer, Credit Unions and the Credit Union Industry: A Study of the Powers, Organization, Regulation and Competition 7, 37 (1977) [hereinafter cited as Credit Union Study]. All members of a credit union must be held together by a "common bond" of occupation, residence, or association (e.g., a church or labor union). Of the three, the occupational form of membership unity is the most prevalent. Id. at 110; Flannery, Credit Unions as Consumer Lenders in the United States, New Eng. Econ. Rev., July/Aug. 1974, at 4-5.

2. Recommended Order at 2, Leon County Teachers Credit Union Case, No. 76-2091 (Fla. Div. of Admin. Hearings June 6, 1977); 105 Cong. Rec. 11968 (1959); Note, Credit Unions—Regulatory Control Development—Problems—Recommendations, 18 Vand. L. Rev. 205, 207-08 (1964); see D. Harless, Nonbank Financial Institutions 70 (1975). Of all the nonbank financial institutions, credit unions achieved the highest average annual growth rate in assets—16.1% per year—between 1945 and 1973. Id. at 8. Despite this rapid growth rate, credit unions only control approximately 4% of the total dollar volume of savings in depository financial institutions. Credit Union Study, supra note 1, at 179. They do, however, hold more than 17% of total consumer installment credit. Id. at 168.

3. D. Harless, Nonbank Financial Institutions 69 (1975). Under both chartering systems, credit unions have experienced tremendous growth. In 1940, state credit unions numbered 5,267, with a total membership of 1.7 million. By 1976, these institutions numbered 9,783, with 15 million members. During that same time period, the number of federal credit unions grew from 3,756 to 12,835, accompanied by an increase in total membership from 1.1 million to 18.6 million. Credit Union Study, supra note 1, at 114.


5. The Act provides that a credit union can "receive from its members . . . payments on shares which may be issued at varying dividend rates . . . subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Administrator." Federal Credit Union Act Amendments of 1977, Pub. L. No. 95-22, § 303(a), 91 Stat. 51 (amending 12 U.S.C. § 1757(c) (1976)). Share accounts are the most prevalent form of credit union account. While these accounts legally represent the holder's purchase of shares in the
have been withdrawable by the member in person or by mail. On December 8, 1977, however, the National Credit Union Administration (NCUA), the regulatory agency for all federally chartered credit unions, promulgated a final rule regulating the offering of a new type of account by credit unions—the share draft account. This account is a regular interest-bearing share account from which withdrawals are accomplished by means of negotiable or nonnegotiable drafts drawn on the credit union payable to the account holder or third persons. The draft is presented to the credit union for payment by a “payable through bank,” and is subject to the credit union’s right to a notice of withdrawal of sixty days or less.

As a result of their close resemblance to interest-bearing checking accounts, which are prohibited by federal law, share draft accounts have been the source of much controversy since their introduction in 1974. In that year, the NCUA published a rule designed to facilitate the establishment by federal credit unions of experimental programs like share drafts. Pursuant to this
rule, the first three credit union share draft programs were approved by the Agency on October 1, 1974.16 Within two years the NCUA had similarly approved experimental share draft programs for nearly four hundred additional federal credit unions.17 Prompted by this proliferation of pilot programs, the American Bankers Association filed suit on September 7, 1976, in the United States District Court for the District of Columbia18 against the NCUA, challenging the power of federal credit unions to establish share draft accounts under the Federal Credit Union Act.19 The question raised by that case was left unresolved, however, when the action was later dismissed without prejudice to the plaintiffs after the NCUA agreed to issue a final share draft regulation.20 As soon as the final rule was promulgated by the NCUA,21 the American Bankers Association reinstated the suit against the Agency and its Administrator, Lawrence B. Connell, Jr., on similar grounds: that is, that federal credit unions lack the statutory power to establish share draft accounts.22 Of course, the NCUA believes that the credit unions possess this power. Consistent with this belief, the Agency has been careful to emphasize that its final rule was issued solely for the purpose of regulating share draft accounts23 and not to empower credit unions to issue them.24 The NCUA position was accepted by the District Court for the District of Columbia in American Bankers Association v. Connell.25

16. 42 Fed. Reg. 11247, 11247 (1977). The share draft concept was jointly developed by the Credit Union National Association (CUNA) and its wholly owned subsidiary ICU Services Corporation. Credit Union Study, supra note 1, at 33. CUNA is a trade association composed of 51 state credit union leagues (including the District of Columbia). Membership in the leagues consists of the vast majority of federal and state credit unions within each state. Id. at 82. ICU Services Corporation is an income-producing corporation established by CUNA to provide services to credit unions, such as a national interlending service among credit unions and a government securities program whereby credit unions can invest in certain government obligations. Id. at 95-96.

17. As of September 30, 1976, 391 credit unions had received NCUA approval to operate share draft programs on an experimental basis. 42 Fed. Reg. 61977, 61977 (1977). Of that number, only 231 federal credit unions had commenced operation of the programs. Id.


19. Id. at 4. Another issue raised by the plaintiff concerned the propriety of the Administrator's action in establishing the pilot program for share drafts. Id. at 5.


21. See note 9 supra and accompanying text.


24. After a thorough review of comments received during the rulemaking period, the NCUA concluded in its final regulation that "share drafts were legal for Federal credit unions." Id. at 61977-78. The agency's belief that credit unions were empowered to issue share drafts, notwithstanding the final regulation, is similarly evinced in hearings before the Senate Committee on Banking, Housing & Urban Affairs. See note 214 infra and accompanying text.

The purpose of this Comment, in light of the banking association's appeal of the district court's decision, is to explore both the legal and policy questions arising from the NCUA's final regulation. The first section will be devoted to a discussion of some pertinent background material necessary for a clear understanding of the share draft controversy. Among the topics covered are the origin of credit unions, the history of the Federal Credit Union Act, and the mechanics of the share draft programs as promulgated by the NCUA rule. The second section will consider whether the federal credit unions have express or implied power under the Act to commence share draft programs. Finally, the third section will discuss whether share draft programs fall within the spirit of the federal prohibition against interest-bearing demand deposits, and if they do, whether in the interest of competitive fairness among financial institutions that policy should be applied to federal credit unions also, or whether the policy's application to other financial institutions should be reexamined.

II. CREDIT UNION HISTORY AND LEGISLATION

A credit union is defined in the federal statute as "a cooperative association organized ... for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." This definition bears some relation to the historical origins of credit unions, which were first formed in the mid-nineteenth century in Germany. Prompted by religious and ethical considerations, these organizations were viewed "as a means of eliminating evil by reducing poverty and as having restorative value and character improvement possibilities because of the self-help aspects." This same ethical paternalism was instrumental in the formation of credit unions in the United States in the twentieth century. Congress saw credit unions as institutions which would enable their members "in good times to accumulate some savings for protection against bad times ... and [would educate their] members in matters having to do with the sane and conservative management of their own money." Nonetheless, in enacting the federal statute, Congress was also prompted by a far more compelling secular purpose—to provide a credit source for people of "small means," who had largely been unable to borrow from other financial institutions. As a result, these low income persons were forced to borrow from loan sharks, frequently at usurious interest rates as high as forty-two percent or more. By 1934

28. Credit Union Study, supra note 1, at 9.
30. Id. at 1; 78 Cong. Rec. 12223 (1934).
31. Credit Union Study, supra note 1, at 8; 78 Cong. Rec. 12225 (1934).
32. 78 Cong. Rec. 12223 (1934). Another reason for the formation of a federal system of credit unions was to eliminate the pernicious effect that usurious interest rates had on the purchasing
when the Federal Credit Union Act was passed, credit of over two billion dollars a year was being extended by loan sharks in the United States.\textsuperscript{33}

Credit unions, as cooperative associations, are able to fulfill their objective of creating a source of credit. All members, by pooling their small savings together, contribute to a source of funds from which loans can be made to any member.\textsuperscript{34} Not everyone, however, can join a particular credit union, since membership is limited by federal law to those "groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district."\textsuperscript{35} This "common bond" concept connotes a group of people familiar with each other by reputation who will work together for a common purpose.\textsuperscript{36} Nevertheless, membership is not limited to natural persons. The federal statute permits incorporated and unincorporated associations to become members of a credit union if they comply with the rules and regulations prescribed by the NCUA Administrator.\textsuperscript{37} Pursuant to this authority, the Administrator has limited membership to those organizations whose own members are also members of the federal credit union as individuals.\textsuperscript{38}

The first credit union law in the United States was passed in Massachusetts in 1909.\textsuperscript{39} Its enactment was due primarily to the efforts of the Boston merchant Edward A. Filene, who had become interested in the credit union movement earlier that year when the first credit union in the United States was established in New Hampshire.\textsuperscript{40} After the Massachusetts statute was enacted, Filene organized and financed a national credit union movement designed to promote the passage of enabling statutes in other states.\textsuperscript{41}

Largely as a result of this movement, thirty-nine states had enacted chartering systems for state credit unions by the time of the passage of the Federal Credit Union Act.\textsuperscript{42} This meant, however, that by 1934 there were
nine states that had not yet enacted enabling statutes for credit unions.\textsuperscript{43} Moreover, because of the strong pressure which had been applied by loan shark lobbyists, many of the statutes which had been passed in the other states contained restrictive organizational provisions.\textsuperscript{44} Thus, in 1934 Congress passed the Federal Credit Union Act for two reasons: to minimize the pernicious effects of loan sharks on consumer purchasing power\textsuperscript{45} and to provide a source of credit for people of small means by establishing chartering mechanisms in those states that were either without enabling statutes or had statutes that were too restrictive to induce much state credit union organization.\textsuperscript{46} With the Act's passage, a dual chartering system for credit unions

\begin{footnotesize}
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  \item 43. There were only forty-eight states in the United States in 1934.
  \item 44. See 78 Cong. Rec. 12226 (1934).
  \item 45. S. Rep. No. 555, 73d Cong., 2d Sess. 1 (1934); see note 32 supra.
  \item 46. See 78 Cong. Rec. 12225-26 (1934); S. Rep. No. 555, 73d Cong., 2d Sess. 1 (1934).
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\end{footnotesize}
came into existence. The federal statute borrowed heavily from the state statutes in existence before its passage. In turn, the seven states that have passed general credit union laws since 1934 have used both the state and federal acts as models. Because of this similarity, state court and administrative decisions concerning state credit union laws are instructive in the interpretation of the federal statute and will be utilized fully throughout this Comment in considering the legality of federal credit union share drafts under the Federal Credit Union Act.

In order to organize a federal credit union, seven or more natural persons must file an organization certificate with the NCUA Administrator. Upon the approval of the certificate by the Administrator, the credit union's corporate existence under federal law begins. Once incorporated, the credit union is vested with all the powers and made subject to all the limitations set forth in the federal statute. Among the enumerated powers are those normally granted to all corporations, such as the power to make contracts and to sue and be sued. In addition, some powers peculiar to financial institu-

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47. The Federal Credit Union Act is “modeled after the better laws in the States . . . .” 78 Cong. Rec. 12224 (1934). This comment echoed an earlier statement made at the time of the bill's introduction when it was said that the proposed federal chartering system followed the effective method of operation that had been established under state laws. 77 Cong. Rec. 3206 (1933).


50. See pt. III infra.

51. 12 U.S.C. §§ 1753-1754 (1976). While a corporation or unincorporated association can become a member of a credit union when the corporation's members are also members of the federal credit union in their individual capacity, a corporation cannot incorporate a federal credit union because of the natural person requirement for incorporators.

52. 12 U.S.C. § 1754 (1976). Factors which the statute requires the Administrator to take into account are “(1) whether the organization certificate conforms to the provisions of this chapter; (2) the general character and fitness of the subscribers thereto; and (3) the economic advisability of establishing the proposed Federal credit union.” Id.

53. Id.

54. See id. § 1757(1), (2).
tions are granted. These include the power to sell negotiable checks and money orders. Conspicuously missing among the express powers is a reference to the manner in which the funds may be withdrawn. The absence of such a provision is largely responsible for the legal controversy over share drafts.

In order to administer the federal statute, Congress created the National Credit Union Administration in 1970. Prior to that date, credit unions had been regulated by the Bureau of Federal Credit Unions, an administrative subagency which had been transferred from one government agency to another, including the Department of Agriculture and the Department of Health, Education, and Welfare. This frequent relocation conferred step-child status on the Bureau of Federal Credit Unions and, as a result, retarded the development of its administrative policies. Thus, a congressional objective in forming the NCUA was to create a separate credit union agency that "would be able to be more responsive to the needs of credit unions and to provide more flexible and innovative regulation."

The NCUA consists of an Administrator, who is the chief executive officer of the agency, and a National Credit Union Board. In order to ensure that the Administrator work in close cooperation with the Board, the Act requires that he must consult with the Board on all matters of policy and must include its recommendations and comments in the Annual Report he is required to submit to Congress. The Administrator is also empowered to prescribe rules and regulations for the Administration of the Act, to revoke or suspend a credit union's charter or to place it in involuntary liquidation, to delegate any function or duty vested in him under the statute, and to perform any function necessary in order to carry out his duties under the Act.

