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Alexander, Ohio Developments, 1980

# DEVELOPMENTS IN OHIO SAVINGS AND LOAN LAW: 1980\*

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## INTRODUCTION

**I**N 1978 the editorial staff of the AKRON LAW REVIEW devoted the winter issue to savings and loan law developments.<sup>1</sup> Again in 1979<sup>2</sup> and 1980<sup>3</sup> those subsequent editorial boards continued that initial commitment to an annual symposium on savings and loan law. This edition marks the fourth in that continuing series. It contains professional work discussing NOW accounts<sup>4</sup> and an industry view<sup>5</sup> of the 1980 Depository Institutions Deregulation Act.<sup>6</sup> Its student project is an extensive analysis of various aspects of the Depository Institutions Deregulation Act.<sup>7</sup> This 1981 edition of the AKRON LAW REVIEW has continued to fulfill the objectives of that first editorial board in 1978: to both provide a forum for professional and student work that explores the legal regimes which impact upon savings associations and to make a continuing contribution to the body of savings and loan law literature that is surely needed by the practicing attorneys who serve as counsel for savings associations.

That need is most greatly felt by those members of the bar who represent state chartered savings associations. Unfortunately, very little material is published each year which deals with savings and loan law developments in the individual states.<sup>8</sup> Most of the legal scholarship addresses federal developments. Certainly there is adequate basis to support the perception that most significant developments in savings and loan law emanate from the federal government. The 1978 Financial Institutions Regulatory and Interest Rate Control Act<sup>9</sup> and the 1980 Depository Institutions Deregulation Act<sup>10</sup> served

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<sup>1</sup> See 11 AKRON L. REV. 399-577.

<sup>2</sup> See 12 AKRON L. REV. 599-706.

<sup>3</sup> See 13 AKRON L. REV. 403-506.

<sup>4</sup> Pfeiler, *Nationwide NOW Accounts: Current Legal Issues, Supervisory Update*.

<sup>5</sup> Bartlett, *Savings Associations and the New Depository Institutions Deregulation and Monetary Control Act*.

<sup>6</sup> Pub. L. No. 96-221, 94 Stat. 132 (1980). (to be codified in scattered sections of 12, 15 U.S.C.).

<sup>7</sup> Student Project: *The Depository Institutions Deregulation and Monetary Control Act of 1980*.

<sup>8</sup> The most comprehensive source for state law developments is the trade publication of the United States League of Savings Associations, entitled *Legal Bulletin*.

<sup>9</sup> Pub. L. No. 95-630, 92 Stat. 3641 (1978) (codified in scattered sections of 5, 12, 15, 28, 31, 42 U.S.C.).

<sup>10</sup> Pub. L. No. 96-221, 94 Stat. 132 (1980) (to be codified in scattered sections of 12, 15 U.S.C.).

to reinforce that perception. Indeed, a quick review of the 1980 rule-making announcements by the Federal Home Loan Bank Board, the Federal Reserve Board, and the Depository Institutions Deregulation Committee could quickly lead one to conclude that the significant developments in savings and loan law occur *only* at the federal level. To so conclude would be a mistake, however. The regime for regulating savings associations is still a dual system,<sup>11</sup> with significant power vested in the individual states to regulate their own state chartered savings association.

Nor are state chartered associations an insignificant portion of the total savings and loan industry. In Ohio, for example, there were 399 federal and state chartered associations at the beginning of 1980.<sup>12</sup> The combined assets of those 399 associations placed the Ohio savings association industry as fourth largest among the several states with some 6.5% of the total assets of the nation's savings and loan industry.<sup>13</sup> Only the savings association industries of California, Florida and Illinois had greater combined assets. Of those 399 associations, 264 were Ohio chartered savings associations. Those Ohio charters had over fifty-five percent (approximately \$20,759,000,000) of the total assets (approximately \$37,857,000,000) held by all Ohio's state chartered and federal associations at year end 1979.<sup>14</sup>

The statutes which specifically delimit the activities permissible to Ohio chartered savings associations are contained in four chapters of the Ohio Revised Code.<sup>15</sup> Supervision of those associations and the responsibility for oversight of those activities is vested in the Ohio Superintendent of Building and Loan Associations.<sup>16</sup> As in many states the most important function of this state regulator is to examine Ohio associations to insure compliance with the state statutes.<sup>17</sup> In recent years a second area of the Superintendent's power has assumed increasing importance. That is his power to expand the category of business activities permissible to Ohio associations. He exercises this authority through the vehicle of parity rules.<sup>18</sup>

<sup>11</sup> For an overview of the dual system see: Scott, *In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies*, 42 U. CHI. L. REV. 235 (1975); and Scott, *Dual Banking System: Model of Competition in Regulation*, 30 STAN. L. REV. 1 (1977).

<sup>12</sup> U.S. LEAGUE OF SAVINGS ASSOCIATIONS, SAVINGS AND LOAN FACT BOOK 49 (1980).

<sup>13</sup> *Id.*, at 50.

<sup>14</sup> [1979] OHIO DIVISION OF BUILDING AND LOAN ASSOCIATIONS 90TH ANNUAL REPORT 3. The comparative consolidated statement of condition of Ohio chartered building and loan associations as of December 31, 1979 shows total assets at \$20,759,034,434.

<sup>15</sup> OHIO REV. CODE ANN. Chapters 1151, 1153, 1155 and 1157 (Page 1968).

<sup>16</sup> See Alexander, *Regulating State Chartered Savings Associations: An Introduction to the Ohio Scheme*, 11 AKRON L. REV. 399, 402-409 (1978).

<sup>17</sup> *Id.*, at 410-417.

<sup>18</sup> OHIO REV. CODE ANN. § 1155.18 (Page 1968). See also *id.*, at 442-454.

In 1967 the Ohio legislature delegated to the Superintendent the power to promulgate rules conferring upon state chartered associations any "right, power, privilege, or benefit" possessed by federal associations "by virtue of statute, rule, or regulation, or judicial decision."<sup>19</sup> These rules remain in effect for only 30 months from the date of their promulgation by the Superintendent. The rules must be enacted into statute by the legislature before the expiration of that period in order that the substance of such rules may become permanent. As the Superintendent has promulgated parity rules with increasing frequency the legislature has tended to simply introduce legislative measures codifying those parity rules, rather than initiate legislative measures in addition to or independent of those parity rule bills.

