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NATIONWIDE NOW ACCOUNTS: CURRENT LEGAL ISSUES, SUPERVISORY UPDATE

THOMAS A. PFEILER*

I. INTRODUCTION

AS OF DECEMBER 31, 1980, financial institutions throughout the nation have been able to offer a special type of interest-paying checking account to their customers at rates of up to 5¼%.¹ Although such accounts are, in reality, savings accounts, under a law passed in early 1980 Congress has authorized depository institutions to permit their savers to make withdrawals from such accounts by means of negotiable check-type instruments.² These are usually referred to as NOW accounts, the acronym for negotiable order of withdrawal. Some institutions, however, are advertising these accounts under unique service marks. As a result, it is prudent for an institution to ask its legal counsel to arrange for a trademark search before undertaking an expensive promotional campaign for a NOW account program under a specific product name or symbol.³

The present availability of NOW accounts signifies the first time

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¹ Perhaps it is more correct to state that financial institutions have been able to offer "the practical equivalent of interest-bearing checking accounts." This qualification seems valid because of technical legal distinctions which continue to differentiate demand deposits from savings deposits. See discussion in text, *infra*, entitled "Interest-Bearing Checking Accounts."

² Consumer Checking Account Equity Act of 1980, Pub. L. No. 96-221, title III, § 303, 94 Stat. 143 (1980).

³ For a discussion of the use of trademarks and service marks in connection with savings account programs, see Wood, *Savings Promotions and Trademark Laws*, 35 LEGAL BULL., 297 (1969).

When negotiable orders of withdrawal were first issued, the acronym "NOW" was registered in a stylized manner as a federal trademark by the Consumer Savings Bank of Massachusetts. When other financial institutions in New England began promoting NOW accounts pursuant to a congressionally authorized experiment in this area, Consumer Savings Bank, owner of the proprietary rights in the trademark, wrote to a number of interested institutions, advised them of its trademark ownership and of the fact that "all" savings banks in Massachusetts, "most" of the cooperative banks and savings associations in Massachusetts and New Hampshire, and "some" commercial banks had paid the trademark owner a one-time fee of fifty dollars for the license to use "NOW" to describe its service. The letter conceded that the widespread unlicensed use of NOW might have caused the mark to become an accepted generic description of the service, thus diminishing the probability that any proprietary rights in the word could be enforced legally. It suggested that some organizations, because of their standards of doing business had, nevertheless, seen fit to pay the fifty dollar license fee in order to eliminate, however remote, any possible future questions on the subject.

A recent trademark search of "NOW" discloses that the original trademark registration has been abandoned. While various other products have adopted it as a service mark and have registered it in a very stylized manner, it is probable that the acronym has become a generic description of a savings account subject to withdrawal by negotiable instrument and cannot be appropriated for exclusive use by any individual financial institution.

since the Depression that banks have been permitted to pay interest on accounts that are subject to withdrawal by check.⁴ Moreover, it is the first time that most savings and loan associations have been permitted to offer checking accounts of any type.⁵ The competition among banks, mutual savings banks, and savings and loan associations authorized to issue NOW accounts is intense. Consequently, in the race for market shares, different institutions are offering NOW accounts upon a wide variety of terms and conditions. A number of legal questions have arisen as a result of these circumstances. It is the purpose of this article to consider and, perhaps, answer some of these questions. Where there is no definitive answer, suggestions as to an analytical or practical approach will be offered. In addition, the significance of various provisions of the implementing regulations will be considered.

II. FEDERAL ENABLING LEGISLATION

Prior to the enactment of present federal enabling legislation, Congress had authorized depository institutions in six New England states plus New York and New Jersey to offer NOW accounts for experimental purposes.⁶ Since many of the legal questions being asked today are directly related to the initial statute, as well as the current federal enabling legislation which replaced it, it is appropriate to briefly examine each of these statutory provisions.

The legal framework for the NOW account experiment was the enactment of Section 1832(a) of Title 12 of the United States Code which, although initially proclaiming a general nationwide prohibition against interest-bearing NOW accounts, made a specific exception to that prohibition by expressly granting corporate authority to depository institutions in those eight eastern states to offer NOW accounts.⁷ When

⁴ Congress did, however, permit the implementation of the "New England Experiment" in 1973 to ascertain the effect of such accounts on both consumers and banking systems. See note 7, *infra*, and related text.

⁵ For a state-by-state survey of state enabling laws which could provide a basis for state-chartered associations to offer NOW accounts, see Pfeiler, *Blueprint for Nationwide NOW Accounts*, 46 LEGAL BULL., 101, 107-12 (1980).

⁶ Pub. L. No. 93-100, § 2, 87 Stat. 342 (1973) (codified at 12 U.S.C. § 1832(a)). NOW accounts first received judicial approval on June 7, 1972 when the Supreme Judicial Court of Massachusetts ruled that under the provisions of the Massachusetts Savings Bank law, savings banks in the state were authorized to permit their savers to withdraw from their savings accounts by means of negotiable orders. See *Consumer Sav. Bank v. Comm'r of Banks*, 361 Mass. 717, 282 N.E.2d 416 (1972). See also, 38 LEGAL BULL., 384 (1972).

For a discussion of the subsequent development and expansion of the experimental NOW account authority of financial institutions throughout all six New England states plus New York and New Jersey, see Pfeiler, *Blueprint for Nationwide NOW Accounts*, 46 LEGAL BULL., 101, 101-03 (1980). In addition to the so-called New England experiment, state-chartered associations in some states, such as Illinois, have been authorized in recent years to issue non-interest bearing NOW accounts (NINOWs).

⁷ Pub. L. No. 93-100, § 2, 87 Stat. 342 (codified at 12 U.S.C. § 1832(a)). 12 U.S.C. § 1832(b) defines the term "depository institution" and subsection (c) prescribes a \$1,000 fine for each violation.

Congress subsequently decided to authorize NOW accounts nationwide, it did so by rewriting Section 1832(a) to eliminate the general prohibition against these types of accounts and to authorize all depository institutions to offer them.⁸

As amended, Section 1832(a) reads:

(a) (1) Notwithstanding any other provision of law but subject to paragraph (2), a depository institution is authorized to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties.

(2) Paragraph (1) shall apply only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit.⁹

It will be observed that the enabling legislation has two basic elements in addition to eliminating the nationwide prohibition against interest-paying NOW accounts: (1) it "authorizes" depository institutions to permit owners of interest-bearing accounts to withdraw funds by means of negotiable instruments which may be payable to third parties; and (2) it imposes ownership restrictions on NOW accounts so authorized. This statutory language is pertinent to a number of the current legal questions that are being asked.

III. AUTHORITY OF STATE-CHARTERED ASSOCIATIONS

State-chartered savings and loan associations have traditionally looked to state law to determine the extent and scope of their corporate powers. The enabling legislation of Section 1832(a), however, defines the term "depository institutions" in such a manner as to encompass state-chartered institutions. For this reason, a key question being asked by savings and loans from various states is whether Section 1832(a) grants NOW account power to state-chartered associations which are otherwise precluded by their own state laws from offering such accounts.

In many respects, Section 1832(a) has definitive application to state-chartered institutions. At the minimum, the legislative enactment repealed the general prohibition against interest-paying NOW accounts which was contained in the original version of Section 1832(a). In so doing, it allowed state-chartered associations to offer NOW accounts where such as-

⁸ Pub. L. No. 96-221, title III, § 303, 94 Stat. 146 (1980) (codified at 12 U.S.C. § 1832(a)). Subsections (b) and (c) of 12 U.S.C. § 1832, see note 7, *supra*, have been retained in the current version.