55. See id. § 1757(13).
57. The regulatory structure for federal credit unions has gone through six phases since the passage of the 1934 Act: (1) in 1934, the Farm Credit Administration was placed in control; (2) the Farm Credit Administration lost its independent status as an agency in 1939, and from then on it regulated credit unions as a unit of the Department of Agriculture; (3) pursuant to his war powers, the President in 1942 transferred the control over credit unions to the Federal Deposit Insurance Corporation; (4) the Federal Security Agency took over the reins in 1948; (5) in 1953, the Department of Health, Education, and Welfare became the responsible regulatory agency; and, finally, (6) the NCUA was created as an independent agency in 1970. Governmental Affairs Division, Credit Union National Association, Legislative History of the Federal Credit Union Act 3-4 (1975).
60. Id. at 3, U.S. Code Cong. & Ad. News at 2481.
64. See id. § 1766(a), (b)(1), (d), (f)(2).
Pursuant to his power to prescribe rules, the NCUA Administrator on December 8, 1977, promulgated a regulation that established the requirements for the maintenance of share draft programs by credit unions.\textsuperscript{65} Congress had mandated in 1969 that the NCUA be more responsive than its predecessor had been to the needs of credit union members in an evolving economy.\textsuperscript{66} Thus, the regulation was specifically intended to provide "members with a contemporary means of withdrawing funds maintained in their share accounts."\textsuperscript{67}

Share accounts, the most prevalent type of credit union account, historically have been subject to withdrawal by the member in person or by written request of the member through the mail.\textsuperscript{68} In today's electronic world, these traditional methods of withdrawal have become anachronistic and inconvenient. Share drafts, however, provide the member with a more modern alternative: the remote withdrawal of share account funds by draft.\textsuperscript{69} From the book of drafts he receives when he opens the account,\textsuperscript{70} a member can draw a draft on his credit union payable to himself or a third party.\textsuperscript{71} The payee deposits the draft into his bank account. The draft works its way through the check clearing system to the "payable through bank," which notifies the credit union of the amount drawn on it.\textsuperscript{72} The credit union then

\textsuperscript{65} 42 Fed. Reg. 11247 (1977) (to be codified in 12 C.F.R. § 701.34); see notes 9-13 supra and accompanying text.
\textsuperscript{67} 42 Fed. Reg. 11247 (1977); see id. at 61978.
\textsuperscript{68} Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 5 (Iowa Dist. Ct. May 24, 1977).
\textsuperscript{69} Congress itself, in a recent committee report accompanying a bill which proposes to give express share draft power to credit unions, has recognized that share drafts "eliminate the delay and inconvenience inherent in making withdrawals by the more traditional means" of withdrawal. S. Rep. No. 407, 95th Cong., 1st Sess. 4 (1977). For a discussion of the proposed legislation, see notes 205-07, 213-15 infra and accompanying text.
\textsuperscript{70} Depending on the board of directors' discretion, the credit union can provide the book of drafts to the member with or without charge. 42 Fed. Reg. 61977, 61980 (1977) (to be codified in 12 C.F.R. § 701.34(b)). Each blank draft in the book has a carbonless duplicate. When the member draws a draft, a duplicate is created which the member can retain for his records. Because of this, the share draft system is truncated; that is, neither the credit union nor its member receive the cancelled share draft from the "payable through bank." \textit{Id.} at 11248. Instead, the draft remains with the "payable through bank." \textit{Id.} That bank microfilms the draft. After a certain period of time the original draft is destroyed and only the microfilm copy is retained by the bank for its records. \textit{Id.} For a discussion of this truncated system, see notes 284-86 infra and accompanying text.
\textsuperscript{71} \textit{Id.} at 11247.
\textsuperscript{72} \textit{Id.} at 11247-48. The payee could also present the draft for payment directly to the drawer's credit union without going through the check clearing process. \textit{Id.} at 11248. Alternatively, he could deposit the draft into his account at the credit union of which he is a member. If the credit union is the same as the drawer's, the credit union can then credit his account and debit the drawer's account. If their credit unions are different, the payee's credit union will give a provisional credit to his account and will deposit the draft in its bank account for collection.
pays this amount to the bank, and debits the member's account.\footnote{73}

Under the Uniform Commercial Code (Code), the share draft takes the legal form of an order\footnote{74} made by the member to his credit union to pay the funds to himself or a third party. The instrument is a draft,\footnote{75} and it is payable on demand because "no time for payment is stated."\footnote{76} Although withdrawable by means of a draft payable on demand, a share draft account is not a demand deposit\footnote{77} because it is subject to the credit union's right to 60-day notice of withdrawal.\footnote{78} This is not contradictory since a draft payable on demand can be written by the drawer to collect an obligation that is not represented by a demand deposit.\footnote{79} A demand deposit refers to the depositor-bank relationship under which the bank is obligated to pay the draft when presented, without any right to receive a notice of withdrawal from the depositor.\footnote{80} The draft payable on demand, however, is associated with the Code's treatment of the depositor-payee relationship and means that the depositor has not designated any time when the payee must present the draft for payment to the bank.\footnote{81} Therefore, while a payee holding a share draft can present the draft to the drawer's credit union as soon as he receives it, he might not be paid upon presentment if the credit union exercises its right to 60-day notice of withdrawal.

\footnote{73} Id. at 11248. Upon receipt of the draft, the "payable through bank" converts the information into an electronic medium which is used to deliver the request to the credit union to pay the draft. The draft itself is not returned to the credit union or its member. \textit{See} note 70 \textit{supra}. The credit union can then make the payment by transferring funds to the bank or by maintaining a settlement account at the "payable through bank" from which the funds can be automatically withdrawn, provided that the bank has not been notified by the credit union of a stop order or a deficiency in the member's account. 42 Fed. Reg. 11247, 11248 (1977).

\footnote{74} "An 'order' is a direction to pay and must be more than an authorization or request." U.C.C. § 3-102(1)(b).

\footnote{75} A draft is an order which can be negotiable or nonnegotiable. \textit{Id.} § 3-104(2)(a), (3). Six requirements must be complied with for the draft to be negotiable: It must be (1) a writing, (2) signed by the drawer, (3) containing an unconditional order, (4) to pay a sum certain in money, (5) on demand or at a definite time, (6) to bearer or to order. \textit{Id.} § 3-104(1).

\footnote{76} \textit{Id.} § 3-108. If a date for payment were stated on the share draft, it would then be payable at a definite time since it would be payable "on or before a stated date . . . ." \textit{Id.} § 3-109(1)(a). This would be a time draft, instead of a draft payable on demand (demand draft).

\footnote{77} Federal reserve regulations define demand deposits as all deposits that are not time or savings deposits. 12 C.F.R. § 217.1(a) (1977). Thus, a demand deposit includes any deposit that does not require a notice of withdrawal or does not give the bank the right to require notice of withdrawal. \textit{See} 12 C.F.R. § 217.1(b), (c), (d), (e)(2) (1977).

\footnote{78} \textit{See} note 13 \textit{supra} and accompanying text. Indeed, a share draft account is not a demand deposit for the additional reason that credit union accounts are not deposits at all. \textit{See} notes 243-45 \textit{infra} and accompanying text.


\footnote{80} \textit{(NOW) Account}, \textit{supra} note 79, at 494 n.121.

\footnote{81} \textit{See} note 76 \textit{supra} and accompanying text.
III. LEGALITY OF CREDIT UNION SHARE DRAFTS

The central issue which must be resolved in the controversy between the American Bankers Association and the NCUA is whether credit unions have the authority under the Federal Credit Union Act to establish share accounts that are subject to withdrawal by negotiable or nonnegotiable draft. Under the Act, a federal credit union may "receive . . . payments on shares." 82 This power enables a credit union to accept funds from its members for deposit into a share account. 83 Share accounts are a hybrid of the permanent share capital of a corporation and a deposit at a commercial bank. 84 The account holder acquires ownership rights in the credit union. These include the right to vote in certain credit union affairs, such as the election of the board of directors and the credit committee, 85 and the right to earn "dividends" 86 as a return on his investment. Unlike the owners of common stock, however, each member is entitled to only one vote irrespective of the number of shares he holds. 87 This difference in voting rights results from the cooperative nature of credit unions. 88 On the other hand, the share account resembles a commercial bank deposit in that the funds are subject to withdrawal by the member. 89 But, while a share account results in a contractual relationship between the member and the credit union, 90 it is unlike a bank deposit in that it does not also create a debtor-creditor relationship. 91 Overall, a credit union account

82. Federal Credit Union Act Amendments of 1977, Pub. L. No. 95-22, § 303(a), 91 Stat. 51 (amending 12 U.S.C. § 1757(7) (1976)). Payments may also be received on share certificates. Id. These are comparable to bank certificates of deposit. Credit Union Study, supra note 1, at 26. Share certificate accounts are not at issue here, however, since share drafts can only be drawn on regular share accounts. See 42 Fed. Reg. 61977, 61980 (1977) (to be codified in 12 C.F.R. § 701.34(a)(1), (4)).

83. See Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 3 (Iowa Dist. Ct. May 24, 1977).

84. Credit Union Study, supra note 1, at 24-25.


88. Credit Union Study, supra note 1, at 7.

89. "Money paid in on shares . . . may be withdrawn as provided in these bylaws on any day when payment on shares may be made." Standard Federal Credit Union Bylaws art. III, § 5. Even if the bylaws did not explicitly permit members to withdraw funds, the power to receive payments on shares implies the power of a credit union to allow withdrawals. Leon County Teachers Credit Union Case, No. 76-2091, at 4 (Fla. Div. of Admin. Hearings Sept. 6, 1977); Michigan Bankers' Ass'n Case (Fin. Inst. Bureau, Michigan Dep't of Commerce Mar. 17, 1977); see pt. III(A) infra.

90. Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 16 (Iowa Dist. Ct. May 24, 1977); LaValley v. Pere Marquette Employes' Credit Union, 342 Mich. 639, 644, 70 N.W.2d 798, 800 (1955).

91. Credit Union Study, supra note 1, at 24. Share accounts bear a closer resemblance to a dividend-earning equity instrument than an interest-earning debt instrument. 42 Fed. Reg. 60905, 60905-06 (1977). The NCUA was careful to make this distinction in its final rule regulating
has more of the attributes of equity than debt. As a result, the general creditors of a credit union would take precedence over the account holders in the event of dissolution.

Although members may withdraw the funds deposited in their share accounts, the Act is silent on the permissible methods of doing so. Indeed, before the new share draft rule was issued, the only reference to withdrawals from a regular share account in the NCUA regulations stated that any governmental unit investing public funds in a credit union account was subject to the credit union's right to require a 60-day notice of withdrawal. The bylaws, with the exception of a similar restriction on the withdrawal rights of all members from regular share accounts, are equally silent. Thus, prior to the new share draft rule, neither the statute, regulations, nor standard bylaws explicitly empowered credit unions to establish any methods of withdrawal, let alone the use of share drafts. It is submitted, however, that credit unions have the implied power to establish methods of withdrawal and that this includes the power to permit withdrawals by means of negotiable or nonnegotiable drafts. Two theories advanced in support of this position will be discussed below.

A. Power To Permit Withdrawals by Any Reasonable Method

Since credit unions have the power to receive payments on shares and the power to allow withdrawals from those share accounts, it was held by the Iowa State District Court in *Iowa Credit Union League v. Iowa Department of Banking* that credit unions have the implied power to permit withdrawals by any reasonable method. Although this case concerned state-chartered credit unions, it arose out of facts strikingly similar to the federal share draft case. On January 22, 1976, the state superintendent of banking, after receiving two opinion letters from the attorney general of Iowa stating that share draft accounts were legal under Iowa law, authorized the credit union league to allow individual credit unions to establish such accounts. The Iowa Bankers Association then petitioned the Department of Banking for a declaratory ruling on the legality of share drafts. The Department held that it

the issuance of share certificate accounts. See *id.* The Administrator felt that if share certificates could earn dividends that were absolutely guaranteed, then the holders of the accounts would cease to be shareholders, and would instead become creditors, of the credit union. Since the guaranteeing of dividends would result in a debtor-creditor relationship between the member and the organization, the regulation specified that dividends could be paid on share certificate accounts at the rate contracted for in advance only if sufficient earnings exist. See *id.* at 60906.

92. See *id.* at 60905-06.
95. See note 13 *supra* and accompanying text.
96. See notes 82, 89 *supra* and accompanying text.
98. *Id.*, slip op. at 15.
was unlawful for Iowa credit unions to conduct share draft programs. In overruling the administrative decision, the trial court noted that Iowa state-chartered credit unions have the power to receive the savings of their members as payments on share accounts, subject to withdrawal "whenever and as frequently as the member desires" unless the credit union exercises the right to a 60-day notice. The court concluded that this power to receive withdrawable shares, in order to be effective, must give rise to the implied power to permit withdrawals by any reasonable commercial practice, regardless of whether an incidental powers clause existed in the Iowa credit union statute.

In accord with the Iowa decision is a declaratory ruling by the Oklahoma Credit Union Board in Oklahoma Bankers Association v. Oklahoma Credit Union League. In this action brought by the state's bankers association, the Board upheld its own rule 15, which permitted state-chartered credit unions to issue share drafts, on the ground that a credit union's "power to receive shares and deposits implies the power to permit withdrawals through any reasonable commercial practices, by agreement of the parties."