The year 1980 reflected this phenomenon. No significant savings and loan legislation was initiated by the General Assembly during 1980. Yet the legal regime affecting Ohio savings associations was altered dramatically during that same year by five significant Superintendent's rules. Four of those were parity rules. Three of the parity rules affected the amount that associations could invest in service corporations,<sup>20</sup> the earnings they may pay on savings accounts,<sup>21</sup> and their lending authority.<sup>22</sup> Those three rules became effective on November 24, 1980. The fourth parity rule, granting associations the authority to offer NOW accounts, became effective on December 31 of that year.<sup>23</sup> The last of these five rules consisted of a major revision of the existing branching rule for Ohio associations.<sup>24</sup> Those amendments were effective January 1, 1981. The changes wrought in the way savings associations do business in this state as a result of each of those five new rules are discussed below.

### I. INVESTMENT IN SERVICE CORPORATIONS

The service corporation parity rule provides as follows:

Notwithstanding divisions (A) and (B) of section 1151.344 of the Revised Code, the percentage limitation for investment in service corporations shall be a total of four percent of a building and loan association's assets.<sup>25</sup>

This rule became effective on November 24, 1980 and expires May 24, 1983. Although the published announcement of this rule does not cite the federal source upon which this regulation is based, there are only two possible such sources. The first was a provision of the Depository Institu-

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<sup>19</sup> *Id.*

<sup>20</sup> OHIO AD. CODE ch. 1301:2-5-23.

<sup>21</sup> *Id.* ch. 1301:2-5-22.

<sup>22</sup> *Id.* ch. 1301:2-5-24.

<sup>23</sup> *Id.* ch. 1301-2-5-21.

<sup>24</sup> *Id.* ch. 1301:2-1-04.

<sup>25</sup> *Id.* ch. 1301:2-5-23.

tions Deregulation and Monetary Control Act of 1980 (hereinafter Deregulation Act). That act amended section 5(c) of the Home Owners' Loan Act of 1933<sup>26</sup> by raising by two percent the ceiling on the amount of assets which a single federal association can invest in service corporations. It also placed one very important qualification upon this additional 2% investment authority. The statute provides that one-half of any amount of investment in excess of 1% must be utilized by the service corporation "primarily for community, inner-city and community development purposes."<sup>27</sup>

The view of the Federal Home Loan Bank Board has long been that this section permitting savings associations to invest in service corporations is not self-implementing, but instead first requires that the Bank Board exercise its plenary rulemaking authority.<sup>28</sup> The Bank Board thus amended its existing service corporation regulation to reflect this new Deregulation Act provision.<sup>29</sup> That Bank Board amendment became effective on August 22, 1980<sup>30</sup> and provides the second source for the Ohio parity rule. This Bank Board amendment to its service corporation regulation not only raised from one percent to three percent of assets the amount which a federal association may now invest in service corporations, it also enacted a curious departure from the substance of the Deregulation Act. Although the Deregulation Act expressly requires that one-half of any amount of investment in excess of one percent must be used by the service corporation for the specified community purposes, the Bank Board's rule provides that "any investment in excess of *two percent* of assets . . . [must serve] primarily community, inner-city or community development purposes."<sup>31</sup> This clear con-

<sup>26</sup> 12 U.S.C. § 1464(c) (1976).

<sup>27</sup> "(B) SERVICE CORPORATIONS.—Investments in the capital stock, obligations, or other securities of any corporation organized under the laws of the State in which the home office of the association is located, if the entire capital stock of such corporation is available for purchase only by savings and loan associations of such State and by Federal associations having their home offices in such State, but no association may make any investment under this subparagraph if its aggregate outstanding investment under this subparagraph would exceed 3 per centum of the assets of the association, *except that not less than one-half of the investment permitted under this subparagraph which exceeds one per centum of assets shall be used primarily for community, inner-city, and community development purposes.*" (Emphasis added.). 12 U.S.C. 1464(c)(4)(B), as amended by Title IV, § 401 of 1980 Depository Institution Deregulation Act.

<sup>28</sup> Alexander, *Savings and Loan Service Corporations: Regulation in Ohio*, 13 AKRON. L. REV. 403, 406-409, (1980).

<sup>29</sup> 45 Fed. Reg. 56,029 (1980) (to be codified at 12 C.F.R. § 545.9-1(d)(i)).

<sup>30</sup> *Id.*

<sup>31</sup> (Emphasis added). The rule expands upon the Deregulation Act provision and defines precisely when investments serve the requisite purposes:

"An association with an aggregate outstanding investment in excess of 2 percent of assets shall designate investments that serve primarily community, inner-city or community development purposes, which shall include the following:

(i) Investments in governmentally insured, guaranteed, subsidized or otherwise sponsored programs for housing, small farms, or businesses that are local in character;

(ii) Investments for the preservation or revitalization of either urban or rural

flict between the Bank Board's rule and the Deregulation's Act provision surely posited a dilemma for the Superintendent when drafting the Ohio service corporation parity rule.

The Ohio statute which authorizes the Superintendent to promulgate parity regulations provides that the substance of such rules may be based either on federal statute or Bank Board regulation. In this particular instance the Bank Board rule confers a greater benefit upon federal associations than does the federal statute, since the Bank Board's rule states that the community purposes qualification is only applicable to the amount of investment in excess of two percent of assets, rather than the statute's statement that this qualification is applicable to any investment in excess of one percent of assets. The Superintendent's solution to this apparent conflict in sources was to simply increase the amount which state chartered associations may invest in service corporations from the former two percent ceiling to four percent without incorporating the community purposes qualification.