⁹ Pub. L. No. 96-221, title III, §§ 303, 306, 94 Stat. 146, 147 (1980). (codified at 12 U.S.C. § 1832(a)).

sociations already possessed the corporate power to do so.¹⁰ Yet, whether this positive grant of authority to offer NOW accounts applies to state-chartered associations is a more dubious question. Proponents argue that the federal legislation preempts any state law which might otherwise preclude state-chartered associations from offering NOW accounts. In order for this view to prevail, however, two factors would have to be established: (1) that Congress intended to preempt such state laws; and (2) that it had the constitutional authority to do so. As to congressional intent, the legislative history is ambiguous. Moreover, even if it could be shown that Congress did intend to preempt state law by conferring corporate powers on state-chartered associations to offer NOW accounts, there is substantial doubt whether it has the constitutional authority to do so.¹¹

It is possible that this issue could be tested in the courts in the near future. For example, a recent decision by the Supreme Court of Wisconsin, reversing the decision of an intermediate court of appeals, held that a non-interest-bearing NOW account service offered by a state-chartered association in Milwaukee since 1976 was illegal because it was inconsistent with the provisions of an applicable state statute governing withdrawals from savings accounts.¹² In all probability, state-chartered associations in Wisconsin will, nevertheless, continue to claim the authority to offer NOW accounts on the basis that Section 1832(a) preempts the state statute as interpreted by the Supreme Court of Wisconsin. Whether these associations will be forced to seek remedial legislation in order to obtain parity with federal associations in offering NOW accounts, however, remains to be seen.

¹⁰ See reference to state enabling laws cited in note 5, *supra*.

¹¹ See W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS*, § 2477 (rev. perm. ed. 1979). According to Fletcher, a corporation obtains its powers from the same source as its existence. Because state-chartered savings and loan associations have traditionally looked to state law to determine the extent and scope of their corporate powers, it is generally held that Congress does not have the ability to either confer or enlarge these powers. As authority for this principle Fletcher cites *Hopkins Federal Sav. and Loan v. Cleary*, 296 U.S. 315 (1935), in which the United States Supreme Court held that a provision of the Home Owners' Loan Act which purported to authorize state-chartered associations to convert to federal charters without permission of the state violated the residual powers clause given the states under the tenth amendment of the United States Constitution. However, in reaching this decision, the Supreme Court specifically stated that it was not considering whether the federal legislative preemption of Wisconsin law would have been sustained if a question of interstate commerce under the Commerce Clause of the Constitution had been involved. Encouraged by this dictum, proponents of the proposition that § 1832(a) confers NOW account enabling authority upon state-chartered associations, notwithstanding any state law to the contrary, have argued that recent judicial decisions have interpreted the Commerce Clause more expansively than cases decided in the *Hopkins* era. See, e.g., *In re Kings County Lighting Co.*, 72 F. Supp. 765 (E.D. N.Y. 1947), *aff'd sub. nom.*, 166 F.2d 784 (2d Cir., 1948); but compare *West Helena v. Federal Home Loan Bank Board*, 553 F.2d 1175 (8th Cir. 1977).

¹² *Wisconsin Bankers Ass'n, Inc. v. Mutual Sav. and Loan Ass'n of Wisconsin*, 96 Wis. 2d 438, 291 N.W.2d 869 (1980).

IV. NOW ACCOUNT OWNERSHIP RESTRICTIONS

Paragraph 2 of Section 1832(a) has, in effect, adopted the regulatory restrictions regarding the ownership of interest-paying NOW accounts that were applicable in the eight eastern states in which the NOW account experiment initially was authorized.¹³ The statutory language mandates that NOW accounts offered by institutions which rely on Section 1832(a) for their corporate authority must consist solely of funds in which the entire beneficial interest is held by one or more individuals or by a non-profit organization which is being operated for a purpose specified in paragraph (2) of that section. Although this statutory language is reasonably specific, numerous questions have arisen regarding whether various types of organizations, groups, or entities will qualify for NOW account ownership. The implementing regulations in this respect do little more than paraphrase the statutory restrictions.¹⁴ The Federal Reserve Board, however, has issued a press release containing a list of depositors who are either eligible or ineligible to hold NOW accounts and, since member banks of the Federal Reserve Board are subject to the identical ownership restrictions as savings associations and mutual savings banks, its list will also provide guidance to the latter institutions.¹⁵

Questions concerning eligibility for NOW account ownership frequently involve small businesses, fiduciary accounts, and various types of public funds. In determining whether a particular organization or entity is eligible to hold a NOW account, the starting point of analysis necessarily must be the statutory language of Section 1832(a)(2). Failure to do so may breed confusion, especially where one type of organization of questionable eligibility has been compared with another of known eligibility without referring to the specific criteria outlined in the statute.

For example, the statute indicates that only funds in which the entire beneficial interest is held by one or more individuals are eligible for NOW account ownership. This necessarily suggests that a sole proprietorship, in which there is ownership of a business by an individual, is eligible to own a NOW account.¹⁶ The preferred institutional practice for opening such an account would be to have the sole proprietor execute an individual ownership NOW account signature card in his name in order to document the

¹³ See 12 C.F.R. §§ 545.4-1(a)(2), 526.1(1), 526.8 (1980).

¹⁴ See 45 Fed. Reg. 66,783 (1980) (to be codified at 12 C.F.R. § 526.1(1)).

¹⁵ See Appendix A. In addition, the Federal Reserve Board has adopted final regulations to implement the statutory authority to issue NOW accounts and to permit federal associations to extend overdraft privileges to their owners. The preamble to these implementing regulations contains guidelines which should also be useful in determining who may hold a NOW account. 45 Fed. Reg. 66,781 (1980).

¹⁶ The eligibility of a sole proprietor to create a NOW account has been confirmed by the Federal Reserve Board. See Appendix A. For a discussion of the legal nature of a sole proprietorship see C. ROHRlich, ORGANIZING CORPORATE AND OTHER BUSINESS § 2.03 (5th

fact that the account is, indeed, that of a sole proprietor. It also would be permissible, however, to indicate the business name under which the sole proprietor operates and for the NOW draft form to bear the name of the business and its address on its face. In addition, as with other individual accounts, the owner could authorize one or more nonowners to withdraw from the account, in this case, by means of negotiable drafts.

The authority given to sole proprietors to open NOW accounts has led many to believe that any small business, no matter how organized, may own a NOW account. The true test, however, is whether the particular business entity meets the eligibility criteria of the statute and regulations. Thus, when counsel is asked whether a neighborhood grocery business or a small insurance operation may hold a NOW account, the response must include these questions: How is it organized? How does it operate? If it is truly a sole proprietorship, then it qualifies. However, if it is incorporated, then it is not eligible to own a NOW account no matter how small the business. The reason is that it no longer constitutes "one or more individuals" and, as such, does not qualify under the NOW account eligibility criteria for organizations set forth in Section 1832(a)(2).

For similar reasons, the Federal Reserve Board has determined that a partnership is not eligible to own a NOW account since it is a profit organization and is disqualified by the language of Section 1832(a)(2) which expressly permits only non-profit organizations, operated primarily for purposes specified, to hold NOW accounts.¹⁷

Trust and other fiduciary accounts have also been the source of NOW account eligibility questions. Again, statutory language prescribing the eligibility criteria is decisive since it provides that NOW accounts may be used to accommodate only those funds which involve an entire "beneficial interest" held by one or more individuals or one of specified various types of non-profit organizations. This terminology clearly appears to envision NOW accounts held by trustees and other fiduciaries; however, it is clear that the beneficial interest in the funds invested by the fiduciary must belong *exclusively* to one or more individuals or qualifying organizations. For example, a revocable trust account for individual beneficiaries as well as a profit-making organization acting as a trustee or fiduciary for an individual or eligible entity would be qualified to hold a NOW account. On the other hand, any portion of funds which are beneficially held by an ineligible entity or organization will not qualify for NOW account ownership. Thus, for example, an attorney's fiduciary account for client funds would be disqualified if any of the funds were beneficially held by organizations not meeting the eligibility criteria of Section 1832(a)(2).