Since there is authority for the proposition that a credit union's express power to receive withdrawable shares gives rise to an implied power to permit withdrawals by reasonable methods, the question then becomes whether share drafts are a reasonable method. In Iowa Credit Union League, the court answered this question affirmatively for two reasons: 1) drafts can be drawn on anyone under common law in the absence of a legislative proscription, and 2) share drafts are a logical extension of the traditional means of withdrawal from share accounts.

A share draft falls within the Code's definition of a "draft" because it is an
order by a member on his credit union to pay himself or a third person.\textsuperscript{109} Under common law, any person who could make a contract\textsuperscript{110} could draw a draft on any other person.\textsuperscript{111} Of course, as a general rule, drawees do not gratuitously pay drafts drawn on them.\textsuperscript{112} At the core of almost every draft is a monetary obligation owing from the drawee to the drawer.\textsuperscript{113} In a case where goods have been sold and delivered by the drawer, the obligation owing to the drawer is the agreed upon purchase price. Similarly, in the case of a credit union share draft, the obligation owing from the credit union, as drawee, to the member, as drawer, is the repayment of funds kept on deposit in a share draft account with the credit union.\textsuperscript{114} Thus, as a matter of common law, there is little question that a share draft can be drawn by the member on his credit union for the purpose of withdrawing funds from his account. This right continues to exist under the Federal Credit Union Act in the absence of any proscription.\textsuperscript{115} Since no express provisions concerning the permissible methods of withdrawal from credit union accounts exist under the Act, NCUA regulations or bylaws,\textsuperscript{116} there would seem to be no prohibition on the power of a member to exercise his right to draw drafts on his credit union.

Credit union share drafts would also appear to be a reasonable method of withdrawal since they are a logical extension of other share account withdrawal methods. Traditionally, credit unions have utilized various two-party and three-party methods of withdrawal.\textsuperscript{117} The two-party methods, wherein the credit union member is both drawer and payee, include withdrawal in person by the member and withdrawal by phone or by mail.\textsuperscript{118} Under the three-party methods, a member can order the credit union to transfer funds from his account to another credit union member's account; he can order the

\begin{footnotes}
\item[109] See notes 74-75 supra and accompanying text.
\item[110] Testimony at Final Hearing, Vol. III, at 134-35 (Dr. E. Allan Farnsworth), Leon County Teachers Credit Union Case, No. 76-2091 (Fla. Div. of Admin. Hearings Sept. 6, 1977).
\item[111] Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 13 (Iowa Dist. Ct. May 24, 1977); Testimony at Final Hearing, Vol. III, at 128 (Dr. E. Allan Farnsworth), Leon County Teachers Credit Union Case, No. 76-2091 (Fla. Div. of Admin. Hearings Sept. 6, 1977). This principle has been carried over to the U.C.C. As an order, a draft "must identify the person to pay with reasonable certainty." U.C.C. § 3-102(1)(b). The person who must pay as drawee can be individual or an organization. Id. § 1-201(30). An organization is broadly defined to include businesses, governments, and partnerships, among others. Id. § 1-201(28).
\item[112] Testimony at Final Hearing, Vol. III, at 128-29 (Dr. E. Allan Farnsworth), Leon County Teachers Credit Union Case, No. 76-2091 (Fla. Div. of Admin. Hearings Sept. 6, 1977).
\item[113] See id. at 129.
\item[114] See Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 3 (Iowa Dist. Ct. May 24, 1977).
\item[116] See notes 94-95 supra and accompanying text.
\item[117] CE 6-3152, slip op. at 5 (Iowa Dist. Ct. May 24, 1977).
\item[118] Id.
\end{footnotes}
credit union to transfer funds from his account to an account at another
financial institution; and he can authorize his credit union in advance to pay
recurring expenses like mortgage and insurance payments out of his share
account. Both the two and three-party methods are similar to share drafts.
Each technique involves an order by the credit union member directing the
credit union to pay himself or a third person. The primary difference among
the methods would appear to be the form of the order—whether it is made
in person, by mail, by draft, or by phone. That this is an insignificant legal
distinction was observed by the Maryland Court of Appeals in Savings Bank
of Baltimore v. Bank Commissioner. In that case a savings bank petitioned
for declaratory relief against the bank commissioner of Maryland who, on the
basis of a state attorney general's opinion, had refused to allow savings banks
to receive deposits subject to withdrawal by check. The court, in overturning
the lower court's decision in favor of the commissioner, noted:

If, as would seem to be conceded, a depositor of the [Savings] Bank, on making a
withdrawal, has the option of requesting cash, or a treasurer's check, or of purchasing
a money order, it seems abundantly clear to us that according him a fourth option of
drawing a check on his own account, whether or not he presents his passbook, is a
distinction without a difference.

The right of credit unions to permit share drafts as a reasonable method of
withdrawal stands on even firmer ground when the chartering statute con-
tains an incidental powers clause under which this power can be implied. Such a provision is present in the Federal Credit Union Act, and it provides
that a federal credit union shall have power "to exercise such incidental
powers as shall be necessary or requisite to enable it to carry on effectively the
business for which it is incorporated." The limitation on a federal credit
union's incidental powers—the business for which the organization is

119. Id., slip op. at 5-6; Brief of Petitioners at 13-14, Leon County Teachers Credit Union
120. There is no distinction with regard to the payment of the order, however. When a
member verbally orders his credit union to transfer funds from his account to a third person,
payment is made when the credit union issues its own check to the third party. Similarly, a credit
union pays a share draft order only after the "payable through bank" has presented the draft to
the credit union and the credit union has drawn its own check payable to the bank. The share
draft, in itself, does not represent a payment by the credit union. See U.C.C. § 3-409(1); Brief of
Petitioners at 15-16, Leon County Teachers Credit Union Case, No. 76-2091 (Fla. Div. of Admin.
Hearings Sept. 6, 1977).
121. 248 Md. 461, 237 A.2d 45 (1968).
122. Id. at 475, 237 A.2d at 53 (emphasis added). The Senate Banking, Housing, and Urban
Affairs Committee acknowledged the similarity between share drafts and previously existing
methods of withdrawal when it said: "[T]he concept of a dividend earning transaction account is
not a recent development for Federal credit unions. The practice of members accessing their share
accounts, by means other than appearing in person, to pay bills goes back several years." S. Rep
123. Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 17 (Iowa
incorporated—may be interpreted in two ways: either that the business of a credit union includes only the express powers granted to it under the federal statute, or that its business includes any act suited to the purpose for which it is organized, to promote thrift and create a source of credit for its members. In either case, share draft programs do appear to further the business for which a credit union is incorporated. If the business of a credit union is defined as the express powers enumerated in the Federal Credit Union Act, then the implied power of permitting reasonable methods of withdrawal must be necessary to one or more of the express powers. In interpreting a similar incidental powers clause under the National Bank Act, the First Circuit Court of Appeals has held that there must be some connection between the incidental activity and the express power in order for the activity to be an incidental power. Certainly, this connection exists here since the power of a credit union to receive payments on withdrawable shares would be nugatory if, in the absence of legislative direction, the credit union could not designate reasonable methods by which the funds might be withdrawn.

The credit union's "business," however, could also mean its statutory purposes. Under the Act, a credit union is organized for two purposes: to promote thrift among its members and to create a source of credit for provident or productive purposes. While credit union share draft accounts will not cause credit union members to save more money than they do presently, their establishment would seem to further the "business" of a credit union by enlarging the institution's existing credit base. As a result, the power to permit share drafts as a reasonable method of withdrawal arises, by implication, under the incidental powers clause of the federal statute.

Share draft accounts, because of their draft withdrawal feature, will be used primarily by members as transaction accounts, that is, accounts from which depositors can meet their ordinary expenses. As transaction accounts, share drafts will compete directly with bank checking accounts. This competition, however, will not induce credit union members to save more of their income in the aggregate. While a share draft account is at a competi-

125. See id. § 1752(1).
126. A national bank shall have power "(t)o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking." Id. § 24 Seventh.
129. See S. Rep. No. 407, 95th Cong., 1st Sess. 4-5 (1977). NCUA data gathered during the experimental period confirms the view that share drafts will be used for transaction purposes. These statistics evince a marked increase in the number of withdrawals from share accounts subject to withdrawal by draft. See 42 Fed. Reg. 61977, 61982 (1977).
130. See Leon County Teachers Credit Union Case, No. 76-2091, slip op. at 5 (Fla. Div. of Admin. Hearings Sept. 6, 1977).
131. The federal statute does not indicate whether the business of a credit union is to promote thrift exclusively within the credit union or to induce saving in the aggregate by members, regardless of the institution into which it is deposited. In light of the legislative history, however, it would seem more probable that the latter was intended. Congress believed that credit unions were necessary since the then existing systems for saving money were not being utilized by
tive advantage to a checking account because of its interest-earning capability, the recognition of this advantage by credit union members will only prompt them to transfer transaction balances from their checking accounts to share draft accounts, and not to save any more of their income.

Moreover, the establishment of share draft accounts, while it will not discourage thrift, will not cause those members who have previously put their savings, as opposed to transaction, balances in share accounts or bank savings accounts to become more thrifty. Share draft accounts, as share accounts, may pay up to 7% interest per year, while thrift funds deposited at any insured savings and loan association may only earn up to 5 1/4% interest per year, and savings accounts at insured commercial banks are limited to a 5% interest yield per year. This difference, however, will not induce credit union members to save more for several reasons. First, this same interest differential is presently available between share accounts and savings accounts at other financial institutions. Thus, if the existence of the 7% return has the effect of prompting members to save more, then the extra savings caused by the rate differential would already be reflected in share account balances. Second, the 7% return is not guaranteed. While savings deposits contractually obligate a commercial bank to pay the agreed upon rate of return to its account holders, the rate of interest to be paid on a credit union account is within the board of directors' discretion. This discretion is limited, however, by the requirement that any interest declared must be payable from credit union earnings after the provision for reserves has been

"people of small means." See S. Rep. No. 555, 73d Cong., 2d Sess. 1-2 (1934). Thus, the congressional intention would seem to be to induce credit union members to save money by means of credit unions, and not necessarily the promotion of thrift exclusively within credit unions.

132. See notes 252-55 infra and accompanying text.


134. 12 C.F.R. § 526.3 (1977). This regulation applies to any "regular account," which means any savings account which is not a certificate account or a notice account. Id. § 526.1(d). A "regular account" would therefore include those savings accounts which, like share drafts, give the association the right to receive notice of withdrawal, but do not require such notice.

135. Id. § 329.6(c) restricts the payment of interest to 5% or less by all non-Federal Reserve member banks which opt for FDIC insurance coverage. All Federal Reserve member banks must be insured by the FDIC. 12 U.S.C. § 1814(b) (1976). As members, these banks are similarly prevented from offering interest greater than 5%. 12 C.F.R. § 217.7(c) (1977).

136. Compare Standard Federal Credit Union Bylaws art. XIV, § 2, with 12 C.F.R. §§ 217.7(c), 329.6(c), 526.3 (1977).

137. The obligation to pay a specified rate of interest on savings deposits results from the debtor-creditor relationship between the bank and its depositor. See Credit Union Study, supra note 1, at 24.

made. Thus, while a member can potentially earn 7% on his share draft account, it is also conceivable that he could receive no return if credit union earnings are insufficient to cover the required reserves. Third, the interest differential is mitigated by the fact that interest credit can only be earned on funds remaining in the share account until the end of the interest period, typically a quarter, while savings accounts at other financial institutions usually earn interest from the day of deposit to the day of withdrawal.

While a power to permit share drafts as a reasonable method of withdrawal may not facilitate the business of a credit union by promoting thrift, it will

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140. Standard Federal Credit Union Bylaws art. XIV, § 1(d).
141. In 1976, fewer than 3% of all federal credit unions established interest periods of a duration shorter than quarterly. See 1976 Annual Report of the National Credit Union Administration 14-15 (1977).
142. For example, interest is earned from day of deposit to day of withdrawal at over 65% of the commercial banks which participated in a congressional study in the New York City and Washington, D.C., metropolitan areas. See Committee on Banking, Housing and Urban Affairs, United States Senate, Consumers Guide to Banking 35-36 (1976).
143. See notes 129-42 supra and accompanying text. This is not to say, however, that share draft accounts, as transaction accounts, are not within the incidental powers of credit unions at all simply because these accounts do not promote thrift. Two state courts have held that the offering by savings banks of similar transaction accounts was not within the incidental powers of those thrift institutions in light of traditional savings bank functions. Androscoggin County Sav. Bank v. Campbell, 282 A.2d 858 (Me. 1971); New York State Bankers Ass'n v. Albright, 38 N.Y.2d 430, 343 N.E.2d 735, 381 N.Y.S.2d 17 (1975). Those decisions, however, are not applicable to the issuance of share draft accounts in that the historical functions of credit unions differ from those of savings banks.