Both the Deregulation Act and the Bank Board's rule granted only a *qualified* right to federal associations to increase their investments in service corporations. Each contains the qualification that some portion of this increased investment authority must be used by the service corporation for community purposes. In this respect Ohio chartered associations fared far better than the federal associations. The Superintendent's parity rule deletes entirely this federal qualification upon increased investment authority in service corporations. Whether this parity regulation exceeds the Superintendent's delegated authority to grant state chartered associations the *equivalent* authority possessed by federal associations is a question which the Ohio legislature may well wish to raise when considering whether to enact the substance of this parity rule into statute.

The Superintendent's cover letter which announced adoption of the final parity regulations stated that the "Service Corporation Investment Rule increases the permissible investment in a service corporation to 4% of an association's assets . . . [and] also eliminates the distinction between wholly- and multiple-owned service corporations."<sup>82</sup> The distinction between wholly-owned and multiple-owned service corporations has its origin in the section 1151.344 of the Ohio Revised Code. Division (A) of that section

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communities;

(iii) Investments designed to meet the community development needs of, and primarily benefit, low- and moderate-income communities; or

(iv) Other community, inner city or community development-related investments approved by the Principal Supervisory Agent (as defined in § 545.14(a)(3) of this Chapter)."

*Id.*

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<sup>82</sup> Letter from Clark W. Wideman, Superintendent of Building and Loan Associations, to all Ohio Savings Associations (November 12, 1980) (on file with the AKRON LAW REVIEW).

permits an association to invest a maximum of two percent of its assets in multiple-owned service corporations.<sup>33</sup> Division (B) of that same section permits an association to invest no more than one percent of its assets in wholly-owned service corporations.<sup>34</sup> The two percent ceiling upon investments in multiple-owned service corporations has also constituted the ceiling on the total amount which a single association could invest in both types of service corporations. That is, the amount that a single association actually invests in a wholly-owned service corporation must be subtracted from this two percent ceiling in order to determine the remaining amount that the association can then invest in multiple-owned service corporations.

It is unclear from the text of the Superintendent's parity regulation whether this relationship between the amounts invested in wholly-owned and multiple-owned service corporations is retained. The regulation simply states that the investment ceiling is raised to four percent of an association's assets. If the former relationship were maintained it would mean that this parity regulation now authorizes an association to invest up to four percent of its assets in multiple-owned service corporations; or up to two percent of that four percent amount in wholly-owned service corporations with the remainder available for investment in multiple-owned service corporations. Under this construction of the new rule, if an individual association elected to invest 1½ % of its assets in a wholly-owned service corporation it could invest no more than 2½ % of its assets in multiple-owned service corporations. It appears, however, that there was no intent to continue this relationship between investments in the two types of service corporations.

The position of Division staff is that the parity regulation eliminates this former distinction. The staff cites in support of this construction of the rule the second sentence in the Superintendent's cover letter which provided that the "rule also eliminates the distinction between wholly- and multiple-owned service corporations."<sup>35</sup> The staff position is that the parity rule will permit a single savings association to invest up to four percent of its assets in multiple-owned service corporations or up to four percent of its assets in wholly-owned service corporations. The amount invested in wholly-owned service corporations must still be added to the amount invested in multiple-owned service corporations so that the total of these investments may not exceed four percent of the association's assets. The changes thus wrought by the parity regulation are two: (1) the section 1151.344 ceiling of two percent which a single association could invest in multiple-owned service corporations has been raised to a four percent

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<sup>33</sup> For a discussion of multiple or jointly-owned service corporations, see Alexander, *Savings and Loan Service Corporations: Regulation in Ohio*, 13 AKRON L. REV. 403, 433-437.

<sup>34</sup> *Id.* at 437-440.

<sup>35</sup> Letter from Clark W. Wideman, Superintendent of Building and Loan Associations, to all Ohio Savings Associations (November 12, 1980) (on file with the AKRON LAW REVIEW).

ceiling; and (2) the section 1151.344 ceiling of one percent which a savings association could invest in wholly-owned service corporations has also been raised to four percent.

## II. EARNINGS ON SAVINGS ACCOUNTS

This parity rule permits the board of directors of a savings association to determine by resolution "not to pay dividends or interest on accounts of less than fifty dollars."<sup>36</sup> The rule became effective on November 24, 1980 and will expire on May 24, 1983. It is based on a Bank Board regulation which provides:

A federal association may, by resolution of its boards of directors, determine not to distribute earning on any savings account of less than a specified minimum amount, which shall be less than \$50. It may also so specify a lower minimum for accounts established under a plan offered by the association to children to encourage thrift.<sup>37</sup>

The consequence of the Superintendent's parity rule must be considered in the context of two different types of savings accounts: (1) non-stock deposits; and (2) withdrawable share accounts. Ohio associations are permitted by statute to pay "interest" on the former,<sup>38</sup> while the nomenclature used in the statutes to refer to similar payments with respect to withdrawable share accounts is the term "dividend."<sup>39</sup> Withdrawable share account is the term used to identify the stock account of a saver who has deposits with a mutual association. The second type of savings association in terms of ownership structure is commonly referred to as a permanent stock association. Such associations receive deposits from savers and pay interest thereon and also have outstanding at the same time a class of equity securities whose owners receive dividends with respect to their shares.

Prior to adoption of this parity rule, section 1151.52 of the Ohio Revised Code provided that mutual associations could elect not to pay dividends on withdrawable share accounts of less than ten dollars. Mutual savings associations were thus *required* to pay dividends on withdrawable share accounts of ten dollars or more. The Superintendent's new parity rule alters this scheme by raising to fifty dollars the minimum size account on which a mutual association is now required to pay dividends.

Section 1151.19 permits stock associations to "receive money on deposit" and further provides that such associations "may pay interest thereon."<sup>40</sup> Although not practicable marketing strategy in today's market

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<sup>36</sup> OHIO AD. CODE ch. 1301:2-5-22.

<sup>37</sup> 12 C.F.R. § 545.3(g) (1980).

<sup>38</sup> OHIO REV. CODE ANN. § 1151.19(A) (Page Supp. 1979).

<sup>39</sup> OHIO REV. CODE ANN. § 1151.52 (Page Supp. 1979). The term "interest" is defined to include "dividends" by OHIO REV. CODE ANN. § 1151.081(G).