¹⁷ The ineligibility of a partnership to create a NOW account has been confirmed by the Federal Reserve Board. See Appendix A.

Although it has been suggested (perhaps facetiously) that funds held by public or governmental units should qualify to hold NOW accounts on the ground that the government is a non-profit charitable organization, the Federal Reserve Board has taken the position that governmental units are ineligible because they "are not organizations operated primarily for a qualifying purpose."¹⁸ On the other hand, it has been found that "independent governmental entities that are separately constituted, such as school districts, most State university systems, and local housing and development authorities, are eligible to hold NOW accounts since they are operated primarily for a qualifying purpose."¹⁹ The final implementing regulations of the Federal Home Loan Bank Board, the Federal Reserve Board, and the Federal Deposit Insurance Corporation, however, have given the statutory term "qualifying purpose" a broad interpretation. In addition, each agency has added the word "fraternal" to the list in the belief that its omission from the language of the statute was unintentional,²⁰ and the term "other similar purpose" in Section 1832(a) has been interpreted by these agencies to include social clubs (such as luncheon clubs), recreational clubs (such as golf and tennis clubs), professional and trade associations (such as bar and medical associations, chambers of commerce, and industry associations), civic groups (such as Rotary and Kiwanis), labor unions, pension funds, volunteer fire companies, and cemetery associations.²¹

V. SAVINGS ASSOCIATIONS AND ATS ACCOUNTS

Because of ownership restrictions, a number of inquiries have been made regarding whether it would be permissible for a savings association to permit the principal stockholder of a small incorporated business to establish an automatic transfer (ATS) account by opening a NOW account in the individual name of the principal stockholder and to link it to a regular passbook account bearing the name of the corporation. Under the deposit contract between the association and the depositor, presentment of a NOW draft to the association for payment from the individual's NOW account would trigger a transfer from the corporate passbook account in an amount sufficient to pay the draft.

Although the form of such an arrangement appears to be within the permissible limits of applicable law and regulations, its validity might be challenged on two grounds: (1) that it is the practical equivalent of a corporate NOW account and, as a result, is invalid as an attempt to circumvent applicable ownership restrictions; and (2) that savings and loan associations lack the corporate authority to offer ATS accounts be-

¹⁸ See Appendix A.

¹⁹ *Id.*

²⁰ See, e.g., 45 Fed. Reg. 66,783 (1980) (to be codified at 12 C.F.R. § 526.1(1)) which applies to all member institutions.

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²¹ See 45 Fed. Reg. 66,781 (1980).

cause such accounts are not included within the statutory enabling authority which establish their validity for Federal Reserve-member banks and FDIC-insured non-member banks.²² Each of these challenges, however, can be disputed. First, since Congress expressly recognized the separate identities of ATS and NOW accounts by adopting individual statutory enabling authority for each of these fund transfer services²³ the claim that a business, by utilizing an ATS account, is merely engaging in the substantive equivalent of a NOW account should fail.

In response to the second challenge, savings and loan associations could argue that they need no express statutory enabling authority to offer ATS accounts; rather, they could maintain that their implied power to offer such accounts stems from an express corporate power to offer both passbook accounts to all types of depositors and NOW accounts to those persons who meet any applicable eligibility ownership requirements.²⁴ In addition, it could be asserted that the only reason Federal Reserve-member banks and FDIC-insured non-member banks needed express enabling authority to validate ATS services was because such services had previously been ruled invalid as a violation of two statutes; however, this finding was made applicable to banks rather than savings and loan associations.²⁵

Although savings associations have strong grounds for claiming the ability to offer ATS accounts, there might be some questions regarding the propriety of their doing so in those circumstances where corporate funds are automatically funneled through an individual account of an officer of the corporation. While this problem could be ameliorated in a single owner corporation if a corporate resolution specifically authorizing the arrangement

²² Pub. L. No. 96-221, title III § 302, 94 Stat. 143 (1980).

²³ Pub. L. No. 96-221, title III, §§ 302, 303, 94 Stat. 143 (1980).

²⁴ As discussed subsequently in this article, state-chartered associations which possess the corporate authority under state law to offer NOW accounts without restrictions as to ownership are neither subject to the ownership restrictions of § 1832(a) nor to any federal regulatory ownership restrictions with respect to non-interest-bearing NOW accounts. They are, however, exposed to ownership restrictions regarding interest-bearing NOW accounts by virtue of 12 C.F.R. § 526.1(1) (45 Fed. Reg. 66,783 (1980)).

²⁵ See United States League of Sav. Assn's. v. Board of Governors of the Federal Reserve System, 463 F. Supp. 342 (D.C. D.C. 1979). The statutes in question are 12 U.S.C. §§ 371(a) and 1828(g) which prohibit Federal Reserve-member and FDIC-insured non-member banks, respectively, from paying interest on demand accounts. The court held that the ATS service authorized by the Federal Reserve Bank and the Federal Deposit Insurance Corporation regulations was an indirect device for paying interest on checking accounts and, thus, violated these sections. In this respect, it is significant to note that when Congress subsequently acted to validate the ATS programs which the banks had been offering, it did so by amending these two statutes to expressly exclude such programs from its prohibitions. The court also found that the ATS services violated 12 U.S.C. § 1832(a) which, until the federal nationwide enabling legislation for NOW accounts was adopted, prohibited depository institutions in states outside of New England, New York, and New Jersey from permitting withdrawals by negotiable order for any interest-bearing accounts. Since this prohibition was repealed when § 1832(a) was rewritten to authorize nationwide NOW accounts, effective December 31, 1980, there is no legal impediment from this source. There is no reason, of course, for the amendments to expressly mention savings and loan associations because the statutory prohibitions were not applicable to them.

was given to the association, it would be more difficult to justify in the case of a corporation having more than one stockholder.

The issue whether savings associations may offer automatic transfer accounts may have even more significance in the case of state-chartered associations. As discussed in the next section, many of these associations are not subject to ownership restrictions with respect to non-interest-bearing NOW accounts (NINOWS). Accordingly, if such a state-chartered association possessed the corporate authority to offer ATS accounts, either by virtue of an express or implied corporate power under the rationale discussed previously, it could logically claim the right to offer corporations and partnerships the practical equivalent of a 5¼ % checking account by establishing an ATS account in the form of a 5¼ % passbook account in the corporate name and linking it to a zero balance NINOW.^{25a}

VI. NON-INTEREST-BEARING NOW ACCOUNTS (NINOWS)

Closely related to the matter of NOW account ownership eligibility is the question whether savings and loan associations may offer non-interest-bearing NOW accounts (NINOWs) to their customers. In the case of federal and state-chartered institutions which derive their corporate authority to offer NOW accounts through Section 1832(a),²⁶ the Federal Home Loan Bank Board (FHLBB) did not authorize these institutions to offer non-interest-bearing NOW accounts. The reason given was that the statute expressly provides that NOW account authority applies only to accounts "on which interest or dividends are paid."²⁷

The final implementing regulations, however, do permit federal associations to offer the practical equivalent of a NINOW account by either paying a very low rate of interest or by establishing a very high NOW account minimum balance below which interest will not be paid.²⁸ While

^{25a} As this article goes to press we have received a copy of an opinion from the Office of General Counsel of the Federal Home Loan Bank Board. It states, in effect, that state-chartered associations are prohibited by Section 1832(2) (as amended effective December 31, 1980) from offering ATS accounts to a for-profit organization. The rationale appears to be that the ownership restrictions contained in paragraph (2) operate in combination with the specific grant of authority in paragraph (1) to depository institutions to ban all interest-bearing checking accounts to for-profit organizations, including those established through an ATS. This same issue is under consideration by the U.S. Court of Appeals for the 10th Circuit which is reviewing a cease and desist order issued by the Bank Board against Otero Savings and Loan Association. It will be interesting to see whether the Court of Appeals accepts the Bank Board's rationale on this issue.