In the two savings bank decisions, the courts concluded that transaction accounts were foreign to the traditional objectives of savings banks to promote thrift and to provide a source of long-term credit, since money deposited into transaction accounts, in that it must be available to meet the withdrawal demand of depositors, cannot be invested in long-term assets. 282 A.2d at 863 (offering of checking accounts by Maine savings banks); 38 N.Y.2d at 439, 343 N.E.2d at 740, 381 N.Y.S.2d at 22 (offering of non-interest-bearing negotiable order of withdrawal (NOW) accounts by New York savings banks). While federal credit unions, like savings banks, were organized for the purpose of promoting thrift, they were not established by Congress to be long-term investors. Under the 1934 Act, credit unions were granted the power to make loans with maturities of only two years or less. Federal Credit Union Act, ch. 750, § 7(5), 48 Stat. 1218 (1934). The intent was that credit unions should meet the “normal short-term-credit” needs of the member. S. Rep. No. 555, 73d Cong., 2d Sess. 3 (1934). Congress has gradually lengthened permissible loan maturities to include even thirty-year residential mortgages. See Federal Credit Union Act Amendments of 1977, Pub. L. No. 95-22, § 302(a), 91 Stat. 49 (amending 12 U.S.C. § 1757(5) (1976)). Congress, however, has not sought to alter the essential character of credit union lending. Thus, in the House report to the amendment permitting mortgage lending it was clearly stated that “such a removal of . . . loan limits is in no way intended to provide an incentive for credit unions to abandon their tradition of providing for the small borrowers.” H. Rep. No. 23, 95th Cong., 1st Sess. 8, reprinted in [1977] U.S. Code Cong. & Ad. News 105, 112. In order to ensure that credit unions did not begin emphasizing long-term loans at the expense of other more modest borrowings, Congress empowered the NCUA to “impose maximums on the percentage of
create a source of credit for credit union members. This statutory purpose of credit unions was foremost in the mind of Mr. Steagall, the Chairman of the House Banking and Currency Committee, who noted in the floor debate on the federal statute that "[t]his system of institutions will fill a most desirable need in the credit world of a class of people who have suffered from exorbitant and unjustifiable interest rates . . . of 42 percent plus." The people to whom he was referring were those of small means, low-income wage earners, whose inability to secure credit from other financial institutions forces them to borrow from loan sharks at usurious interest rates. Today, it is still difficult for lower-income groups to obtain credit from financial institutions other than credit unions. "The credit union may literally be the only place where a poor man can borrow." Loan companies and banks lend primarily on the basis of objective criteria applied by professional loan officers, who look to the educational background or continuous employment of a potential borrower. The low-income wage earner can seldom meet these prerequisites. But at a credit union, where a loan committee composed of peers judges the member on his ability to repay by taking both subjective and objective factors into account, the low-income wage earner has a reasonable chance of getting the loan. Still, the low-income group cannot even borrow

a credit union's portfolio that may be allocated for . . . long-term obligations." Id. at 9, U.S. Code Cong. & Ad. News at 112. In accordance with this directive, the NCUA's final rule on real estate limits "[t]he aggregate dollar amount of real estate loans outstanding to 25 per centum of the Federal credit union's assets without prior written consent of the Administration." 43 Fed. Reg. 14924, 14927 (1978) (to be codified in 12 C.F.R. § 701.21-6(b)(4)). Thus, while credit unions can now make certain long-term loans, congressional restrictions on this power are intended to ensure that credit unions maintain their traditional function of creating a short-term source of credit for their members. Short-term loans, since they do not require the same degree of account stability as do long-term investments, are not incompatible with the establishment of share draft accounts. As a result, the historical functions of credit unions, unlike savings banks, do not preclude the issuance of transaction accounts as an exercise of the institution's incidental powers.

144. While the purpose clause does not expressly say that the source of credit is to be made available only to credit union members, the loan provision in the statute indicates that this was the intention of Congress: "A Federal credit union . . . shall have power . . . to make loans . . . and extend lines of credit to its members, to other credit unions, and to credit union organizations . . . ." Federal Credit Union Act Amendments of 1977, Pub. L. No. 95-22, § 302(a), 91 Stat. 49 (amending 12 U.S.C. § 1757(5) (1976)). A loan to another credit union or to an organization of credit unions, while it does not directly benefit the lender's members in the form of a larger source of credit for them, does indirectly benefit the borrower's members by increasing the available funds from which they might receive a loan.

145. 78 Cong. Rec. 12223 (1934).
147. See notes 30-33 supra and accompanying text.
148. Low Income Credit Unions, supra note 27, at 236.
149. "The plain fact of the matter is that many banks consider the very poor to be very bad credit risks. This drives the poor into the open, avaricious arms of loan sharks . . . ." 115 Cong. Rec. 13997 (1969) (remarks of Senator Scott).
150. Low Income Credit Unions, supra note 27, at 235-36.
from a credit union unless that credit union has an adequate credit base from which to make the loans. Today, “[t]he basic [problem] of low income credit unions remains paid-in capital. Without it there can be no loans made . . . .”\textsuperscript{151} The issuance of credit union share drafts, however, will help alleviate this problem of deficient capital. These accounts, which can potentially yield interest at a higher rate than comparable savings and demand deposits at other institutions, will most likely prompt some credit union members to transfer funds from their checking and savings accounts into credit union share draft accounts. While this transfer will not be reflective of any increase in the aggregate level of members' savings,\textsuperscript{152} it will result in a greater source of funds from which the credit union can make loans to its members.\textsuperscript{153}

Undoubtedly, the creation of a source of credit remains an important congressional objective for credit unions today, forty-four years after the passage of the Federal Credit Union Act. In 1970, Congress acknowledged this need to increase the existing credit base for credit unions by providing for share account insurance for all credit unions and allowing nonmember accounts for credit unions serving predominately low-income members.\textsuperscript{154}

[\textquote*{Share insurance . . . [will] provide additional funds for credit unions serving residents in the inner city where it is difficult to attract deposits. . . . [S]hare insurance should also enable the average credit union to be more competitive in attracting savings . . . .}\textquote*{Credit unions which are serving low-income persons need assistance in attracting capital . . . [b]ecause those who are members have relatively little in savings to deposit in their credit union . . . . In order to overcome this deficiency, it is necessary for credit unions serving low-income persons to receive capital from outside sources.}\textquote*{In sum, credit unions possess the implied power under the Federal Credit Union Act to permit the use of share drafts as a reasonable method of withdrawal from share accounts. This power arises from the express power to issue withdrawable share accounts. Moreover, the implied power to use share drafts as a reasonable method of withdrawal from share accounts can be inferred from the incidental powers clause for two reasons: 1) share drafts are necessary to the exercise of the express power to receive payments on.}

\textsuperscript{151} Id. at 238.

\textsuperscript{152} See notes 131-42 supra and accompanying text.

\textsuperscript{153} There is little question that Congress intended the statutory purpose of providing a source of credit to mean a source of lendable funds \textit{within} the credit union, and not in the economy in the aggregate. This view rests on the congressional belief that credit unions were necessary since the “masses of the people” were unable to secure credit from most other financial institutions, and, as a result, these people could be better assisted by an increase in credit union, as opposed to aggregate, lendable funds. See S. Rep. No. 555, 73rd Cong., 2d Sess. 1-2 (1934).


\textsuperscript{155} See notes 1128, 91st Cong., 2d Sess. 2-3 (1970).

\textsuperscript{156} See notes 106-22 supra and accompanying text.

\textsuperscript{157} See notes 96-105 supra and accompanying text.
withdrawable shares,\textsuperscript{158} and 2) share drafts create a source of credit for credit union members.\textsuperscript{159}

B. Power To Agree on the Terms of Withdrawal

In addition to its power to receive payments on withdrawable shares,\textsuperscript{160} a credit union has the power to contract.\textsuperscript{161} Indeed, the purchase of shares by the member creates a contractual relation between the credit union and himself.\textsuperscript{162} The terms of that contract, as with any contract, are settled in accordance with the agreement of the parties.\textsuperscript{163} This freedom of contract, as a principle of common law, is altered only if a statute, like the Federal Credit Union Act, expresses a purpose to alter it.\textsuperscript{164}

One of the most important terms in a contractual relationship between a financial institution and an account holder is the method of withdrawal. This withdrawal term, like all other contractual terms, is subject to the agreement of the parties.\textsuperscript{165} Of course, Congress can expressly or impliedly limit this

\textsuperscript{158} See notes 126-27 supra and accompanying text.

\textsuperscript{159} See notes 144-55 supra and accompanying text.

\textsuperscript{160} See notes 82, 89 supra and accompanying text.


\textsuperscript{162} See note 90 supra and accompanying text.

\textsuperscript{163} See note 165 infra and accompanying text.


\textsuperscript{165} This principle was recognized in People v. Binghamton Trust Co., 139 N.Y. 185, 34 N.E. 898 (1893), where the New York Court of Appeals held that a trust company that had established interest-bearing accounts subject to withdrawal by written order or check had not violated the banking law by receiving deposits as if it were a savings bank. \textit{Id.} at 191-92, 34 N.E. at 900-01. The trust company, when it opened an account, issued a passbook containing various "rules governing deposits," including a rule that all withdrawals must be made by written order or check and that all withdrawals were subject to the trust company's right to a notice of withdrawal. \textit{Id.} at 187-88, 34 N.E. at 899. Although the trust company's powers under its charter were not precisely in issue, the court, in discussing the power of the trust company and the depositor to agree to these rules, remarked that it knew "of no principle of law which, as to ... the obligation to repay, moneys, denies the entire freedom to regulate them by such a contract as the parties are willing to enter into." \textit{Id.} at 189, 34 N.E. at 900; \textit{accord}, Hajoca Corp. v. Security Trust Co., 41 Del. 514, 521, 25 A.2d 378, 381 (Super. Ct. 1942); Magness v. Equitable Trust Co., 176 Md. 528, 6 A.2d 241 (1939); State v. Crookston Trust Co., 203 Minn. 512, 515-16, 282 N.W. 138, 140 (1938); State v. Lincoln Trust Co., 144 Mo. 562, 592, 46 S.W. 593, 600 (1898); David v. Manufacturers Hanover Trust Co., 59 Misc. 2d 248, 249, 298 N.Y.S.2d 847, 848 (Sup. Ct. 1969); 9 C.J.S. \textit{Banks and Banking} § 267, at 545-46 (1938).

The Supreme Court of Michigan has recognized that this same freedom of contract principle applies to credit union share accounts. LaValley v. Pere Marquette Employes' Credit Union, 342 Mich. 639, 70 N.W.2d 798 (1955). The terms of the share account contract at issue included a prohibition on the making of deposits or withdrawals by a member without presentation of the passbook. \textit{Id.} at 644-45, 70 N.W.2d at 800. In upholding the validity of this term, the court remarked that the credit union and its member may contract as to the withdrawable nature of the account "as they see fit." \textit{Id.} at 646, 70 N.W.2d at 801; \textit{accord}, Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 16 (Iowa Dist. Ct. May 24, 1977) (share drafts are
freedom of contract in the enabling statute. Thus Congress has expressly prohibited federal savings and loan associations from issuing savings accounts "subject to check or to withdrawal or transfer on negotiable or transferable order or authorization to the association." On the other hand, Congress has not placed any similar restriction on withdrawal from credit union share accounts. In fact, the Federal Credit Union Act neither expressly proscribes nor prescribes any methods of withdrawal.

Whether the federal statute impliedly proscribes freedom of contract with respect to share account withdrawal methods is a more complex question. A logical point of departure on this issue is the history of the Federal Credit Union Act. As the legislative history indicates, Congress believed that the most important credit union objective was the creation of a short-term credit source for people of small means who had previously been largely unable to borrow from other financial institutions. Congress felt that this problem, if left unresolved, would continue to result in usury and, as a consequence, the destruction of the "buying power of the masses." Because of the sig-

Moreover, attorney general opinions in six states have concluded that the maintenance of share draft programs by state credit unions is permissible. Letter from James A. Ostendorf, assistant attorney general of Maryland, to William L. Wilson (Oct. 31, 1977) (experimental program permissible if authorized in bylaws); Letter from Rufus L. Edmisten, attorney general of North Carolina, to William L. Cole (Oct. 28, 1975) (state credit union administrator can authorize share drafts in the bylaws); Letter from Donald A. Antrim, assistant attorney general of Ohio, to Eugene Conkle (Aug. 2, 1976) (permissible withdrawal method); Texas Atty. Gen. Opinion No. H-1084, at 21 (Nov. 3, 1977) (no specific statutory prohibition of share drafts); Letter from H. Wright Volker, assistant attorney general of Utah, to W. S. Brimhall (Sept. 10, 1975) (permissible if authorized in bylaws approved by state regulatory agency); Wash. AGLO 1977 No. 40 (Sept. 29, 1977) (program legal whereby member draws check on commercial bank that looks to member's credit union share account for payment). Opinions rendered in two states, however, have concluded that share draft programs are prohibited by explicit statutory provisions forbidding the offering of checking accounts by credit unions. Ark. Atty. Gen. Opin. No. 76-111 (Aug. 18, 1976); 37 Mont. Att'y Gen. Opin. 86 (Nov. 10, 1977). In New Mexico, the attorney general has decided that state credit unions are prohibited from offering share drafts because of the absence of any express authority in their chartering statute Letter from Robert G. Gardenhire, assistant attorney general of New Mexico, to Herbert H. Hughes (Dec. 8, 1976). The Oregon attorney general concluded that the state credit union administrator could not authorize share drafts pursuant to his power to restore competitive equality between state and federal credit unions because, at the time, federal credit unions were merely operating under an experimental share draft program. Letter from Lee Johnson, Oregon attorney general, to John D. Olin (Aug. 25, 1976). Finally, in a nonformal legal guideline, the Idaho attorney general decided that credit unions are probably not authorized to offer NOW-type accounts. Letter from Rudy Barchas, deputy attorney general of Idaho, to Tom McEldowney (Dec. 2, 1976).