<sup>40</sup> OHIO REV. CODE ANN. § 1151.19(A) (Page Supp. 1979).



place, this statute allows stock associations to elect not to pay interest on deposits. Unlike mutual associations which were *required* by statute to pay dividends upon accounts of ten dollars or more, stock associations had complete discretion to unilaterally determine what size accounts would receive interest. A stock association could elect not to pay interest on all accounts smaller than ten dollars, fifty dollars, a hundred dollars or any other amount.

Rather than confer an added benefit or power upon stock associations, the Superintendent's new parity regulation restricts this discretion heretofore possessed by stock associations. As a result of this parity regulation the range of elections permissible to stock associations has now been narrowed to accounts of less than fifty dollars. Stock associations may no longer determine to withhold payment of interest on accounts that are fifty dollars or larger.

This new parity rule also provides that:

This fifty dollar limitation shall not apply to an account subject to a negotiable order of withdrawal as defined in Rule 1301:2-1-21 of the Administrative Code.<sup>41</sup>

That NOW account rule is one of the five rules adopted in 1980. The definition of negotiable order of withdrawal in that rule is "a savings account of a member."<sup>42</sup> Although not expressly so stated, the NOW account parity rule anticipates that such accounts will be offered by both mutual associations and stock associations. By exempting NOW accounts from the fifty dollar limitation the rule grants both types of associations complete latitude to fix the minimum size of NOW accounts which will bear interest.

### III. RESIDENTIAL AND CONSUMER LENDING

This is the last of the three parity rules which became effective on November 24, 1980. It too expires on May 24, 1983. Unlike parity rules of past years this particular rule contains no express language drafted by the office of the Superintendent. Instead, the rule states that:

(A) . . . [A] building and loan association shall possess, and may exercise, the same lending and investment powers and authorities as those granted to federal savings and loan associations in Federal Home Loan Bank Board Resolution number 80-700, dated [N]ovember 10, 1980, and Federal Home Loan Bank Board Resolution number 80-701, dated [N]ovember 10, 1980.

(B) Nothing in paragraph (A) above shall act to repeal, derogate or take away from any building and loan association any right, power or privilege currently authorized by chapter 1151. of the Revised

<sup>41</sup> OHIO AD. CODE ch. 1301:2-5-22.

<sup>42</sup> *Id.* ch. 1301:2-5-21.

Code, even though such right, power or privilege may exceed those authorities granted to federal savings and loan associations.<sup>43</sup>

Appended to the parity regulation were forty-four pages of text. Those pages consisted of photo copies of the summary information and full text of the Bank Board's two new lending rules. The Superintendent's cover letter justified his use of this novel format for a parity rule in the following way:

We are currently drafting specific rules dealing with residential and consumer lending and investment in corporate debt securities and commercial paper. When those rules are completed, Rule 1301:2-5-24 will be repealed and replaced by the more specific rules. Adoption of an interim rule such as this is in keeping with our desire to give state-chartered associations every advantage given to federal associations.<sup>44</sup>

Prior years' parity rules have always identified the specific state statute which was affected and then proceeded to state the substance of that change. The Superintendent's remarks in his cover letter were a candid acknowledgment that the task of drafting such specific amendments to incorporate the substance of the new lending authority of federal associations is not easily accomplished.

Regardless of how one defines "lending statute" there are at least nineteen sections of the Ohio Revised Code which grant various types of lending authority to savings associations.<sup>45</sup> The comprehensive scope and complexity of these two new federal regulations will require the division staff to draft a comprehensive recodification of Ohio's lending statutes in order to incorporate the substance of those two Bank Board rules. Although this author can readily sympathize with the task that now confronts the division staff, it is equally easy to empathize with the reader who must wade through these two Bank Board resolutions in order to determine what new lending authority state associations have received. Those who engage in such an endeavor must be particularly wary and avoid recommending a course of lending which is not clearly authorized by the new Bank Board resolutions. The Superintendent has broad authority with respect to unauthorized loans. After notice and hearing the Superintendent may (1) issue a cease and desist order to an association to halt unauthorized lendings; (2) order the association to establish a special reserve with respect to unauthorized loans; or (3) order the association to dispose of the unauthorized loans within ninety days.<sup>46</sup>

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<sup>43</sup> *Id.* ch. 1301:2-5-24.

<sup>44</sup> Letter from Clark W. Wideman, Superintendent of Building and Loan Associations, to all Ohio Savings Associations (November 12, 1980) (on file with the AKRON LAW REVIEW).

<sup>45</sup> OHIO REV. CODE ANN. §§ 1151.29, 1151.291, 1151.292, 1151.293, 1151.294, 1151.295, 1151.296, 1151.297, 1151.298, 1151.299, 1151.30, 1151.301, 1151.31, 1151.311, 1151.32, 1151.323, 1151.342, 1151.343 and 1151.344 (Page Supp. 1979).

<sup>46</sup> OHIO REV. CODE ANN. § 1155.02 (Page Supp. 1979).

The purpose of this portion of the text is to provide as much guidance as is possible to the reader who may be contemplating exercising the additional lending authority conferred by this parity regulation. The material is organized to identify the new loan categories and compares those new loans with existing Ohio statutes that authorize similar types of loans. It must be remembered, however, that any interpretation of this parity rule can be no more than just that - one writer's interpretation. No definitive description of the additional lending authority conferred upon Ohio chartered associations is possible until this "interim rule" is replaced with the specific rules promised in the Superintendent's cover letter.

### A. Consumer Loans

The Bank Board's resolution permits a federal association to now make a "secured or unsecured loan to a natural person for personal, family, or household purposes"<sup>47</sup> that is, to make consumer loans. The total of such loans may not exceed an amount equal to 20% of the association's assets.<sup>48</sup> Federal associations may originate, purchase, sell, service and purchase participations in these loans.<sup>49</sup> These loans can be made directly or through a dealer, provided that the dealer has been approved by the association's board of directors.<sup>50</sup> The one significant limitation on these loans is the limitation on unsecured loans to one borrower. Any association, regardless of asset size or net worth, may make up to \$3,000 in unsecured loans to a single borrower.<sup>51</sup> If the lesser of one-fourth of one percent of an association's assets or five percent of its net worth is greater than \$3,000, then the association may make unsecured loans to a single borrower totalling that greater amount.