²⁶ A state-chartered savings and loan association might derive its corporate authority to offer NOW accounts from § 1832(a) through a so-called state "tie-in" statute. For a state-by-state survey of such statutes, see Pfeiler, *Blueprint for Nationwide NOW Accounts*, 46 LEGAL BULL. 101, 110-11 (1980).

²⁷ See preamble to final federal association implementing regulations, 45 Fed. Reg. 66,781 (1980).

²⁸ In its preamble to the final implementing regulations, 45 Fed. Reg. 66,781 (1980), the FHLBB determined that the rate set by the Depository Institutions Deregulation Committee (DDIC) for NOW accounts is a maximum rate so that a very low interest rate may be

this is useful, it does not give federal savings and loan associations competitive parity with commercial bank checking account powers by permitting such associations to offer direct NINOW accounts to business corporations. State-chartered associations in some states, on the other hand, are in a more favorable position in this regard. For example, in Illinois these associations have been authorized to issue NINOWs since January 1, 1976,²⁹ and since regulatory NOW account ownership restrictions then in effect applied only to interest bearing NOW accounts,³⁰ such associations have been authorized to offer NINOWs to all types of depositors.

Does the new version of Section 1832(a), however, place ownership restrictions on NINOWs? As previously noted, this section applies only to accounts on which interest or dividends are paid. Accordingly, the ownership restrictions contained in paragraph 2 of Section 1832(a) do not apply to state-chartered associations which otherwise possess the authority to offer NOW accounts without restriction as to ownership. Similarly, the only federal regulatory ownership restrictions applicable to NOW accounts offered by state-chartered associations are those contained in the FHLBB's final rate control regulations, and these only apply to NOW accounts on which interest is paid.³¹ It follows that a state-chartered association which has the corporate authority to offer non-interest-bearing NOW accounts without restriction as to ownership may continue to offer such accounts to all types of depositors: individual, corporate, or otherwise. Such associations, however, will be subject to the same ownership restrictions as federal entities with respect to interest-bearing NOW accounts by virtue of the rate control regulations noted previously.

VII. CASHIER'S CHECKS

When the proposed NOW account regulations for federal associations were opened for comment by the FHLBB, numerous questions were re-

paid on such accounts; it also reported that the final regulations amended 12 C.F.R. § 545.3(g) (1980) which had placed a fifty dollar limitation on the amount of the minimum balance that federal associations are permitted to establish for regular savings accounts. The amendment excludes NOW accounts from the dollar limitation altogether, thus permitting associations to establish any minimum balance for NOW accounts and to refrain from paying interest on these accounts when the balance falls below the minimum balance so established.

²⁹ Illinois Savings and Loan Act, ILL. ANN. STAT. ch. 32, § 709(a) (Smith-Hurd 1970). Section 709(a) expressly permits the Commissioner of Savings and Loans to issue regulations "authorizing the establishment of negotiable order of withdrawal accounts." See also Rules and Regulations, Office of the Savings and Loan Commissioner, Art. VIII, §§ 1-7 (January 1, 1976); although these regulations do not prohibit interest on NOW accounts by Illinois-chartered associations, they were issued on a non-interest-paying basis in order to comply with the prohibition in the original version of 12 U.S.C. § 1832(a). Now that this prohibition has been replaced by Pub. Law No. 96-221, effective December 31, 1980, such associations may issue interest-paying NOW and NINOW accounts pursuant to the Commissioner's regulations.

³⁰ See 12 C.F.R. §§ 545.4-1(a)(2), 526.1(1) and 526.8 (1980).

³¹ See 45 Fed. Reg. 66,783 (1980) (to be codified at 12 C.F.R. § 526.1(1)).

ceived regarding whether federal associations were given authorization to offer NOW accounts on their own behalf.³² This question was apparently motivated by the desire of such institutions to issue cashier's checks to their customers in the same manner as commercial banks. In its preamble to the final regulations,³³ the FHLBB indicated that savings associations were not authorized to open NOW accounts for this purpose because such associations do not qualify for NOW account ownership under the eligibility criteria set forth in Section 1832(a)(2). Although the ruling of the FHLBB on this point undoubtedly is correct, it does not preclude such associations from issuing cashier's checks since their authority to do so does not depend upon their legal ability to open either checking or NOW accounts. Rather, in accordance with judicial decisions which have considered the legal incidents of cashier's checks³⁴ most, if not all, savings associations possess the implied corporate authority to permit their issuance. In the absence of an express prohibition to the contrary in the form of a statute, regulation, charter, or bylaw, all corporations, including savings and loan associations, possess the implied power to do whatever is necessary or reasonably appropriate in furtherance of their express corporate powers.³⁵ This general principle of corporate common law is incorporated into paragraph 3 of corporate Charters N and K (rev.) for federal savings associations:

In addition to the foregoing powers expressly enumerated, this association shall have the power to do all things reasonably incident to the accomplishment of its express objectives and the performance of its express powers. . . .³⁶

The transfer of funds is an essential ingredient in virtually every type of transaction in which a savings association is expressly authorized to engage. Since the issuance of cashier's checks provides a more efficient means of furthering authorized transactions than the drawing of checks or money orders on other institutions, there should be no question that both federal and state-chartered savings associations, unless otherwise expressly prohibited, possess the implied corporate power to issue cashier's checks.³⁷

³² 45 Fed. Reg. 46,431 (1980), containing the proposed regulations, requested submission of comments on the proposal by September 6, 1980.

³³ See 45 Fed. Reg. 66,781 (1980).

³⁴ *Kaufman v. Chase Manhattan Bank, Nat'l Ass'n*, 370 F. Supp. 276 (D.C. N.Y. 1973) (a cashier's check is a draft or bill of exchange which is drawn by a bank upon itself, payable to another person, and accepted by the act of issuance; since the bank is both the drawer and the drawee, the draft is a promise by the bank to draw the amount thereof from its own resources and to pay it on demand); *TPO v. Federal Deposit Ins. Corp.*, 487 F.2d 131 (C.A. N.J. 1973) (a cashier's check is equivalent to a negotiable promissory note of a bank).

³⁵ See W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* §§ 2485-2487 (rev. perm. ed. 1979).

³⁶ 12 C.F.R. § 544.1 (1980).

³⁷ This interpretation is consistent with a similar position taken by the National Credit Union Administration to the effect that, while a federal credit union may not establish its own share draft account, it may offer the functional equivalent of a cashier's check by drawing a draft upon itself. See 45 Fed. Reg. 75,172 (1980).

This is accomplished by drawing the draft upon itself so that it is contractually obligated in its corporate capacity to pay the amount thereof on demand. As an operational matter, a cashier's check containing the routing and transit number of the issuing association can be cleared in a manner similar to other items. When issued to a savings account customer in payment of a withdrawal, for example, the appropriate customer account would be debited and a subsidiary account to a general ledger account descriptive of "cashier's checks payable" would be credited. When the cashier's check is presented to the association for payment, the subsidiary account would be debited and cash or the appropriate customer account would, accordingly, be credited.

VIII. ADVERTISING AND PROMOTION OF NOW ACCOUNTS

A. *Federal Agency Guidelines*

On September 30, 1980 the Federal Home Loan Bank Board adopted a policy statement regarding the advertising of NOW accounts which had been issued September 12, 1980 by the Federal Financial Institutions Examination Committee.³⁸ While the policy statement deals primarily with the advertising of such accounts prior to the December 31, 1980 effective date of the enabling authority, it also contains guidelines for the advertising of NOW accounts on and after that date. Institutions under the jurisdiction of the FHLBB were reminded that they must adhere to the advertising requirements applicable to all interest or dividend earning programs when marketing their NOW accounts.³⁹ In addition, they were specifically forewarned that if a specific rate of interest (or dividends) to be paid on a NOW account is advertised, such advertisement must comply with the provisions of the FHLBB's requirements regarding the advertising of interest on deposits, and that any conditions or charges imposed on such accounts should be disclosed in the advertisement or promotional material.⁴⁰ The policy statement promulgated by the FHLBB also requires institutions to inform their customers "not later than the time a NOW account is opened, or an existing account is converted to a NOW account, of the method that will be used in computing and paying interest, including conditions that must be satisfied to earn a stated return and charges that may be assessed against the account."⁴¹

This latter requirement may be satisfied by giving each NOW account customer a copy of the rules of classification applicable to their particular account at the time it is opened.