167. See notes 94-95 supra and accompanying text.
168. See notes 30-31 supra and accompanying text.
nificance that Congress attached to this goal, it is suggested that any contractual term regarding a share account which undermined the achievement of this source of credit would be impliedly proscribed by the federal statute. The establishment of share draft accounts, however, is not inconsistent with the maintenance of a short-term lending function. Indeed, share drafts promote this function by creating a larger source of credit for members. As a result, to the extent that share drafts do not undermine the maintenance of a short-term lending function, these accounts would not seem to be implicitly prohibited by the Federal Credit Union Act.

Still, the American Bankers Association, the plaintiff in American Bankers Association v. Connell, relying on recent congressional statements concerning negotiable order of withdrawal (NOW) legislation in 1973, has argued that the federal statute impliedly prohibits a credit union from issuing share draft accounts. The defendant, the NCUA, relied on the same statements to show the congressional belief that no such impediment to the offering of share drafts exists under the Act. In its decision on the share draft issue, the court in American Bankers Association considered the inferences drawn by the parties from the 1973 legislative history concerning NOW accounts. In view of this and the fact that the two types of accounts are

170. See note 143 supra.
171. See notes 150-53 supra and accompanying text.
173. For a discussion of NOW accounts, see notes 178-95 infra and accompanying text.
176. Points and Authorities in Support of Defendants' Motion for Summary Judgment at 31, American Bankers Ass'n v. Connell, No. 77-2102 (D.D.C. Mar. 7, 1978). In essence, both parties attempted to determine the intention of the Congress that had enacted the federal statute in 1934 by the use of congressional actions or statements made in subsequent legislative sessions. The courts, however, have generally disfavored this practice. As the branch of government responsible for the interpretation of federal statutes, the federal courts have held, as a general rule, that in determining the intention of a prior Congress, the legislative history of a subsequent bill is of little persuasive significance. Waterman Steamship Corp. v. United States, 381 U.S. 252, 269 (1965). This is so regardless of whether the subsequent bill is enacted or not. United States v. Wise, 370 U.S. 405, 411 (1962) (unenacted bill); United States v. UMW, 330 U.S. 258, 281-82 (1947) (unenacted bill); see United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 348-49 (1963) (enacted bill). But see Haynes v. United States, 390 U.S. 85, 87 n.4 (1968) (legislative history of a proposed but unenacted amendment is not controlling, but may be pertinent in discerning intent of a prior Congress). Moreover, even in the exceptional case, in which a court may consider the history of a subsequent bill pertinent in discerning the intent of a prior Congress, the persuasiveness of the subsequent history varies inversely with the length of time between the two sessions. See United States v. Southwestern Cable Co., 392 U.S. 157, 170 (1968); Rainwater v. United States, 356 U.S. 590, 593 (1958).
177. No. 77-2102, slip op. at 6-8 (D.D.C. Mar. 7, 1978). While Judge Robinson of the district court considered these inferences in reaching his decision, he found them to be of "minimal utility" in the share draft issue since neither position of the litigants was more persuasive than the other. Id., slip op. at 6-8.
practically similar, a brief discussion of the NOW legislation advances the analysis of share draft accounts.

NOW accounts, which were pioneered in Massachusetts in the early 1970's, are essentially interest-bearing savings accounts from which the depositor can make withdrawals by means of negotiable or nonnegotiable drafts to himself or a third party, subject to the institution's right to a notice of withdrawal.\footnote{178} NOW's are conceptually close to share drafts since both accounts, although they are subject to a notice of withdrawal, are for all practical purposes interest-bearing checking accounts.\footnote{179}

Prior to the 1973 federal legislation,\footnote{180} savings accounts subject to withdrawal by draft payable to a third person were illegal under regulations of the Federal Reserve Board,\footnote{181} Federal Deposit Insurance Corporation (FDIC),\footnote{182} and Federal Home Loan Bank Board (FHLBB).\footnote{183} These regulations effectively prevented all federal commercial banks, FDIC-insured state commercial banks, federal savings and loan associations, and insured state savings and loan associations from offering NOW accounts.\footnote{184} As a result, the only major depository institutions, besides credit unions,\footnote{185} that could issue NOW accounts were savings banks\footnote{186} that were not members of the Federal Reserve

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\footnote{178}{Congress has defined NOW's as "an account where (1) payment of interest or dividends may be made; (2) the depository institution may require the account holder to give notice of intended withdrawal not less than 30 days before the withdrawal is made; and (3) the account holder is allowed to make withdrawals by negotiable or transferable instrument or other similar item for the purpose of making payments to third parties." S. Rep. No. 407, 95th Cong., 1st Sess. 18 (1977).}

\footnote{179}{See pt. IV(C) infra.}


\footnote{181}{12 C.F.R. § 217.5(c)(1) (1977). This section, which remains in effect today, does not explicitly forbid third-party payments, but does so impliedly by allowing member banks to permit withdrawals only by payment directly to the depositor except in a few cases, such as when a third person presents the passbook along with the order of withdrawal. Id. As a result of the 1973 legislation, NOW accounts are explicitly exempted from the section's coverage. Id. § 217.5(c)(3).}

\footnote{182}{With the exception of NOW accounts, withdrawal by draft is still prohibited by FDIC regulations. Id. § 329.5(c)(1), (4). The provision is substantially the same as the Federal Reserve Board regulation except that the FDIC regulations are inapplicable to "mutual savings banks or to guaranty savings banks operating in the State of New Hampshire." Id. § 329.0.}

\footnote{183}{"Savings accounts in a Federal association shall not be subject to check or to withdrawal or transfer on negotiable or transferable order or authorization to the association." Id. § 545.4-1(a)(1). Since the enactment of the 1973 legislation, a limited exception to this rule exists in favor of NOW accounts. Id. § 545.4-1(a)(3).}

\footnote{184}{See (NOW) Account, supra note 79, at 478-82 & n.66.}

\footnote{185}{Credit unions were not precluded from offering NOW accounts because there were no explicit restrictions on the methods of withdrawal from a share account in the federal statute, regulations, or bylaws. See notes 94-95 supra and accompanying text.}

\footnote{186}{All savings banks are chartered under state law. S. Rep. No. 407, 95th Cong., 1st Sess. 24 (1977). Presently, savings bank chartering systems exist in 17 states, most of which are located in the New England and Middle Atlantic states. D. Harless, Nonbank Financial Institutions 24}
Massachusetts savings banks, largely unfettered by federal regulation, led the NOW movement beginning in 1972 when a savings bank sought and received a declaration in state court that NOW's were a permissible method of withdrawal from savings accounts under Massachusetts law.

Congressional reaction to the Massachusetts decision took the form of two proposals: 1) the prohibition of NOW accounts in all fifty states, and 2) the authorization for NOW's on a nationwide basis. The statute that was eventually enacted in 1973 was a compromise in that every "depository institution" was prohibited from offering NOW's in every state except Massachusetts and New Hampshire. The purpose behind the legislation was to balance the noncompetitive situation which existed in those two New England states as a result of the ability of savings banks in Massachusetts and New Hampshire to offer NOW accounts while other depository institutions in those states were precluded from doing so by federal regulations. Curiously, however, credit unions were specifically excluded from the definition of a "depository institution."

(1975). Legislation has been proposed in Congress, however, to give savings banks in those 17 states the option of converting to a federal charter. See S. 2055, 95th Cong., 1st Sess. § 402 (1977).

187. (NOW) Account, supra note 79, at 481-82.

188. Massachusetts savings banks escaped federal regulation in 1972 unless they were Federal Reserve members. This was so, even if they were FDIC insured, because as mutual savings banks they were not subject to FDIC regulations on insured nonmembers. 12 C.F.R. § 329.0 (1977).

189. Consumers Sav. Bank v. Commissioner of Banks, 361 Mass. 717, 282 N.E.2d 416 (1972). This action was brought by Consumers Savings Bank against the state commissioner of banks seeking a declaratory judgment reversing the commissioner's ruling preventing Consumers from offering NOW accounts to its depositors. Id. at 717, 282 N.E.2d at 416. Massachusetts banking law provided that savings bank deposits could be withdrawn in such manner as the bank's bylaws permitted. Since Consumers' bylaws allowed withdrawals by "written instrument," the court concluded that Consumers was authorized to offer NOW accounts under Massachusetts banking law. Id. at 718-19, 282 N.E.2d at 417-18. As a result of this ruling, any Massachusetts savings bank which had, or adopted, similar bylaws could also issue NOW accounts. In September 1972, New Hampshire Savings Bank in Concord became the first institution in New Hampshire to offer NOW accounts. S. Rep. No. 407, 95th Cong., 1st Sess. 2 (1977). New Hampshire savings banks that were FDIC insured were explicitly exempted from that federal agency's prohibition of NOW-type accounts. See note 182 supra and accompanying text.


194. See notes 180-84 supra and accompanying text.

195. "The [conference committee] compromise also deletes credit unions from the definition of
ascertainable from the legislative history of the bill. As a result, the parties in American Bankers Association have drawn opposing inferences from this exclusion and used them to support their respective positions on whether share draft accounts are impliedly proscribed under the Federal Credit Union Act.  

The American Bankers Association took the position that Congress excluded credit unions from the definition of "depository institution" because it did not want to extend the privilege of offering NOW accounts to those organizations in Massachusetts and New Hampshire. The Association concluded, therefore, that Congress believed that without such a grant of power credit unions were powerless to offer NOW's—and as a result, the conceptually similar share drafts—under the Federal Credit Union Act. This position rested primarily on a statement made during the floor debate on the bill by Representative Wright Patman that "all depository institutions except credit unions [would] be permitted to offer NOW accounts in the two States." The NCUA, however, drew the opposite inference from the exclusion of credit unions; that is, that "Congress intended to let credit unions use their already existing power to allow [NOW and share draft] withdrawals." This position appears more plausible than the bankers' argument, in light of the historical context of the NOW legislation. Prior to that legislation, restrictive regulations precluded practically every federal and state chartered bank and savings and loan association from offering NOW accounts in the fifty states. Thus, in enacting the NOW bill, it would appear more likely that Congress was removing these restrictive regulations on the issuance of NOW accounts in Massachusetts and New Hampshire rather than empowering banks and savings and loan associations to establish NOW's in the two states. Accordingly, since no comparable rules had

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196. See notes 172-76 supra and accompanying text.
198. See note 179 supra and accompanying text.
201. See notes 180-84 supra and accompanying text.
202. This interpretation is buttressed by the fact that if the bankers' position were correct, then Congress, by granting powers to both federal and state chartered institutions, might be acting unconstitutionally. The powers of state chartered institutions, which are delineated in state chartering statutes, originate with the state legislatures. If Congress were to grant additional powers to these institutions, then an argument might be made that the federal government was infringing upon the powers reserved to the states under the tenth amendment ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const. amend. X.). This constitutional issue would be avoided if the congressional action is viewed as a removal of the regulatory restrictions, since in this case Congress would be merely restoring the right to these state institutions to
prevented federal credit unions from offering NOW’s prior to the legislation, Congress saw no reason to include them in the bill’s definition of “depository institution.”

Another “implied proscription” argument was advanced by the Independent Bankers Association of America (IBAA) in support of the plaintiffs in American Bankers Association. In its amicus curiae brief, the IBAA contended that since the Senate was presently considering legislation that would “permit . . . [credit union] account holders to maintain . . . share draft accounts,” Congress must have believed that credit unions are implicitly precluded by the federal statute from offering these accounts now. Credit Union National Association (CUNA), however, took the contrary position that, despite the explicit language of the proposed Senate bill “permitting” share drafts, the legislative history of that bill evinced the congressional opinion that the bill simply recognized the existing credit union power under the federal statute to issue these accounts. Since the court in American Bankers Association considered these inferences in its share draft decision, a brief discussion of the parties’ arguments would once again seem appropriate.

The IBAA position rested upon a literal construction of the present Senate bill “permitting” credit unions to offer share draft accounts. This position, however, appears untenable in that courts are loath to draw the inference that legislation which expressly authorizes certain powers necessarily implies the absence of those powers before the legislation. Moreover, the fact that the NCUA has supported the present Senate bill “authorizing” share drafts is irrelevant to the issue of whether credit unions are impliedly proscribed from offering those accounts. The Supreme Court has consistently refused to draw any inference from the fact that a federal agency like the NCUA petitions Congress for a clarifying amendment to a vague statutory provision.

exercise their explicit and implicit powers under the state chartering statutes. They could then offer NOW accounts so long as they were so empowered under their respective enabling statutes.

203. See note 185 supra and accompanying text.


206. See note 16 supra.


208. No. 77-2102, slip op. at 6-8 (D.D.C. Mar. 7, 1978); see note 177 supra and accompanying text.

209. See Franklin Nat’l Bank v. New York, 347 U.S. 373 (1954). In this case, the Supreme Court held that a legislative authorization for national banks to receive savings deposits, at a time when many national banks had already been offering these accounts, should be interpreted as “declaratory of the right of a national bank” not only to enter into, but also to continue, the offering of savings accounts. Id. at 377.