The only authority for consumer loans presently possessed by Ohio associations is the second mortgage loan authority contained in section 1151.343(B). That section provides in part:

"(B) [A]n association may make any of the following loans provided that it shall not charge, collect, or receive interest, finance charges and penalties in excess of the maximum rate or amount which competing lenders, chartered, licensed or authorized to do business in this state are permitted to charge by law for the same type of loan:

- (1) A second mortgage loan made pursuant to sections 1321.51 to 1321.60 of the Revised Code;
- (2) A second mortgage in excess of any amount authorized by divis-

<sup>47</sup> 45 Fed. Reg. 76,104 (1980) (to be codified at 12 C.F.R. § 541.25).

<sup>48</sup> 1980 Depository Institutions Deregulation Act Title IV, § 401 amending § 5(c) of Home Owners Loan Act of 1933 to add new section 12 U.S.C. (464(c)(2)(B)); 45 Fed. Reg. 76,104 (1980) (to be codified at 12 C.F.R. 545.7-10).

<sup>49</sup> 45 Fed. Reg. 76,104 (1980) (to be codified at 12 C.F.R. 545.7-10(a)).

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* (to be codified at 12 C.F.R. 545.7-10(c)).

ion (B)(1) of this section but not in excess of an amount that could be made under a first lien on real property under any other section of Chapter 1151. for such loans . . .<sup>52</sup>

Sections 1321.51 to 1321.60 contain the Ohio Second Mortgage Lending Act. That act regulates loans which are secured by either "a mortgage on the borrower's real estate which is other than a first lien on such real estate or a security interest in any personal property of the borrower."<sup>53</sup> Industry lobbyists secured enactment of section 1151.343(B)(1) in order to obtain authority for state chartered associations to make loans secured solely by personal property. The industry had to concede a *quid pro quo* to opponents of the bill before it could be finally enacted. That concession was that these loans be subject to the same usury limitations as applicable to other second mortgage lenders. Lobbying groups for competing financial institutions were particularly concerned that savings associations not be permitted to make consumer loans under the umbrella of the general exemption from Ohio's usury statute otherwise available to lending activities by Ohio savings associations.<sup>54</sup> Having conceded this *quid pro quo* the industry soon discovered that section 1151.343(B)(1) actually conferred much less than had been sought by savings association lobbyists.

Shortly after enactment of 1151.343(B)(1) the Superintendent informed the industry that second mortgage loans could be made only if secured by an interest in real estate. The industry's trade association vigorously contested this interpretation of the statute. A later Superintendent sought to resolve this dispute with the industry. He requested the Ohio Attorney General to opine whether this section did indeed "authorize a state-chartered building and loan association to make loans upon the security of personal property acquired by a borrower with the proceeds of a loan transaction."<sup>55</sup> The answer received from the Ohio Attorney General was that this section did not authorize state-chartered associations to make loans secured only by a security interest in personal property. The Attorney General stated that savings associations must comply with the other limitations contained in the Ohio Second Mortgage Lending Act with respect to disclosures, advertising and amortization periods, and then construed that Act as imposing an additional requirement applicable only to savings associations: that savings associations must secure those loans with a second mortgage in real estate.<sup>56</sup> The consequence of this opinion has been that savings associ-

<sup>52</sup> OHIO REV. CODE ANN. § 1151.343(B) (Page Supp. 1979).

<sup>53</sup> OHIO REV. CODE ANN. 1321.52 (Page Supp. 1979).

<sup>54</sup> OHIO REV. CODE ANN. § 1151.21 (Page 1968). For a discussion of this usury law exemption granted to Ohio Savings Association, see Yurchuck, *Ohio Usury Laws and the Real Estate Mortgage Lending Market - A Savings Association Viewpoint*, 12 AKRON L. REV. 671 (1979).

<sup>55</sup> Op. Ohio Att'y Gen. § 75-033 (1975).

<sup>56</sup> *Id.*

ations have been unable to make consumer loans directly; utilizing instead the vehicle of service corporations for their consumer lending activities.<sup>57</sup>

Adoption of the Bank Board's consumer lending authority and the Superintendent's parity rule accomplishes what the industry had sought to accomplish years ago with enactment of section 1151.343(B)(1). Associations may now make personal, family and household loans secured only by personal property, or even unsecured. In addition, the Ohio Second Mortgage Lending Act's other limitations will no longer be applicable to these loans. This means that the general usury exemption available to savings associations is now likewise applicable to consumer lending activity. One question that remains unanswered by the new parity rule is whether the twenty percent of asset limitation on the total amount of money invested in consumer loans applicable to federal associations will be applicable to state-chartered associations. Similarly unanswered is whether the Bank Board's limitation on loans to a single borrower is applicable for Ohio associations.<sup>58</sup> Associations relying on this parity rule should make these consumer loans in conformity with both the loans to one borrower limitation and the twenty percent of asset ceiling contained in the present federal regulation until this interim rule is replaced by the specific parity rule promised by the Superintendent.

### B. *Corporate Debt Securities*

Ohio associations presently lack authority to invest in any form of corporate debt securities, with only one exception. They may invest in debt securities issued by service corporations.

The Bank Board regulation incorporated in the Superintendent's parity rule permits federal associations to invest in and sell (other issuer's) commercial paper<sup>59</sup> and corporate debt securities.<sup>60</sup> The total amount that a single association may invest in such securities may not exceed twenty percent of the association's assets.<sup>61</sup> (The total amount invested in consumer loans is aggregated together with investments in debt securities in computing

<sup>57</sup> See generally Alexander, *Savings and Loan Service Corporations: Regulation in Ohio*, 13 AKRON L. REV. (1980).

<sup>58</sup> Ohio's Loans-to-one borrower limitation is contained in OHIO REV. CODE ANN. § 1151.292 (H) (Page Supp. 1979).

<sup>59</sup> "Any note, draft, or bill of exchange which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." 45 Fed. Reg. 76,109 (1980) (to be codified at 12 C.F.R. § 541.27).