³⁸ See Appendix A, attachment B. See also 45 Fed. Reg. 66,870 (1980).

³⁹ *I.e.*, 12 C.F.R. §§ 526.6, 563.27 (1980).

⁴⁰ 45 Fed. Reg. 66,871 (1980).

B. *Interest-Bearing Checking Accounts*

Because of the functional similarity between NOW accounts and checking accounts, a great number of financial institutions are advertising the former as interest-paying checking accounts. While this practice was not permitted savings associations during the so-called New England experiment,⁴² a recent letter ruling by the FHLBB Office of General Counsel, prepared as a result of consultation with other banking agencies, has approved the practice on the basis that the official title of the Act authorizing nationwide NOW accounts is "The Consumer Checking Account Equity Act of 1980."⁴³ Consequently, it appears that banking agencies are willing to eliminate various technical legal distinctions in order to permit NOW accounts to be advertised as financial writers and the public perceive them: as interest-bearing checking accounts.

C. *Give-away or Premium Promotions*

NOW accounts are also subject to extensive regulation in connection with the use of such promotional devices as premiums as a means of attracting savings deposits.⁴⁴ At the present time, the primary limitations on the use of such devices by savings associations are imposed under the rate control regulations of the Depository Institutions Deregulation Committee (DIDC).⁴⁵ Applicable to all depository institutions, the rate control regulations impose various maximum interest rate limits on different classes of deposits and require that the value of all covered premiums be counted as interest

⁴² A March 3, 1976 letter opinion of the Federal Home Loan Bank of Boston issued to all member institutions prohibited the practice because of technical legal distinctions between checking accounts as demand accounts and NOW accounts as non-demand accounts. For a detailed discussion of these distinctions, see Pfeiler, *Blueprint for Nationwide NOW Accounts*, 46 LEGAL BULL., 101, 112-14.

⁴³ Pub. L. No. 96-221, title III § 303, 94 Stat. 143 (1980).

⁴⁴ For many years, the Federal Savings and Loan Insurance Corporation [FSLIC] has imposed regulatory restrictions upon FSLIC-insured institutions with respect to promotional devices used to attract savings deposits. While FSLIC regulations still impose restrictions in this area, see, e.g. 12 C.F.R. § 563.24 (1980), the primary limitations on such devices are now imposed through regulations which limit the rates of interest which depository institutions are permitted to pay on various classes of deposits. Prior to the enactment and regulatory implementation of the Depository Institutions Deregulation Act of 1980, Pub. L. No. 96-221, title II, § 202, 94 Stat. 142 (1980), rate control limitations for savings and loan association deposits were imposed by the FHLBB in 12 C.F.R. §§ 526.1, 526.2 (1980). These regulations continue in effect today, but as more fully explained in note 45, *infra*, they must be read in conjunction with similar regulations issued by the DIDC.

⁴⁵ Under the provisions of the Depository Institutions Deregulation Act of 1980, Pub. L. No. 96-221, title II, § 203, 94 Stat. 142 (1980), the authority to prescribe rules and rate ceilings governing the payment of interest on savings deposits was transferred from various federal banking agencies (including the FHLBB) to a newly created DIDC made up of representatives from the Federal Reserve Board, Federal Deposit Insurance Corporation, the Secretary of the Treasury, National Credit Union Administration Board and the FHLBB, each of which was given a vote in the deliberations of the committee. The Comptroller of the Currency was named a non-voting member of the DIDC. The DIDC has been authorized to phase-out and eliminate maximum rates of interest payable on deposits over a six-year period ending March 31, 1986. In the meantime, existing rate control regulations of the various federal banking agencies apparently are superseded by the DIDC regulations to the extent that they are inconsistent therewith.

in determining compliance with rate limits.⁴⁶ The regulations also provide, however, that the value of cash or premiums, whether in the form of merchandise, credit, or cash, which are given by a depository institution to a depositor, may be regarded as an advertising or promotional expense rather than a payment of interest *if*:

- (1) the premium is given to a depositor only at the time of the opening of a new account or an addition to, or renewal of, an existing account;
- (2) no more than two premiums per account are given within a 12-month period; and
- (3) the value of the premium or, in the case of articles of merchandise, the total cost (including shipping, warehousing, packaging, and costs) does not exceed \$10 for deposits of less than \$5,000 or \$20 for deposits of \$5,000 or more. . . .⁴⁷

Further concerning the promotion of NOW accounts, the question has arisen regarding the propriety of allowing a savings association to open a NOW account in a small amount, such as ten dollars, in the name of the borrower for every home mortgage loan originated by the association. In the opinion of this writer, such a practice is permissible as a legitimate cross-selling activity, and the ten dollars would not have to be counted as part of the interest rate on the NOW account since the rate control regulation, described previously, applies only to premiums which are given by a depository institution to a depositor. In the instant example, the ten dollar NOW account is given by the institution to its borrower and not to a depositor because the deposit relationship does not exist between the institution and the new borrower until after the ten dollar NOW account has been opened in the latter's name. This interpretation is consistent with the substance of a long-standing FHLBB general counsel opinion construing the related third party promotional prohibition applicable to all institutions insured by the Federal Savings and Loan Insurance Corporation.⁴⁸ That opinion holds that a mortgage banker's action in opening a savings account in an insured association in the name of the borrower for every home loan purchased from the mortgage banker by the association does not constitute a promotional device within the meaning of 12 C.F.R. § 563.24 because it is not given for the opening of an account but, rather, for the purchase of a mortgage by the insured association.⁴⁹

⁴⁶ Depository Institutions Deregulation Act of 1980, Pub. L. No. 96-221, title II, § 202, 94 Stat. 142 (1980).

⁴⁷ See Fed. Reg. 68,643 (1980) (to be codified at 12 C.F.R. § 1204.109). This regulation also provides that averaging the price of various premiums will not be permitted and that depository institutions will be required to certify that the total cost of a premium does not exceed the \$10/\$20 limitation. A form for the required certification is also prescribed.

⁴⁸ See 12 C.F.R. § 563.24 (1980).

⁴⁹ See PRATHER, SAVINGS ACCOUNTS 694 (5th ed. 1974). Although the opinion cited in Prather's textbook deals with the third party give-away prohibition in 12 C.F.R. § 563.24,

IX. IMPLEMENTING FEDERAL REGULATIONS

No discussion of current legal issues in this area would be complete without enumerating some of the more significant federal regulations that have been issued by various federal banking agencies with respect to NOW accounts. Although some of these have already been discussed in the context of specific legal issues, the remainder deserve to be noted, if not discussed, in detail.⁵⁰

A. *Interest Ceilings on "Transaction Accounts"*

As indicated earlier, the statutory responsibility for imposing interest rate ceilings on savings deposits was transferred early in 1980 from the various federal banking agencies to the newly formed DIDC.⁵¹ An important policy issue facing the Committee was what maximum rate ceilings should be established for interest-bearing transaction accounts of various types. For example, ATS accounts had been subject to the 5¼ % ceiling applicable to regular passbook accounts, thus enabling commercial banks to offer their eligible customers the practical equivalent of an interest-paying checking account at that rate. Since the rate ceiling on NOW accounts

its reasoning appears to apply with equal force to the give-away limitations currently contained in 12 C.F.R. § 526.2(f) (1980). The latter regulation, which incorporates the same limitations on premiums imposed by the DIDC in 12 C.F.R. § 1204.109 (45 Fed. Reg. 68,643 (1980)), defines the term 'give-away' as "[a]ny premium given by a member to induce new savings accounts or additions to existing ones." 12 C.F.R. § 526.1(i) (1980). Thus, a premium given by a member institution, other than for the purpose of inducing new savings accounts or additions to existing ones (such as a gift to a new borrower), does not constitute such a promotional device.