"Public policy requires that agencies feel free to ask [for] legislation which will terminate or avoid adverse contentions and litigations." Therefore, the fact that the NCUA has not petitioned for, but has merely supported, the present Senate bill can certainly lead to no inference that the Agency is admitting "that it is acting upon a wrong construction" of the power of credit unions to issue share drafts under the federal Act.

In opposition to the IBAA position, CUNA maintained that since the Senate bill is merely for the purpose of regulating share draft accounts, and not for the purpose of empowering credit unions to issue them, Congress has manifested its belief that these accounts are presently authorized under the federal statute. The legislative history clearly supports this view. In committee hearings on the bill, the NCUA Administrator called upon the legislators to recognize that federal credit unions already possess the power to issue share drafts under the federal statute. Therefore, the NCUA Administrator contended, the Senate bill does not provide credit unions with share draft authority, but merely regulates the issuance and maintenance of those accounts. In recognizing this distinction between regulation and authorization in its report, the Senate committee demonstrated its belief that share drafts are not impliedly proscribed under the federal Act:

Title I authorizes federally chartered or insured commercial banks, savings and loan associations, mutual savings banks and credit unions to offer negotiable order of withdrawal (NOW) accounts to individuals. In addition to authorizing credit unions to offer NOW accounts, the bill prescribes that share draft accounts conform to the rules and regulations prescribed for NOW accounts.

In conclusion, since there are no express or implied proscriptions on a credit union's power to contract with its members on the terms of their share account relationship, the parties are free to agree on share drafts as a method of withdrawal from the accounts. In addition, both the power to receive withdrawable shares and the incidental powers clause give rise to an implied power to permit share drafts as a reasonable method of withdrawal. For these reasons, it is submitted that credit union share drafts are legal under the Federal Credit Union Act. Moreover, the existence of the power to permit

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212. Id.
216. See pt. III(A) supra.
217. The question of whether federal credit unions possess the statutory power to offer share draft accounts was recently addressed by the District Court for the District of Columbia. American Bankers Ass'n v. Connell, No. 77-2102 (D.D.C. Mar. 7, 1978). This case, instituted by the plaintiffs shortly after the NCUA promulgated its final share draft rule, was brought on the ground that federal credit unions lacked the statutory authority to establish share draft accounts.
share drafts under the federal Act renders untenable the American Bankers Association's contention that the NCUA, in issuing the share draft regulation, exceeded its statutory power to "prescribe rules and regulations for the administration"\footnote{218} of the Act.\footnote{219}

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\textit{Id.}, slip op. at 1-3. Since no genuine issue of fact existed between the parties' positions, both the bankers and the NCUA filed motions for summary judgment. \textit{Id.}, slip op. at 1. In holding that the Federal Credit Union Act includes the power to issue share draft accounts, the court granted the NCUA's motion. \textit{Id.}, slip op. at 5-6, 10.

The primary issue confronted by the court was whether federal credit unions were empowered to permit their members to use share drafts as a means of accessing their share accounts. See \textit{id.}, slip op. at 3. At the outset, the court observed that "it is uncontested that [federal credit unions] possess the power to authorize and regulate withdrawals from share accounts." \textit{Id.}, slip op. at 4. The source of this power, however, is not found within an express provision of the federal statute. \textit{Id.} Instead, this power impliedly arises from the statutory provision granting credit unions authority to "exercise such incidental powers as shall be necessary or requisite to enable [credit unions] to carry on effectively the business for which [they are] incorporated." \textit{Id.} (quoting 12 U.S.C. § 1757(15) (1976)). The court went on to observe that the question of whether share drafts are a valid exercise of this implied power to establish methods of withdrawal from share accounts depends on the "relationship between share drafts and share accounts." \textit{Id.}, slip op. at 5 n.5. The district court, noting that share drafts simply constituted a variation on the traditional methods of accessing share accounts, held that credit unions were empowered to authorize share drafts as a method of withdrawal. "Share drafts are simply a variation on established methods of accessing members' accounts, similar to previous procedures for credit union third-party payments, and similarly valid as part of the exercise of [federal credit unions'] incidental powers under the [federal statute]. To rule otherwise would be to raise form over substance, to deny the history of the use of drafts in commercial practice, and to unreasonably limit the undisputed power of [federal credit unions] to honor and regulate share account withdrawals." \textit{Id.}, slip op. at 5-6 (footnote omitted).


\footnote{219} The bankers' claim that the NCUA exceeded its authority is made under the Administrative Procedure Act. 5 U.S.C. §§ 551-559, 701-706 (1976). That Act provides for the judicial review of administrative action, \textit{id.}, § 704, and mandates that if a reviewing court should find an agency's action to be in excess of authority it shall "hold unlawful and set aside [the] agency action . . . ," \textit{id.} § 706(2). There is no right of review, however, in two cases: when the statute governing the agency precludes review and when the "agency action is committed to agency discretion by law." \textit{id.} § 701(a)(2). An administrative regulation which exceeds the statutory power to prescribe rules and regulations for the administration of a federal statute "is a mere nullity." Manhattan Gen. Equip. Co. v. Commissioner, 297 U.S. 129, 134 (1936); \textit{see} Investment Co. Inst. v. Camp, 401 U.S. 617, 639 (1971). In \textit{American Bankers} the plaintiff's argument hinges on the absence of the power of federal credit unions to issue share drafts under the Act. Since credit unions possess this power under the federal statute, the promulgation of the NCUA regulation falls within the statutory authority of the Agency to administer the Federal Credit Union Act.

Moreover, the bankers have claimed that the NCUA regulation on share drafts was arbitrary and capricious. See No. 77-2102, slip op. at 3, 9-10 (D.D.C. Mar. 7, 1978). The Administrative Procedure Act requires that a court set aside an administrative action on review if it finds that action to be "arbitrary, capricious, [or] an abuse of discretion." 5 U.S.C. § 705(2)(a) (1976). Such a decision by the reviewing court necessitates a finding that the agency's action was not based on a consideration of the relevant factors and that there was a clear error in judgment. \textit{Citizens To Preserve Overton Park, Inc. v. Volpe}, 401 U.S. 402, 416 (1971); \textit{L. Jaffe, Judicial Control of Administrative Action} 182 (1965). In the case of share drafts, the NCUA regulation would not
IV. SHARE DRAFTS AND THE FEDERAL POLICY AGAINST INTEREST-BEARING DEMAND DEPOSITS

Share draft and NOW accounts, as third-party transaction accounts, are for all practical purposes interest-bearing checking accounts. Federal policy, however, is unmistakably opposed to an interest-bearing account from which checks can be drawn. This fact raises a number of issues: (1) Does the federal policy cover credit unions?; (2) Are share drafts demand deposits?; (3) Whether or not they are demand deposits, do share drafts fall within the spirit of this policy; and (4) If they do come within the policy's purpose, should the prohibition on interest-bearing demand deposits be explicitly enlarged to cover share drafts, or should the policy's application to other financial institutions be reexamined?

The federal policy against interest-bearing demand deposits has existed since 1933, when it was included as a provision in the Glass-Steagall Act. The provision reads: "No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand." This prohibition was clearly included in the 1933 Act to promote the stability of the banking industry. In the 1920's and, especially in the early 1930's, the banking industry had experienced an inordinate number of failures. At the time of the passage of the Glass-Steagall Act, the prevailing theory explaining these failures was that they had been caused by excessive interest rate competition over demand deposit funds. Such com-
petition had forced interest rates up to such a height that banks were compelled to engage in risky investments and lower their deposit reserves to precarious levels in order to earn a return on demand deposits. Accordingly, it was believed that an absolute prohibition on the payment of interest on demand deposits would further bank security. Moreover, bank instability was exacerbated by the practice of many rural banks of depositing their liquid funds in interest-bearing demand deposits at large city banks during the periods of the year when agricultural loan demand was low. The city banks often invested those funds in high-yielding risky assets, including call loans to security market investors. When the seasonal demands for agricultural credit coincided with downturns in the economy and stock markets, the large city banks were often unable to call the loans collateralized by stock in order to meet the withdrawal demands of the country banks. As a result, bank stability was further jeopardized.

Undoubtedly, the excessive interest rate competition theory must have weighed heavily in the congressional decision to prohibit interest-bearing demand deposits in 1933. Whether the validity of that theory, however, was ever established by Congress is another question. The legislative history sheds little light on an answer to this question since there were no hearings held on the prohibition and there was no debate on the committee reports recommending passage of the bill. This has prompted one commentator to observe that the legislation may have been hastily enacted by Congress, as a reaction to the prevailing bank crisis, without a careful consideration of the prohibition's merits. Thus, while the purpose behind the policy against

227. American Institute of Banking, Federal Regulation of Banking 54 (1975); Demand Deposits, supra note 225, at 4; Prochnow, Time Deposit Banking, 82 Banking L.J. 941, 944 (1965); (NOW) Account, supra note 79, at 475.

228. A Study of the Staff of the Board of Governors of the Federal Reserve System, The Impact of the Payment of Interest on Demand Deposits 9-10 (1977) [hereinafter cited as Interest Impact]. This concern had been voiced as early as 1873 when William Richardson, the Secretary of Treasury, cautioned against the deleterious effects of paying interest on demand deposits.

229. Demand Deposits, supra note 225, at 4.

230. Id.

231. Interest Impact, supra note 228, at 9.

232. A. Cox, Regulation of Interest Rates on Bank Deposits 24 (1966). The 1933 Act was not accompanied by a voluminous legislative history. Interest Impact, supra note 228, at 9. Moreover, from the brief history that does exist, it appears that the interest prohibition received very little attention since it was clearly overshadowed by the provisions establishing federal deposit insurance, see 12 U.S.C. § 1814 (1976), and separating commercial and investment banking, see id. §§ 24 Seventh, 378.

233. A. Cox, Regulation of Interest Rates on Bank Deposits 21-25 (1966). In 1932, both the House and the Senate considered bills that limited the rate of interest on both demand and
interest-bearing demand deposits is relatively clear—to promote bank security—it is possible that this prohibition may have been enacted on the basis of a theory that was unsubstantiated.\(^{234}\)

A. Credit Unions and the Federal Policy

Given the Glass-Steagall Act's policy on interest-bearing demand deposits, the first question to be resolved is whether credit unions are covered by this prohibition. It is submitted that credit unions are not subject to the prohibition because, although it has been expressly applied to other financial institutions, credit unions have never come explicitly within its purview. The first institutions to be covered by the policy were the Federal Reserve member banks in 1933.\(^{235}\) Two years later this group was enlarged when the prohibition was applied to all FDIC-insured banks.\(^{236}\) However, the Federal Credit Union Act, enacted in 1934 in the midst of the concern over the pernicious impact of interest-bearing demand deposits, did not include a provision prohibiting interest on any type of account.\(^{237}\) Indeed, the only reference in

savings deposits. The ceiling rate for both types of deposits was set at 3½% in the Senate and 4% in the House. \textit{Id.} at 21. The Senate bill was passed in January of 1933, but time limitations precluded its consideration by the House before the end of the Seventy-second Congress on March 4th of that year. \textit{Id.} During the month of March 1933, in the midst of the nation's worst banking crisis, over 4,500 bank failures were recorded. \textit{Id.} at 21 & n.67. This prompted President Roosevelt to declare the well-known "Bank Holiday" on March 6th. \textit{Id.} at 22. After the Congress reconvened, the final version of the bill that had passed the Senate in January was reintroduced with two radical changes as a response to the banking crisis: the prohibition of interest on demand deposits and the deposit insurance provision. \textit{Id.} at 22. While considerable time was spent debating the deposit insurance section, the bill passed both houses in less than a month after its introduction with nearly no deliberation on the interest prohibition provision. \textit{Id.} at 24.

\(^{234}\) See notes 271-74 infra and accompanying text.


\(^{236}\) Act of Aug. 23, 1935, ch. 614, § 101, 49 Stat. 702 (codified at 12 U.S.C. § 1828(g) (1976)). The pervasiveness of the interest prohibition is evidenced by the fact that of the 14,194 national and state commercial banks in the United States at the end of 1973, only 218 were noninsured. Similarly, only 160 of the 482 mutual savings banks were noninsured. J. White, Banking Law 715 (1976).