<sup>60</sup> "A marketable obligation, evidencing the indebtedness of any corporation in the form of a bond, note and/or debenture which is commonly regarded as a debt security and is not predominantly speculative in nature. A security is marketable if it may be sold with reasonable promptness at a price which corresponds reasonably to its fair value." *Id.* (to be codified at 12 C.F.R. § 541.28).

<sup>61</sup> *Id.* (to be codified at 12 C.F.R. § 549.9-4(a)).

the twenty percent ceiling.) Associations are also permitted to purchase the shares of open-ended mutual funds whose portfolios are limited solely to investments in securities which would otherwise be authorized investments for the savings association.<sup>62</sup> Securities purchased pursuant to this authority must be rated at the time of purchase by "at least one nationally recognized investment rating service"<sup>63</sup> to be in either one of the two highest grades for commercial paper and to be in one of the four highest grades for commercial debt securities. Additional limitations include the "requirements" that: (1) these debt securities be denominated in dollars and that the issuer be domiciled in the United States;<sup>64</sup> (2) investments in a single issuer's securities may not exceed one percent of the associations assets;<sup>65</sup> (3) the average maturity of the association's portfolio of these debt securities may not exceed six years;<sup>66</sup> (4) informational files must be maintained by the association to establish that it exercised prudent judgment in making these investments;<sup>67</sup> as well as miscellaneous limitations applicable to convertible securities.<sup>68</sup>

State chartered associations that now invest in these debt securities should also comply with all the same limitations otherwise applicable to federal associations under the Bank Board rule.

### C. Real Estate Loans

Perhaps the most significant departure from prior real estate lending policies of the savings and loan industry was the removal by the Deregulation Act of the first-lien requirement. The rule adopted by the Bank Board mirrored the Deregulation Act's elimination of this requirement.<sup>69</sup> The term "real estate loans" is now defined as "any loan secured by real estate where the association relies substantially upon the real estate as the primary security for the loan."<sup>70</sup> In the past Ohio has likewise required that associations secure real estate loans with first liens.<sup>71</sup> Adoption of the parity rule means that Ohio associations may now make real estate loans pursuant to sections 1151.29, 1151.291, 1151.297, and 1151.298 with only subordinated liens on the real estate.

A similarly affected general limitation on real estate loans is the geo-

<sup>62</sup> *Id.*

<sup>63</sup> *Id.* (to be codified at 12 C.F.R. § 549.9-4(b)(1)).

<sup>64</sup> *Id.* (to be codified at 12 C.F.R. § 549.9-4(b)(2)).

<sup>65</sup> *Id.* (to be codified at 12 C.F.R. § 549.9-4(b)(3)).

<sup>66</sup> *Id.* (to be codified at 12 C.F.R. § 549.9-4(b)(5)).

<sup>67</sup> *Id.* (to be codified at 12 C.F.R. § 549.9-4(b)(6)).

<sup>68</sup> *Id.*

<sup>69</sup> 1980 Depository Institutions Deregulation Act Title IV, § 401 amending § 5(c) of the Home Owners' Loan Act of 1933 (*see* 12 U.S.C. 1464(c)(1)(B)); 45 Fed. Reg. 76,095 (1980) (to be codified at 12 C.F.R. § 545.6(a)).

<sup>70</sup> 45 Fed. Reg. 76,095 (1980) (to be codified at 12 C.F.R. § 545.6(a)).

<sup>71</sup> Ohio Rev. Code Ann. § 1151.292(A) (Page Supp. 1979).

graphical limitation. The former requirement that federal associations confine their lending activities primarily to their local areas has been eliminated. Ohio has a counterpart to the federal limitation. Generally real estate securing a real estate loan had to be "located within this state or within 100 miles of this state."<sup>72</sup> That limitation on lending activity by Ohio associations is similarly eliminated by the parity rule.

The various statutes in Ohio authorizing residential loans contain maximum amortization periods of up to thirty years.<sup>73</sup> All of these have apparently been altered by the parity rule. Federal and Ohio associations are now permitted to make home loans with a maximum term of up to 40 years.<sup>74</sup>

#### IV. NEGOTIABLE ORDERS OF WITHDRAWAL ACCOUNTS

An Ohio statute expressly prohibits associations from offering checking accounts:

A building and loan association may permit withdrawal of deposits upon such terms as it provides except by check or draft; but no such association shall carry for any member or depositor any demand, commercial or checking account.<sup>75</sup>

The NOW account parity rule abrogates this statute and expressly provides that associations may offer accounts "from which the owner may make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties."<sup>76</sup> The authority for this parity rule is contained in both Title III of the Deregulation Act<sup>77</sup> and the implementing regulation of the Federal Home Loan Bank Board issued on October 8, 1980.<sup>78</sup>

The parity rule provides that NOW accounts may be offered to natural persons and charitable organizations.<sup>79</sup> An association need not issue either a passbook or certificate evidencing ownership of NOW accounts. As in the instance of the Bank Board rule, the Superintendent's rule also provides that Ohio associations "may extend secured or unsecured credit in the form of overdraft privileges."<sup>80</sup> Thus Ohio associations have the same authority as other financial institutions that can now offer interest-bearing checking accounts. The parity rule also provides that an association may "charge a

<sup>72</sup> OHIO REV. CODE ANN. § 1151.292(B) (Page Supp. 1979).

<sup>73</sup> See OHIO REV. CODE ANN. §§ 1151.29, 1151.292 and 1151.297 (Page Supp. 1979).

<sup>74</sup> 45 Fed. Reg. 76,096 (1980) (to be codified at 12 C.F.R. § 545.6-2(a)(1)), adopted in OHIO AD. CODE ch. 1301:2-5-24(A).

<sup>75</sup> OHIO REV. CODE ANN. § 1151.23 (Page 1968).

<sup>76</sup> OHIO AD. CODE ch. 1301:2-5-21(A).

<sup>77</sup> 1980 Depository Institutions Deregulation Act Title III, § 303.

<sup>78</sup> 45 Fed. Reg. 66,781 (1980) (to be codified at 12 C.F.R. § 545.4-1).