⁵⁰ Effective July 10, 1980, the Federal Home Loan Bank Board issued final amendatory regulations to implement the authority of federally-chartered associations to engage in credit card operations. See 45 Fed. Reg. 46,338 (1980) (to be codified in 12 C.F.R. § 545.4-3). In addition, the Board amended 12 C.F.R. §§ 545.9-1 & 545.5-1, effective the same date, to permit subsidiaries of federal associations to engage in credit card operations, and to remove regulatory restrictions regarding nationwide NOW accounts. Credit card loans, of course, are one means of offering NOW account overdraft credit.

Effective September 18, 1980, the FHLBB issued regulations to: (1) authorize the Federal Home Loan Banks to participate in the collecting, processing, and settlement of payment instruments drawn on or issued by their members or eligible institutions; (2) authorize necessary services incidental thereto; and (3) establish principles for the pricing of Federal Home Loan Bank services. See 45 Fed. Reg. 64,161 (1980) (to be codified in 12 C.F.R. §§ 534.1-534.7). The regulations implement the statutory authority conferred by Pub. Law No. 96-221, title III, § 311 (1980).

Effective November 13, 1980, the Federal Reserve Board revised Regulation D, 12 C.F.R. § 204, to implement the Monetary Control Act, Pub. Law No. 96-221, title I, § 101, 94 Stat. 132 (1980), which imposed new uniform reserve requirements upon depository institutions including, for the first time, savings and loan associations which offer transaction accounts or nonpersonal time deposits. Net transaction account balances held by associations are reservable at a rate of 3% for the first \$25 million in balances and 12% for balances above that amount. This primarily applies to NOW accounts, telephone bill-payment accounts and ATS accounts. An eight-year phase in is allowed for institutions that were allowed by federal statute to offer such accounts prior to April 1, 1980. Likewise, nonpersonal savings deposits are reservable at a rate of 3%, with an eight year phase-in permitted. In general, a nonpersonal deposit is one that is held by a person or entity other than an individual or a deposit that is transferrable to another person or entity. 45 Fed. Reg. 73,013 (1980).

⁵¹ See note 45, *supra*, and related text.

during the experimental period was 5%, the DIDC had to decide how to eliminate the disparate treatment between the ceiling rates on ATS and NOW accounts.⁵²

By resolution dated September 9, 1980, the DIDC made public its determination that, effective December 31, 1980, ATS accounts and NOW accounts would be subject to the same 5¼% rate ceiling.⁵³

B. Federal Association Regulations

Besides the specific provisions already discussed, the final implementing regulations for federal association NOW accounts contain several provisions which merit comment.⁵⁴ The proposed regulations, for example, would have expressly exempted NOW accounts from regulatory provisions which prohibit associations from advertising that they will pay holders of their securities "on demand"; in addition, the proposals would also have eliminated NOW accounts from the 30-day notice period which may be invoked by federal associations pursuant to Section 5(b)(1) of the Home Owners' Loan Act of 1933 before paying withdrawals on savings accounts.⁵⁵ In the final regulations, however, the FHLBB decided not to exempt NOW accounts from the 30-day notice provisions, and also withdrew its proposed amendment to 12 C.F.R. § 563.6 which would have permitted NOW accounts to be characterized as "demand securities."⁵⁶ In making these changes, the FHLBB explained that Congress specifically recognized that the 30-day notice is generally not required in practice and that this policy is not expected to change.⁵⁷ The significance of this action is to preserve the technical legal distinctions between NOW accounts as savings accounts on the one hand, and checking accounts as demand accounts on the other. The fact

⁵² Although Public Law 96-221 does not specifically provide that there be no rate differential between these two types of transaction accounts, the Conference Report accompanying that legislation states that the DIDC is expected to "provide competitive equality between ATS and NOW accounts." H.R. REP. No. 842, 96th Cong., 2d. Sess. 74 (1980).

⁵³ Although the DIDC resolution apparently was not published in the Federal Register, it is mentioned in the FHLBB's preamble to the final NOW account regulations for federal associations; see 45 Fed. Reg. 66781 (1980). On October 9, 1980, the DIDC formalized by regulation the 5¼% rate ceiling for NOW accounts. 45 Fed. Reg. 68,644 (1980) (to be codified at 12 C.F.R. § 1204.108). The preamble to that regulation makes it clear that the ceiling rates of interest payable on all other types of transaction accounts (including savings accounts subject to automatic transfers, telephone transfers, pre-authorized non-negotiable transfers and savings accounts accessible by automated teller machine, remote service unit or other electronic devices) were not affected by the DIDC's action. The practical effect of this was to leave ATS accounts at Federal Reserve-member and FDIC-insured banks subject to the applicable ceiling on passbook accounts, viz., 5¼%. See 45 Fed. Reg. 68,640 (1980) (to be codified at C.F.R. § 1204.112). If savings and loan associations were to offer ATS accounts as discussed earlier, 12 C.F.R. § 526.3(9) (1980) would limit such accounts to a maximum rate of 5¼%.

⁵⁴ 45 Fed. Reg. 66,781 (1980) lists these various regulations together with an explanatory preamble.

⁵⁵ See 12 U.S.C. § 1464(b)(1) (1976).

⁵⁶ 45 Fed. Reg. 66,781 (1980).

⁵⁷ *Id.*

that NOW accounts are not demand accounts as a technical matter, however, is not expected to cause any practical problems with respect to how these accounts function.⁵⁸

Several revisions were also made to existing federal association regulations in order to provide operational flexibility for NOW accounts. The FHLBB, for example, amended a regulation to exempt NOW accounts from the general requirement applicable to other savings accounts that passbook or certificates be issued as evidence of ownership.⁵⁹ This amendment is in conformity with current practices of banks and other institutions which issue draft-type instrument accounts. Federal association regulations governing the distribution of earnings were also liberalized to permit federal associations to distribute earnings in regular cycles ending on any day of the month, as long as the cycle is regular and on a monthly, quarterly, or semi-annual basis. Made applicable to all savings accounts, the revision will permit federal associations to spread out their NOW account work by selecting different statement periods for different classes of depositors.⁶⁰

In issuing its final regulations regarding the authority of federal associations to offer NOW account overdraft protection, the FHLBB acknowledged two sources of overdraft credit: (1) direct "NOW account loans,"⁶¹ and (2) the use of the federal associations' new credit card authority.⁶² In a related provision, the FHLBB also amended its conflict-of-interest regulations to require board of directors' approval of overdraft credit loans to affiliated persons only at the time the original line of overdraft credit is extended or increased, rather than for each overdraft loan itself.⁶³

The final regulations also authorize federal associations to "charge a fee for making any payment or transfer or for maintaining a NOW account."⁶⁴ For example, federal associations would be permitted to charge depositors fees for handling NOW drafts on insufficient funds.

⁵⁸ For a detailed analysis which concludes that a NOW draft can be negotiable despite the fact that it is drawn on a non-demand savings deposit with respect to which thirty days notice prior to payment legally can be required, see Pfeiler, *NOW Accounts: A Legal Prognosis*, 42 LEGAL BULL. 149, 155-60 (1980). The basic rationale is that the uniform Commercial Code requires only that the instrument itself be written as a demand order. See also *Consumer Sav. Bank v. Comm'r of Banks*, 361 Mass. 717, 282 N.E.2d 416 (1972); but see *Pennsylvania Bankers Ass'n v. Secretary of Banking*, 481 Pa. 332, 392 A.2d 1319 (1978).