\(^{237}\) Similarly, the prohibition which does exist for Federal Reserve members and FDIC-insured banks should not be read into the Federal Credit Union Act. In North Arlington National Bank v. Kearney Fed. Savings & Loan Ass'n, the Third Circuit indicated that the explicit policy limiting the establishment of national bank branches under the National Banking Act should not be read into the chartering statute for federal savings and loan associations since the policy considerations underlying the limitation on bank branching were not applicable to federal savings and loan associations. 187 F.2d 564, 567 (3d Cir.), \textit{cert. denied}, 342 U.S. 816 (1951); \textit{accord}, United States v. First Fed. Sav. & Loan Ass'n, 151 F. Supp. 690, 697-98 (E.D. Wis.), \textit{modified on other grounds}, 248 F.2d 804 (7th Cir. 1957), \textit{cert. denied}, 355 U.S. 957 (1958). In the federal share draft case, Credit Union National Association has contended that the policy prohibiting
the statute to the payment of interest specifically provides that the board of
directors of a credit union may declare a “dividend” at “such intervals as the
board of directors may authorize . . . pursuant to such regulations as may be
issued by the Administrator . . . .”238 Pursuant to this power, the NCUA
Administrator has placed a seven-percent ceiling on interest payments.239

B. Share Drafts and Demand Deposits

All credit union share draft accounts, as share accounts, are subject to the
organization’s right to a 60-day notice of withdrawal240 which cannot be
waived.241 As a result, credit union share draft accounts are not demand
deposits.242 Moreover, even the repeal243 of the bylaw provision which grants
this right to a 60-day notice would not provide credit unions with the
opportunity to issue demand deposits. This is because federal credit unions
have no power to issue deposits under the Federal Credit Union Act at all.244
A deposit, such as a savings or checking account at a commercial bank,
creates a debtor-creditor relationship between the institution and the account
holder. Credit unions only have the power to issue share accounts, share draft
accounts, and share certificate accounts. These accounts, which are more
closely akin to equity than debt, result merely in a contractual relationship
between the member and the credit union.245

interest-bearing demand deposits should not restrict credit unions under the Federal Credit Union
Act since that prohibition was adopted to prevent the pernicious effects resulting more from
interest payments on commercial and interbank deposits than on individual accounts. Thus, the
reasons underlying this policy are not applicable to the share accounts held by individual credit
union members. Amicus Curiae Reply to Plaintiffs' Motion for Summary Judgment and
Memorandum of IBAA at 7-8, American Bankers Ass'n v. Connell, No. 77-2102 (D.D.C. Mar. 7,
1978).

(amending 12 U.S.C. § 1763 (1976)).
239. See note 133 supra and accompanying text.
242. See notes 77-81 supra and accompanying text.
243. Repeal of a bylaw can be accomplished by the approval of the NCUA Administrator
after a two-thirds affirmative vote of the credit union’s board of directors. See Standard Federal
Credit Union Bylaws art. XXI. It is highly doubtful, however, that the Administrator would
approve a repeal of the bylaw provision granting credit unions the right to 60-day notice of
withdrawal. The NCUA has indicated its extreme reluctance to erode the distinction between
share accounts and demand deposits. For instance, the NCUA regulation on share drafts
prohibits the “blanket guarantee” of a share draft since this “necessarily waives the right to
require notice, an important distinction between the share draft account concept and a demand
244. Federal credit unions only have power to receive payments on shares and share
51 (amending 12 U.S.C. § 1757(6) (1976)). In addition, credit unions possess the implied power to
offer share draft accounts to their members. See pt. III supra. Many state credit unions, however,
do have the power to receive deposits. See CUNA Governmental Affairs Division, Credit Union
National Association, Comparative Digest of Credit Union Acts 40 (1977 ed.).
245. See notes 84-93 supra and accompanying text.
C. Share Drafts and the Purpose Behind the Policy

While share draft accounts are not explicitly covered by the federal prohibition, they may nonetheless fall within the spirit of that policy. As has been noted, share draft and NOW accounts, while not technically demand accounts because of the right to notice of withdrawal, are for all practical purposes payable on demand.246 This is because credit unions and other financial institutions rarely invoke the right to notice of withdrawal.247 It is submitted that the reason for this reluctance is that many of these institutions fear that a weakening in their competitive positions would result if they were to require notice of withdrawal from an account since many depositors might transfer their accounts to other institutions where their funds would not be so encumbered.

Since share drafts are in effect demand accounts, it seems that they may fall within the spirit of the federal policy. The purpose behind that policy was to promote bank security by prohibiting the payment of interest on accounts subject to withdrawal on demand.248 The stability of credit unions might likewise be enhanced if they were not permitted to pay "dividends" on share draft accounts.249 The balances in those accounts, which are practically withdrawable on demand, could then be placed in more liquid and secure, albeit lower-yielding, investments and loans, which would still earn money for the credit union. This increased security for credit unions, however, would not be comparable to that effected for banks by the interest prohibition for at least three reasons. First, credit unions could always invoke the right to notice in an emergency cash shortage situation. Second, unlike commercial banks, credit unions are not obligated to pay any interest on share draft accounts.250 Any bad debts, therefore, associated with the investment in risky assets would first be reflected in the nonpayment of interest since credit unions are precluded from paying interest on any account unless their earnings exceed the required reserves. Finally, the interest prohibition's extension to credit unions would result in higher account carrying costs for credit unions since members would find it economically sound to open separate share draft accounts rather than drawing share drafts directly against their already

246. See note 220 supra and accompanying text.


248. See note 224 supra and accompanying text.

249. A similar concern over the deleterious effects of interest-bearing NOW accounts on bank security was voiced during the floor debate on the 1973 law that permitted such accounts in Massachusetts and New Hampshire. "I have come to the conclusion that I have no objection to permitting savings banks to provide checking accounts to their customers. The payment of interest on the balances of these accounts, however, trouble [sic] me. . . . [I]f more and more of the savings banks' assets are committed to the NOW accounts, I am not sure banks could continue paying as much as 4 percent or more, as some of them are doing without running into problems." 119 Cong. Rec. 15007 (1973) (remarks of Representative Cleveland).

250. See notes 138-39 supra and accompanying text.
existing share accounts. In this way, the member could still receive interest on the funds left in the share account not subject to withdrawal by share drafts.

D. Share Drafts and the Interest Prohibition

On the other hand, if it is granted that share drafts arguably fall within the spirit of the federal policy against interest-bearing demand deposits, the question then becomes whether that policy should be extended to encompass credit unions or whether the application of the interest prohibition to other financial institutions should be reconsidered. In opposing the establishment of share draft accounts by credit unions, the American Bankers Association has argued that these accounts, because of their interest-earning capability, have a competitive advantage over checking accounts in the attraction of deposit funds. This "competitive inequity" between the two institutions, however, is mitigated by certain bank practices which effectively allow them to circumvent the prohibition on interest-bearing checking accounts. Although that prohibition applies to the payment of interest both "directly or indirectly," the proscription on indirect payments has not been strictly enforced. As a result, banks have increasingly utilized indirect methods. "The prohibition on the payment of interest on demand deposits enacted in the 1930's did not actually end such payments; rather it changed their form." Instead of earning explicit interest on his account as a credit union member does, a bank depositor earns "implicit interest." For example, in the case of individual depositors, banks have provided implicit interest by not charging any service fees on checking accounts or by charging an amount beneath actual bank cost. The implicit interest rate in such a case would be the

251. The proposed share draft regulation required that a credit union member open a separate account for his share draft withdrawals. 42 Fed. Reg. 11247 (1977). During the comment period, many interested parties pointed out that allowing the member to write share drafts against his regular share account would reduce costs for the credit unions. Id. at 61990. The NCUA accordingly modified this provision in its final regulation to permit members to draw drafts against either their regular or separate share accounts, depending on the agreement reached between the members and their credit union. Id.

252. Plaintiffs' Statement of Points and Authorities in Support of a Motion for Summary Judgment at 19, American Bankers Ass'n v. Connell, No. 77-2102 (D.D.C. Mar. 7, 1978); Plaintiffs' Brief in Reply to Defendants' Motion for Summary Judgment at 8, American Bankers Ass'n v. Connell, No. 77-2102 (D.D.C. Mar. 7, 1978). This advantage is magnified by the fact that a credit union member can earn up to 7% interest on his account without maintaining a minimum balance greater than five dollars. See Standard Federal Credit Union Bylaws arts. III, § 3, XIV, § 2.


254. NOW Hearings, supra note 214, at 32 (statement of Dr. Arthur F. Burns).

255. NOW Hearings, supra note 214, at 32 (statement of Dr. Arthur F. Burns). One commentator contends that the payment of implicit interest on demand deposits has become an increasingly necessary competitive measure for banks in the last 15 years as the general level of interest rates has risen, and as investors have become more attentive to the return they earn on their assets. Demand Deposits, supra note 225, at 5.

256. NOW Hearings, supra note 214, at 32 (statement of Dr. Arthur F. Burns). Other services that banks provide at less than cost include portfolio investment analysis, tax advice, credit
difference between the actual service charge and the actual cost of the services. Similarly, banks pay interest indirectly by offering gifts to new depositors and by providing convenient banking locations and hours for customer use. To attract commercial depositors, banks also circumvent the prohibition on interest by providing services for free or at a subsidized rate. For example, a bank can provide the business with a lock-box, which is essentially a bank depository into which the accounts receivable of the business can be paid. This process expedites the receipt of cash by the business and thereby increases the time during which the business can earn an explicit return on the money. Zero balance accounts also provide businesses with implicit interest. Under this method of circumventing the interest prohibition, the depositor maintains a regular account, in which a balance must be maintained on the average, and a zero balance account. The depositor draws checks on the account with no balance, and at the end of the day the bank covers these checks by transferring funds from the regular account or from the customer's money market assets which are maintained at the bank. By not requiring funds in the account until the check clears, the bank effectively permits the business to earn explicit interest on the cash which would normally be tied up in a checking account.

Federal regulatory agencies have facilitated this trend of circumventing the policy against interest-bearing demand deposits by promoting Electronic Funds Transfer Systems (EFTS), which, in essence, provide for the transfer of funds held in bank account balances by means of electronic devices.

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257. *Interest Impact*, supra note 228, at 19. Thus, if the actual service charge worked out to be 4% on the average checking account balance, and the service charges only amounted to 2%, the implicit interest rate would be 2%. The Federal Reserve study estimates that implicit interest rates amount to approximately 4% at small- and medium-size banks, and 4.7% at large banks (total deposits over $200 million). *Id.* at 19-21. These rates are even more attractive in that they are not subject to income taxation as explicit interest rates are. *Demand Deposits*, supra note 225, at 9. Whether it is more advantageous to receive interest implicitly or explicitly depends on an individual's marginal tax rate. *Id.* at 10. For example, for an individual in a 50% marginal tax bracket, the receipt of implicit interest of 4% in a bank checking account would be preferable to the explicit return he could earn in a share draft account because, even assuming that the credit union paid the maximum 7% rate, he would only get a 3.5% after-tax return on the credit union account.

258. *Interest Impact*, supra note 228, at 19; *Demand Deposits*, supra note 225, at 5.

259. *Interest Impact*, supra note 228, at 23.

260. *Id.* & n.3. Payable-through-drafts drawn by the bank customer on himself similarly provide businesses with implicit interest. These drafts can be utilized to increase the time between the drawing of the draft and its actual payment by the bank because, unlike checks, payable-through-drafts cannot be paid by the bank until the customer approves. This delay can be further magnified by clearing the draft through a distant “payable through bank.” To the extent that the delay is increased by the use of payable-through-drafts, the bank customer can earn interest by maintaining the requisite balances for the payment of those drafts in an interest-earning asset. *Id.*

Bank customers now have the right to transfer funds from a savings account to a demand deposit by a mere telephone call, and thus maximize the explicit interest return on their combined deposits. Both savings and loan customers and bank depositors have the ability to authorize the association, by telephone or otherwise, to pay a third person from the customer's savings account on a periodic or nonrecurring basis. This payment can be made directly to the third party, or if so authorized by the third party, can be made into his account. Some savings and loan institutions have even placed remote-service units in retail establishments, so that a depositor shopping in the store can make deposits to, or withdrawals from, his savings account. Since a withdrawal can then be used to pay the merchant for goods, the savings account becomes, in effect, an interest-bearing checking account. Finally, the Federal Reserve Board and the FDIC have issued rules that will permit all insured banks to transfer funds automatically from an individual's savings account to his checking account if the depositor's check overdraws his checking account. If such a transfer is made, the regulations do not require the banks to impose a penalty in the form of an interest forfeiture. These rules appear to come the closest of any of the agency-promulgated methods to creating interest-bearing demand deposits.

The competitive situation, therefore, between banks and credit unions with regard to transaction accounts is not as inequitable as it might first appear because banks have been successful in providing indirect interest payments to their depositors, in spite of the clear statutory prohibition on the payment of interest "by any device whatsoever." Thus, the competitive edge that credit unions enjoy in issuing share draft accounts is reduced primarily to that of


See id. § 545.4-1(a)(1) (savings and loan associations); id. § 217.5(c)(1)(vii) (member banks of the Federal Reserve System); id. § 329.5(c)(1)(vi) (FDIC-insured banks).

Id. § 545.4-2(b)(1). Permission for remote-service units has been granted on an experimental basis and is due to expire on June 30, 1978. 43 Fed. Reg. 9790 (1978). In its place, the Federal Home Loan Bank Board has proposed a permanent rule governing remote-service units. Id. at 7327. The legality of the remote-service units is presently being challenged by the Independent Bankers Association of America. Independent Bankers Ass'n of America v. Federal Home Loan Bank Board, No. 76-0105 (D.D.C., filed Jan. 19, 1978); see Memorandum of Independent Bankers Ass'n of America, Amicus Curiae, in Support of Plaintiffs' Motion for Summary Judgment at 5 n.6, American Bankers Ass'n v. Connell, No. 77-2102 (D.D.C. Mar. 7, 1978).

43 Fed. Reg. 20001 (1978) (to be codified in 12 C.F.R. § 217.5(c)(2)) (Federal Reserve member banks); id. at 20222 (to be codified in 12 C.F.R. § 329.5(c)(2)) (FDIC-insured banks).