<sup>79</sup> OHIO AD. CODE ch. 1301:2-5-21(A).

fee for making any payment or transfer or for maintaining a 'NOW' account."<sup>81</sup>

NOW accounts offered by federal associations and FSLIC insured state-chartered associations are insured just as any other insured deposit account. One interesting aspect of the Ohio rule affects Ohio's counterpart to FSLIC, the Ohio Deposit Guarantee Fund (hereinafter ODGF). Although that entity performs the same insurance of account function as the FSLIC and FDIC, unlike those two federal agencies, ODGF is not a government agency of this state. It is a private corporate body specifically permitted to engage in its activities by Ohio statutes.<sup>82</sup> Although the Superintendent has supervisory jurisdiction over ODGF, management decisions are vested within the board of trustees of ODGF. The statutes vest sole authority in the Board to define the extent of insurance coverage. Nowhere is the Superintendent permitted to substitute his management decisions for those of the Board. Yet the NOW account parity rule provides that:

Deposits or funds in a "NOW" account *shall* be guaranteed to the same extent as deposits guaranteed under division (B) of section 1151.87 of the Revised Code.<sup>83</sup>

Section 1151.87(B) states that a guaranty fund ". . . may . . . [g]uarantee moneys on deposit."<sup>84</sup> The statute neither requires any coverage nor does it specify minimum levels of coverage. The parity rule both requires coverage and mandates the extent of that coverage. Obviously the Superintendent has preempted the Board and imposed his decision for the management judgment clearly vested in the Board of ODGF. For this reason this portion of the parity rule is *ultra vires* the Superintendent's power.

It is possible that the intent behind the parity rule was to grant ODGF authority to insure NOW accounts, even though the Fund clearly possessed such authority already as a result of the broad language of section 1151.87. More importantly, even if ODGF lacked statutory authority to insure NOW accounts, the Superintendent has no power to grant such authority to a deposit guaranty fund. The statute authorizing parity rules permits the Superintendent to "authorize building and loan associations . . . to exercise such right, power, privilege or benefit" as possessed by federal associations.<sup>85</sup> The definition of "building and loan association"<sup>86</sup> does not include "deposit guaranty associations."<sup>87</sup> Any power or authority received by the FSLIC could not be incorporated in a parity rule and conferred upon

<sup>81</sup> *Id.*

<sup>82</sup> See OHIO REV. CODE ANN. § 1151.80 *et seq.* (Page 1968).

<sup>83</sup> OHIO AD. CODE ch. 1301:2-5-21(D) (emphasis added).

<sup>84</sup> OHIO REV. CODE ANN. § 1151.87(B) (Page 1968).

<sup>85</sup> OHIO REV. CODE ANN. § 1155.18 (Page 1968).

<sup>86</sup> OHIO REV. CODE ANN. § 1151.01(A) (Page 1968).

<sup>87</sup> OHIO REV. CODE ANN. § 1151.80(B) (Page 1968).



ODGF, since that additional power would be neither possessed by a federal association, exercised by an Ohio building and loan association, nor received via the vehicle of the parity rule by a building and loan association.

Any parity rule that attempts to directly affect the activities of ODGF is thus clearly invalid. The Superintendent has no authority to adopt parity rules that affect powers other than those exercised by building and loan associations. To the extent that the NOW account parity rule *requires* ODGF to provide coverage of NOW accounts that rule is invalid.<sup>88</sup>

## V. BRANCHING RULE

Since this writer has previously discussed in some detail Ohio's branching scheme,<sup>89</sup> that scheme is only briefly reviewed here in order to provide a background for discussion of the changes which have resulted from the Superintendent's parity rule amendment of the existing branching rule. There are four sources for Ohio's present branching scheme. The first is a general statute which provides that associations must first secure the approval of the Superintendent before opening any new branch offices.<sup>90</sup> A second specific statute contains an exception to that rule for certain drive-in facilities and pedestrian facilities.<sup>91</sup> Associations can open those two types of branch offices without any prior approval from the Superintendent. The remaining two sources for Ohio's branching scheme are contained in rules of the Superintendent.

In 1973 the Ohio legislature required the Superintendent to adopt a rule outlining the policies which were utilized when exercising his general authority to oversee branching activities by state-chartered savings associations.<sup>92</sup> It is that rule which was amended by the recent rule discussed below. A second rule, still in effect today, was adopted by the Superintendent in 1975.<sup>93</sup> That rule addresses the single topic of remote service units, a type of facility exempted from the coverage of the general branching rule. Remote service units, and qualifying drive-in and pedestrian facilities are still covered by their respective specific rule and statute. Matters concerning all other types of branches are covered by the general branching rule<sup>94</sup>

<sup>88</sup> This coverage mandated by the Superintendent obviously increases ODGF's risk of loss. This mandate by the state of Ohio raises the interesting question whether the state has thus assumed some liability to depositors of ODGF insured associations in the event this increased loss liability results in ODGF's inability to cover future depositors' losses.

<sup>89</sup> See Alexander, *Regulating State Chartered Savings Associations: An Introduction to the Ohio Scheme*, II AKRON L. REV. 399, 402-409 (1978).

<sup>90</sup> OHIO REV. CODE ANN. § 1151.05 (Page 1968).

<sup>91</sup> OHIO REV. CODE ANN. § 1151.052. (Page 1979).

<sup>92</sup> 135 Ohio Laws 1611, 1630, H.B. No. 366, § 3 (1973).

<sup>93</sup> Superintendent Regulation 75-5: Remote Service Units (Temporary Provision) (eff. July 31, 1975) issued by Roger W. Tracy, Jr., Superintendent, Division of Building and Loan Associations (on file with the AKRON LAW REVIEW).

which was amended effective January 1, 1981 by the fifth of the rules adopted by the Superintendent to grant equal benefits to state-chartered savings associations.

It should be emphasized again that this amended branching rule is not a true parity rule. The Superintendent has statutory rule making power with respect to the branching rule independent of the rule making authority contained in the parity statute.<sup>95</sup> Unlike the four rules discussed above, the branching rule is immediately permanent, not temporary, as with the four parity rules discussed above. The Superintendent's new branching rule accomplishes the same objective as the four parity rules discussed above. That is, these amendments to the branching rule mirror the Bank Board's recent changes in the federal branching rule.