⁵⁹ 45 Fed. Reg. 66,783 (1980) (to be codified at 12 C.F.R. § 545.2(b)).

⁶⁰ 45 Fed. Reg. 66,783 (1980) (to be codified at 12 C.F.R. § 545.3(a)).

⁶¹ 45 Fed. Reg. 66,782 (1980).

⁶² *Id.* Credit card authority is given in 45 Fed. Reg. 46,338 (1980) (to be codified at 12 C.F.R. § 545.4-3).

⁶³ 45 Fed. Reg. 66,784 (1980) (to be codified at 12 C.F.R. § 545.4-3).

⁶⁴ 45 Fed. Reg. 66,783 (1980) (to be codified at 12 C.F.R. § 545.4-1(c)); see also the related exemption from the limitations on service charges for savings accounts in 12 C.F.R. § 545.1(c) (1980).

C. *Applicability of Regulation J, Clearing House Rules, and State Law*

A significant provision of the proposed regulations would have provided that applicable Federal Reserve regulations and operating letters, clearing house rules, and Uniform Commercial Code provisions govern the handling of negotiable orders of withdrawal. This provision, however, was not included in the final regulations. In explaining this action, the FHLBB stated its belief that NOW drafts should be treated as checks for the purposes of those provisions, and that it was not necessary to provide by regulation that federal and state law govern the rights and obligations of associations in offering NOW accounts.⁶⁵ While the FHLBB is probably correct, it is interesting to note that it *did* incorporate the provisions of the Uniform Commercial Code in its final regulations governing the rights, powers, responsibilities, duties and liabilities of the Federal Home Loan Banks in carrying out their functions in connection with the collection, processing and settlement of NOW drafts. Attorneys who are concerned about the possibility that NOW drafts might not be treated as checks for these purposes might wish to consider incorporating the appropriate provision by reference in their NOW account contractual documents.

X. CONCLUSION

The foregoing discussion has exposed and examined some of the more common legal questions that currently are being asked by operating personnel of savings institutions which, for the first time, are offering a new type of interest-paying transaction account to their customers. As the competition for NOW accounts intensifies and transaction volume increases, additional legal questions regarding the rights, duties, and liabilities of the parties engaged in these transactions will undoubtedly arise. The substantial body of case law precedent that exists in the checking account field should provide helpful guidance in this connection. Technical legal differences, however, exist to differentiate NOW accounts from checking accounts and even from other NOW accounts. These differences, together with operational innovations and different methods of packaging, marketing and delivering these services, can be expected to present novel questions for the attorney whose savings and loan association client is committed to maximizing its share of the NOW account market.

⁶⁵ See 45 Fed. Reg. 64,164 (1980).

APPENDIX A, FEDERAL RESERVE PRESS RELEASE,
OCTOBER 20, 1980

Summary of Depositors Eligible to Hold NOW Accounts at Member Banks

Title III of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221) ("Act") authorizes depository institutions (except credit unions) nationwide effective December 31, 1980, . . . to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties (section 303 of Title III of P.L. 96-221; 12 U.S.C. § 1832(a)(1)) ("NOW accounts").¹

Section 303 of the Act also provides that a NOW account must consist:

. . . solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit. (Section 303(b) of Title III of P.L. 96-221; 12 U.S.C. § 1832(a)(2)).

Under Title II of the Act, the Depository Institutions Deregulation Committee ("DIDC") is authorized to establish an interest rate ceiling on NOW accounts that is applicable to all depository institutions authorized to offer such accounts. The DIDC has adopted a ceiling of 5¼ per cent on NOW accounts at all depository institutions effective December 31, 1980.² Since the definitional authority of the Board under section 19 of the Federal Reserve Act was not transferred to the DIDC, the Board retains the authority to rule on questions concerning the types of depositors eligible to maintain NOW accounts at member banks. The Federal Deposit Insurance Corporation and Federal Home Loan Bank Board retain similar authority for institutions subject to their jurisdiction.

Under the statute, NOW accounts are available only to individuals and to qualifying organizations. Qualifying organizations must meet two separate tests of eligibility. First, they must be operated primarily for "religious, philanthropic, charitable, educational, or other similar purposes;" second, they must not be operated for profit. This test is almost identical to the class of entities currently eligible under Regulation Q to maintain a NOW account in New England, New York and New Jersey. Regulation Q permits fraternal organizations to maintain NOW accounts; however, the statute omits fraternal organizations from the list of eligible NOW depositors. Since the

¹ NOW accounts are currently permitted to be offered by depository institutions located in New England, New York, and New Jersey only.

² 12 C.F.R. § 1204.108. The current ceiling of 5 per cent applicable to NOW accounts offered by member banks in New England, New York, and New Jersey will remain in effect until December 31, 1980.

statutory provisions were based on Regulation Q, it is believed that the omission of the term *fraternal* was unintentional and without significance. Accordingly, nonprofit organizations operated primarily for fraternal purposes, such as social and recreational clubs, will be regarded as within the scope of the statute consistent with the intent of Congress as to the type of entities eligible to maintain NOW accounts. Governmental units, even though not operated for profit, generally do not qualify to hold NOW accounts since they are not organizations operated primarily for a qualifying purpose. However, independent governmental entities that are separately constituted, such as school districts, most State university systems, and local housing and redevelopment authorities, are eligible to hold NOW accounts since they are operated primarily for a qualifying purpose. In addition, funds held in a fiduciary capacity may be classified as a NOW account so long as an individual (or individuals) or a qualifying organization has the entire beneficial interest in the funds. Thus, a profit-making organization could hold a NOW account as a trustee or other fiduciary for an entity that is qualified to hold a NOW account in its own capacity.

With reference to NOW account eligibility, the Federal Reserve has advised member banks in states where NOW accounts are already available that the class of depositors eligible to hold NOW accounts under the Act is virtually identical to the class of depositors eligible to hold savings deposits without limit (with the exception of governmental units). In this connection, the interpretations and opinions issued with respect to the class of depositors eligible to hold savings accounts without limit are illustrative of the classes of depositors eligible to hold NOW accounts under the Act and Regulation Q. A Board interpretation (§ 3105 of the *Published Interpretations*) regarding specific types of depositors eligible or ineligible to hold savings accounts, and thus NOW accounts, is attached for reference (*Attachment A*). In addition, Federal Reserve staff has made the following determinations specifically regarding NOW account eligibility or ineligibility. Those generally found *eligible* to maintain NOW accounts at member banks include:

individuals

sole proprietors

husband and wife operating unincorporated businesses

local housing authority

residential tenants' security deposits

independent school districts

redevelopment authority

escrow funds (provided entire beneficial interest is held by individuals or qualifying organizations)

labor unions

trust and other fiduciary accounts (provided entire beneficial interest is held by individuals or qualifying organizations)
 pension funds
 trade associations

Those generally found *ineligible* to maintain NOW accounts at member banks include:

realty or real estate investment trusts
 credit unions
 Blue Cross/Blue Shield and similar plans
 military exchanges and purchasing cooperatives
 hospital districts
 State and local governmental units (except those qualifying above)
 partnerships operated for profit
 professional corporations
 business corporations
 trustees in bankruptcy (unless entire beneficial interest in the bankrupt's funds is held by individuals or qualifying organizations)
 political parties or campaign committees

(Staff intends to present to the Board in the near future the issue of whether nonprofit hospitals should be permitted to maintain NOW accounts.)

On September 25, 1980, the Board announced the adoption of a policy statement concerning advertising by member banks of NOW accounts. The policy statement reminds member banks that are currently offering or preparing to offer NOW accounts that all NOW advertisements or solicitations are subject to the advertising requirements contained in section 217.6 of Regulation Q. The policy statement is attached for reference (*Attachment B*). It should be noted that the Federal Reserve does permit member banks to advertise NOW accounts as interest-bearing checking accounts.