Id. at 20002, 20223.

convenience. Through the practices mentioned above, bank customers can effect earning results comparable to those achieved by credit union members. A credit union member can pay his bills to third parties by drawing a draft directly against an interest-earning share draft account. A bank customer generally cannot, since his drafts or checks are written against a non-interest-bearing checking account. But by transferring his funds from his savings account to his checking account when he is ready to pay third parties, he can bring about the same result. Of course, the bank customer is required to telephone his bank within the hours established for such calls in order to effect a fund transfer. Hence, it is a little more inconvenient for him to pay third parties than it is for the credit union member who can accomplish the same result directly from his share draft account. On the other hand, the transfer from a savings to a checking account may result in a higher interest return to the bank customer. For while savings deposits usually earn interest from the day of deposit to the day of withdrawal, share draft accounts can only receive interest on those funds that are on balance at the end of an interest period, typically a quarter.

Since the competitive advantage of share draft accounts over checking deposits in the attraction of deposit funds appears negligible, if not nonexistent, it is clearly unnecessary to extend the interest prohibition to share drafts. Still, the question remains whether the policy prohibiting interest-bearing demand deposits should continue to be applied to other financial institutions. It is submitted that it is time for a reexamination of the policy, with a view towards its gradual elimination.

It is questionable, first of all, whether the policy was ever warranted. Congressional records indicate that the prohibition was enacted hastily, as a response to the banking crisis, and without substantiation of the theory which engendered it—that interest rate competition undermined the stability of banks. As a result, many commentators and government officials are now calling for a repeal of the prohibition on the ground that the theory

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268. Of course, a limited exception to this fact exists in New England where it is now possible for depositors to draw a negotiable order of withdrawal directly against their savings accounts. See notes 191-92 supra and accompanying text. The original legislative authorization for NOW accounts only covered Massachusetts and New Hampshire. See Act of Aug. 16, 1973, Pub. L. No. 93-100, § 2(a), 87 Stat. 342 (codified at 12 U.S.C. § 1832(a) (1976)). This group was enlarged in 1976 to include Connecticut, Maine, Rhode Island, and Vermont. See Act of Feb. 27, 1976, Pub. L. No. 94-222, § 2, 90 Stat. 197 (codified at 12 U.S.C. § 1832(a) (1976)).

269. See notes 141-42 supra and accompanying text.

270. See notes 231-34 supra and accompanying text.

271. The Staff of the Federal Reserve Board has concluded that the interest rate competition theory “appear[s] to have had little validity at the time the prohibition was enacted.” Interest Impact, supra note 228, at 14. In support of this conclusion, the staff cited studies by Albert Cox and George Benston on the question of whether interest rate competition caused bank instability in the early 1930's. Id. at 12-13. While Cox found no support for the theory, Benston discovered a slight inverse relationship between demand deposit interest rates and bank insolvencies. Id. at 13-14.
which lay behind it has either been disproved or never been proved, or that the prohibition is a distortion of free markets.

Even assuming, however, that the theory was valid in 1933, the prohibition against interest-bearing demand deposits would no longer appear necessary to protect the security of banks because of the existence of alternative methods to accomplish this objective. The 1933 Act recognized the availability of alternative methods since it utilized deposit insurance and reserve requirements in addition to the prohibition on interest. Deposit insurance, since it insure depositors against the possibility of bank failures, promotes the security of customer deposits more than the security of banks. But reserve requirements can promote bank stability by requiring the institutions to set aside a certain percentage of their customers' deposits in order that the demand for withdrawals from checking accounts can be met under normal circumstances.

Reserve requirements might be an adequate guarantee of bank stability by themselves. If not, measures other than an interest prohibition can be utilized. For one, banks themselves could take the steps appropriate to ensuring stability. If the interest prohibition were repealed, banks could still make interest-bearing checking accounts profitable without resorting to investment in high-yielding assets. Banks could, for example, levy service charges on the accounts in order to reduce the explicit interest cost.

272. NOW Hearings, supra note 214, at 99 (statement of George A. LeMaistre, Chairman, FDIC); American Institute of Banking, Federal Regulation of Banking 54 (1975).

273. NOW Hearings, supra note 214, at 11 (statement of W. Michael Blumenthal, Secretary of the Treasury).

274. The Federal Reserve After 50 Years: Hearings Before the Subcomm. on Domestic Finance of the House Comm. on Banking and Currency, 88th Cong., 2d Sess. 1135 (1964) (statement of Professor Milton Friedman).

275. Moreover, one report argues that the objective of bank stability should be deemphasized today. In 1933 it attained a preeminent public policy position because of the inordinate number of bank failures. Today, it should take its place along with other equally important public policies, such as improved competition, greater disclosure, and enhanced market influence upon banks. Golembe Assocs., Inc., Memorandum re: Banking Reform—Once Over Lightly, Vol. 1976-2 Golembe Reports 5.


277. See id. § 461. The imposition of reserve requirements against deposit liabilities of banks was primarily intended in 1933 to ensure bank liquidity. The requirements have recently taken on more importance as a monetary policy tool since "increases in the level of required reserves restrict bank lending and the amount of deposits banks can create [and] [r]eductions in reserve requirements produce less restrictive monetary conditions." Report of the President's Commission on Financial Structure and Regulation 66 (1971), reprinted in J. White, Banking Law 167 (1976).

278. This position was taken by the proponents of a recent banking act, Public Law 94-200, which had originally included, when proposed, a provision permitting NOW accounts to be offered on a nationwide basis. "We have also included in this bill a requirement for those financial institutions which offer NOW accounts . . . to provide appropriate reserves so that the NOW account will not become a source of financial instability. We did not have these protective provisions in the 1930's." 121 Cong. Rec. 34560 (1975) (remarks of Representative Rousselot).

279. This has become a prevalent means of protecting security among the New England
seems to be a preferable way of maintaining bank security in that, unlike the interest prohibition, it does not result in a distorted allocation of the cost of bank services among customers.\textsuperscript{280} In addition, the imposition of activity fees will result in a more "efficient allocation of resources"\textsuperscript{281} since bank customers will refrain from the wasteful use of checks and other banking services. Similarly, the substitution of service charges for the prohibition of interest will permit more freedom of choice for the depositor in deciding how to spend his interest.\textsuperscript{282} "[T]he consumer is able to weigh the personal value of a service against its actual price and make a more informed choice . . . . At present, the consumer can only effectively 'spend' his 'interest' on whatever free services or gifts are offered by the depository institution."\textsuperscript{283}

Banks could also reduce the explicit interest cost of demand deposits by introducing the truncated system that credit unions have pioneered for share drafts. Under this system, when the share draft arrives at the "payable through bank" for collection, the bank transfers the relevant data onto an electronic medium and communicates via the medium with the credit union.\textsuperscript{284} The credit union member does not receive the draft back. His ability to reconcile his account statement is not impaired, however, since each time he writes out a draft, a copy is automatically made by a carbonless duplicate.\textsuperscript{285} Since each check presently costs approximately twenty cents to process,\textsuperscript{286} this system could result in significant savings.

\begin{itemize}
\item institutions offering NOW accounts. Many of them are imposing service charges and minimum balance requirements in order to make the accounts profitable. Wall St. J., Oct. 11, 1977, at 12, col. 1. This same reasoning prompted the NCUA Administrator in his final regulation to allow credit unions to charge activity fees on share draft accounts. The proposed regulation had prohibited any activity fees. \textit{See} 42 Fed. Reg. 61977, 61980 (1977).
\item If explicit interest is permitted on demand deposits, the "existing inequities whereby some depositors subsidize the expense of servicing others' accounts will be eliminated. The consumer will receive the full value of his money to the bank in the form of explicit interest, and will pay only for those services he 'consumes'. Under the present 'no interest' scheme, the depositor who writes few checks is subsidizing the depositor who writes many." \textit{S. Rep. No. 407, 95th Cong., 1st Sess. 9 (1977).}
\item NOW Hearings, supra note 214, at 7 (statement of W. Michael Blumenthal, Secretary of the Treasury). Because banking services are "offered below cost or even free, institutions encourage over-utilization of these services by consumers and add unnecessary expenses to their operation. . . . [T]his misallocation of resources tends to be greater as the banking structure becomes more competitive. Competition forces firms to be efficient, but if banks are forbidden to pay interest, competitive pressures forces [sic] them to be inefficient—to offer higher levels of services at greater discounts from cost. . . . [The payment of interest on transaction balances] will reduce or eliminate many of these inequities and inefficiencies. . . . [Consumers] will also have an incentive to cut back on wasteful consumption of unneeded services." \textit{S. Rep. No. 407, 95th Cong., 1st Sess. 6 (1977).}
\item NOW Hearings, supra note 214, at 32-33 (statement of Dr. Arthur F. Burns); \textit{S. Rep. No. 407, 95th Cong., 1st Sess. 7 (1977).}
\item \textit{S. Rep. No. 407, 95th Cong., 1st Sess. 7 (1977).}
\item Id. at 11247.
\item Shick, A History and Overview of Major Economic Aspects and User Concerns,
Moreover, the federal banking agencies could promulgate new regulations in lieu of the interest prohibition to ensure the security of banks. As in the case of savings deposits, an interest ceiling could be placed on demand deposits. Indeed, the original version of the bill which was eventually enacted as the Glass-Steagall Act contained a provision limiting the rate of interest on demand deposits to 3 1/2 percent. That provision was dropped in favor of a stronger measure, the interest prohibition section, as a result of the crisis atmosphere ensuing after the inordinate number of bank failures in early 1933. Alternatively, banks could be precluded from investing in certain types of high-yielding risky investments. This would force banks in their own self-interest to maintain low interest rates on demand deposits in order to make those accounts profitable. Finally, service charges could be required. This would eliminate the possibility that, if left to the banks' discretion, many of them would refrain from imposing service charges in order to get a competitive edge over other institutions.

Overall, there are numerous ways of promoting bank security other than by prohibiting interest payments. While it is not within the scope of this Comment to compare one method with another, it is submitted that the best alternative to the interest prohibition method would be the one that provides, in addition to bank security, maximum freedom of choice for both the customer in spending his interest and the bank in competing for demand deposit funds.

V. CONCLUSION

With the advance of Electronic Funds Transfer Systems (EFTS), practices in the traditionally staid banking community have been undergoing radical changes in recent years. Designed to take advantage of the technological achievements in the data processing field, EFTS essentially provides for the transfer of money held in bank account balances through the use of electronic devices. For example, automated teller machines now provide bank customers with twenty-four hour service. By means of such terminals, customers can make deposits, withdrawals, and transfer funds between their savings accounts. 

287. Congress has delegated the responsibility for setting interest ceilings on savings deposits to the Federal Reserve Board for all its member banks, see 12 U.S.C. § 371(b) (1976), and to the FDIC for all nonmember insured banks, see id. § 1828(g).

288. A. Cox, Regulation of Interest Rates on Bank Deposits 21 (1966); see note 233 supra and accompanying text.

289. A. Cox, Regulation of Interest Rates on Bank Deposits 21-22 (1966); see note 233 supra and accompanying text.


291. See note 261 supra and accompanying text.
Remote-service units (RSU) go one step further by permitting savings and loan customers to effect these same transactions at a location remote from the institution, such as in a grocery or department store. In a banking world marked by these and other EFTS innovations, share drafts simply become "necessary for the continuing success of credit unions."  

Prior to the federal share draft regulation, credit union members were permitted to withdraw their funds by means of a personal appearance, a telephone call, or the mail. As has been discussed, however, credit unions were empowered under the Federal Credit Union Act to authorize other reasonable methods of share account withdrawal, including the utilization of share drafts. Nonetheless, federal credit unions did not offer share draft accounts until they were prodded by the NCUA's regulation prescribing the requirements for the maintenance of those accounts. In doing so, the NCUA, by providing credit union members with a "contemporary means of withdrawing funds" from their share accounts, carried out the congressional mandate that it be responsive to the needs of credit unions and their members in an evolving economy.  

While share drafts are legal under the Federal Credit Union Act, it is arguable that, as interest-bearing transaction accounts, share drafts provide credit unions with a competitive advantage over banks, which are prohibited by federal policy from offering demand deposits upon which interest is earned. Banking practices, however, have successfully circumvented this prohibition by eroding the distinction between savings accounts and checking deposits. As a result, the competitive inequity between credit unions and banks is not significant enough to justify the application of this policy to credit unions. Indeed, in view of the circumventions of the policy against interest-bearing demand deposits so far and the promise that EFTS will contribute to this trend in the future, the time appears ripe for a reevaluation of the policy's application to banks. Only then will the capabilities of electronic technology be fully realized in the banking industry.

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293. See note 264 supra and accompanying text.
294. Iowa Credit Union League v. Iowa Dep't of Banking, CE 6-3152, slip op. at 13 (Iowa Dist. Ct. May 24, 1977).
295. See notes 7, 68 supra and accompanying text.
296. See pt. III supra and accompanying text.
297. See notes 15-17 supra and accompanying text.
299. Id. at 61978.
300. See notes 246-52 supra and accompanying text.
301. See notes 253-69 supra and accompanying text.
302. See pt. IV(D) supra and accompanying text.