On May 5, 1980 the Bank Board adopted final amendments to its branching rule.<sup>96</sup> Those amendments were later supplemented on December 4 by technical amendments and the Bank Board's policy statement on branching.<sup>97</sup> This new federal branching policy became effective on January 1, 1981. The new policy authorized all federal associations to branch state-wide within their situs state. The criteria which were formerly applied when the Bank Board determined whether to approve a branch application were modified to exclude the "need" and "probability of success" requirements. The "undue injury test" was retained and a Community Reinvestment Act requirement was added to the new rule. All those changes have been mirrored in the Superintendent's amendments to Ohio's general branching rule. That new Ohio rule became effective on January 1, 1981.

The rule eliminates the prior three-tiered definition of branch, and now provides for only one type of branch office, defined to be "any office other than [the association's] home or principal office as designated in its articles of incorporation."<sup>98</sup> The rule exempts from the definition of branch office any "agency office, data processing or administrative office, drive-in or pedestrian office, . . . remote service unit or . . . employee facility."<sup>99</sup> All but one of these facilities are excluded from the requirement that an association first secure the Superintendent's approval before opening any branch office.

The rule specifically provides that an association may not establish an employee facility until the Superintendent has granted written approval for such an office. The rule contains no procedures or criteria to be applied by the Superintendent when determining whether to approve a request for

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<sup>95</sup> See Alexander, *Regulating State Chartered Savings Associations: An Introduction to the Ohio Scheme*, II AKRON L. REV. 399, 442-454 (1978).

<sup>96</sup> 45 Fed. Reg. 31,046 (1980) (to be codified at 12 C.F.R. § 545.14).

<sup>97</sup> 45 Fed. Reg. 83,196 (1980) (to be codified at 12 C.F.R. §§ 545.14(h) and 556.5).

<sup>98</sup> OHIO AD. CODE ch. 1301:2-1-04(A).

such a facility. It simply states that any "facility within an administration building or data processing center for the exclusive use or training of employees of the association" cannot be operated without the Superintendent's prior approval.<sup>100</sup>

Prior to these amendments the rule was addressed primarily to the subject of applications to open a new branch office. The scope of that coverage has been broadened. The rule now covers the process for closing a branch and for upgrading an existing branch. In the past there was no formal requirement that an association secure the approval of the Superintendent before closing a branch or even that the Superintendent be notified of a branch closing. The rule now provides that:

An association shall notify the Superintendent not less than sixty days, or, in the case of an emergency, as early as circumstances permit, before closing a branch office.<sup>101</sup>

Under the prior rule satellite offices and low cost branch offices were not always permitted to be as large as a regular branch office. The rule now permits associations to enlarge or "upgrade" those facilities. To upgrade an existing branch the association must notify the Superintendent of such plans at least thirty days prior to upgrading that existing facility.<sup>102</sup> If the Superintendent does not object with thirty days of receipt of that notice, the association may proceed to upgrade.<sup>103</sup> The Superintendent reserves the power to either require additional information before upgrading or to require the association to submit an application for upgrading. The rule is silent with respect to the procedures for processing such an application and states no criteria for determining whether to approve an application to upgrade an existing facility.

Two significant changes were made in the procedures for processing branch applications. There is no longer any restriction on the number of branch applications that an association may have pending with the Superintendent at the same time.<sup>104</sup> In addition, the new rule eliminates the former requirement that an association can branch no more than 100 miles from its home office. Associations are now permitted to branch statewide.<sup>105</sup>

Final changes in the new branching rule relate to the criteria to be applied to determine whether to approve a branch application. The rule retains the former requirements that the branch office can only be established

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<sup>100</sup> *Id.* ch. 1301:2-1-04(L).

<sup>101</sup> *Id.* ch. 1301:2-1-04(J).

<sup>102</sup> *Id.* ch. 1301:2-1-04(I)(2).

<sup>103</sup> *Id.* ch. 1301:2-1-04(I)(3).

<sup>104</sup> *Id.* ch. 1301:2-1-04(B)(2).

<sup>105</sup> *Id.* ch. 1301:2-1-04(B)(1). <http://www.akronlawreview.com/vol14/iss3/1>

if there will be no *undue injury* to existing domestic associations<sup>106</sup> and that "the policies, condition, and operation of the applicant afford no basis for supervisory objection."<sup>107</sup> Eliminated in the new rules are the prior two criteria that there be a *need* for the branch office in the community of its proposed location and that the branch office would be *successful*. The single new criterion for determining whether to approve a branch application is stated as follows:

In addition, in considering whether to approve an application, the Superintendent will assess and take into account an institution's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods; assessment of an institution's record of performance may be the basis for denying an application.<sup>108</sup>

This latter criterion mirrors the federal requirement that an applicant association be in compliance with the federal Community Reinvestment Act.<sup>109</sup>

#### CONCLUSION

The decade of the 80's will challenge savings associations more than any other single period in the entire history of this industry. The Deregulation Act has, for all practical purposes, eliminated the wall between commercial banking and the business of savings associations. Competition for the full range of customers has become an immediate objective for S&L management. How well state chartered associations meet that challenge to compete with commercial banks and federal associations will be determined in part by their ability to provide broader services and product lines. Ohio has attempted to give its associations that ability already possessed by federal associations through the medium of the five rules discussed above. It now remains to be determined whether the management of these state chartered associations possess the management skills necessary to implement these new powers.

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<sup>106</sup> *Id.* ch. 1301:2-1-04(F)(1)(a).

<sup>107</sup> *Id.* ch. 1301:2-1-04(F)(1)(b).

<sup>108</sup> *Id.* ch. 1301:2-1-04(F)(2).

<sup>109</sup> 12 U.S.C. § 2901 (1976). This requirement is found in the Bank Board rule at 45 Fed. Reg. 83,196 (1980) to be codified at 12 C.F.R. § 545.14(h)(1)).