Member banks that are offering automatic transfers of funds from savings to checking (ATS accounts) are reminded that such accounts under section 217.5(c)(2) of Regulation Q and section 302(a) of Title III of the Act, are available only to individuals (including sole proprietors) or to accounts in which the entire beneficial interest is held by an individual or individuals. Unlike NOW accounts, ATS accounts are not available to nonprofit organizations operated primarily for religious, philanthropic, charitable, or fraternal purposes. Member banks also are reminded that the advertising guidelines announced for ATS accounts on October 5, 1978, remain in force and should be adhered to in all advertising and promotional materials for ATS accounts. The guidelines generally provide that advertisements should indicate that ATS consists of two separate accounts and that ATS may not be advertised as an interest-bearing checking account. . . . Staff believes that,

it is important to continue to distinguish between ATS and NOWs because reserve requirements on ATS balances are subject to the phase-in provisions of the Monetary Control Act, while NOW account balances outside New England, New York, and New Jersey are immediately subject to full reserve requirements.

ATTACHMENT A

¶ 3105. Deposits of certain organizations.—The definition of savings deposits in Regulation Q, which relates to payment of interest on deposits, and in Regulation D, which relates to reserves of member banks, reads in part as follows:

“The term ‘savings deposit’ means a deposit, evidenced by a pass book, consisting of funds (i) deposited to the credit of one or more individuals, or of a corporation, association or other organization operated primarily for religious, philanthropic, charitable, educational, fraternal or other similar purposes and not operated for profit, or (ii) in which the entire beneficial interest is held by one or more individuals or by such a corporation, association or other organization. . . .”

It will be noted that under this definition member banks may classify deposits of one or more individuals as savings deposits if the deposits comply in other respects with the regulation; but they may not classify deposits of any corporation, association or other organization as savings deposits unless (1) such organization is operated primarily for religious, philanthropic, charitable, educational, fraternal or other similar purposes; (2) such organization is not operated for profit; and (3) such deposits comply in other respects with the requirements of the regulation.

With respect to many organizations such as churches, charity hospital associations, fraternal orders and endowed educational institutions which are not operated for profit, no questions have arisen since such organizations are obviously operated for religious, philanthropic, charitable, educational, fraternal or other similar purposes. However, numerous questions have arisen as to whether deposits of certain other types of organizations which are near the border-line of the definition may be classified by member banks as savings deposits. The Board has given careful study to these questions and has reached the conclusion that the types of organizations set forth below may be considered to be operated primarily for religious, philanthropic, charitable, educational, fraternal or other similar purposes and, therefore, that deposits of such organizations may be classified by member banks as savings deposits if the organizations are not operated for profit and if the deposits otherwise comply with the requirements of the definition.

Professional associations, such as bar, medical, and dentists' associations.

Trade associations, including manufacturers' associations, retailers' associations, and chambers of commerce.

Business men's clubs, such as Rotary Clubs and Kiwanis Clubs.

Recreational clubs, such as golf and tennis clubs.

Social clubs, such as luncheon clubs and college fraternities.

Labor unions of the usual type.

Volunteer fire companies and ladies' auxiliaries thereof.

Cemetery associations.

School districts.

Police or firemen's pension or relief associations (including a special fund held by a political subdivision to provide pensions for police or firemen).

American Automobile Association, Retired Officers Association, and other similar organizations.

The Board has also reached the conclusion that deposits of the organizations listed below may not be classified by member banks as savings deposits either because the organizations are not operated primarily for religious, philanthropic, charitable, educational, fraternal or other similar purposes or because they are operated for profit.

Building and loan associations.

Mutual or cooperative fire or life insurance associations.

Reciprocal or inter-insurance associations.

Cooperative marketing associations, such as citrus growers or dairy-men's cooperative marketing associations.

Credit unions, Federal or State.

States and municipalities and other political subdivisions thereof (except school districts) including departments, boards, and commissions of such political subdivisions.

Although deposits of the types of organizations listed immediately above may not be classified by member banks as savings deposits for the purpose of payment of interest or of computation of reserves, attention is invited to the fact that any of such organizations may maintain time deposits with member banks. With respect to such deposits, which may be either in the form of time certificates of deposit or time deposits open account, member banks may pay interest in accordance with the provisions of Regulation Q and maintain reserves in accordance with the provisions of Regulation D relating to time deposits.

The above lists of organizations which may or may not maintain savings deposits in member banks are not intended to be complete but merely contain examples compiled from various cases which have been

submitted to the Board. Any necessary inquiry as to the proper classification of other organizations for this purpose should be submitted directly to the Federal Reserve Bank of the district in which the inquiry arises rather than to the Board. The Federal Reserve Banks will, in so far as possible, answer such questions in the light of the illustrative cases stated above. 1937 BULLETIN 1073.

ATTACHMENT B

Policy Statement Regarding Advertising of NOW Accounts

The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the Office of the Comptroller of the Currency (hereafter "the agencies") wish to remind commercial banks and thrift institutions under their jurisdiction that any such institution offering or preparing to offer negotiable order of withdrawal (NOW) accounts must adhere to the advertising requirements applicable to all interest or dividend earning accounts when marketing NOW accounts. These basic advertising requirements appear in Section 217.6 of the Federal Reserve's Regulation Q (12 C.F.R. 217.6) with respect to all Federal Reserve System member banks, including all national banks; Section 329.8 of the FDIC Rules and Regulations (12 C.F.R. 329.8) for all FDIC-insured nonmember institutions; and Section 526.6 of the FHLBB's Regulations for the Federal Home Loan Bank System (12 C.F.R. 526.6) and Section 563.27 of the Federal Savings and Loan Insurance Corporation's Regulations (12 C.F.R. 563.27) with respect to all savings institutions chartered by the FHLBB, insured by the FSLIC, or which are otherwise members of the Federal Home Loan Bank System.

The agencies recognize that those institutions receiving NOW account authority for the first time on December 31, 1980,¹ may engage in advance NOW account promotional programs and may offer accounts that will be converted to NOW accounts on December 31, 1980. In this connection, the agencies draw special attention to the regulatory requirements that no representation (e.g., any advertisement, announcement, solicitation, etc.) made with respect to an interest or dividend earning account, such as a NOW account, may be inaccurate or misleading or misrepresent the account contract or service being offered. Consistent with these regulatory requirements, any advertisements or promotional materials issued before December 31, 1980 for NOW accounts or accounts that will be converted to NOW accounts should prominently indicate that, under Federal law, NOW account services are not available before December 31, 1980.

Institutions receiving NOW account authority on December 31, 1980

¹ NOW accounts are currently authorized only in the six New England states and in New York and New Jersey. Title III of the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221, 94 Stat. 146) provides nationwide NOW account authority effective December 31, 1980.

should ensure that all advertisements or promotional materials accurately describe the nature of the service to be offered on or after December 31, 1980. In this regard, accounts that will be converted to NOW accounts should not be characterized, prior to their conversion, as NOW accounts or described in such a way as to imply that the accounts are interest-bearing accounts upon which negotiable or transferable orders of withdrawal may be drawn.

Institutions are also reminded that, if a specific rate of interest (or dividends) to be paid on a NOW account is advertised, such advertisements must comply with the provisions of the agencies' regulations regarding the advertising of interest on deposits. In addition, if conditions or charges will be imposed on the account, that fact should be disclosed in the advertisement or promotional material. Consistent with the agencies' regulations, an institution should inform its customer not later than the time a NOW account is opened, or an existing account is converted to a NOW account, of the method that will be used in computing and paying interest on the account, including conditions that must be satisfied to earn a stated return and charges that may be assessed against the account.

