

STUDENT COMMENT

THE NEGOTIABLE ORDER OF WITHDRAWAL (NOW) ACCOUNT: "CHECKING ACCOUNTS" FOR SAVINGS BANKS?

It has been estimated that of the 439.6 billion dollars on deposit in savings accounts in banks across the United States, some 71.6 billion dollars are kept in mutual savings banks.¹ When considered in conjunction with the fact that mutual savings banks² are authorized to operate in only eighteen states,³ these figures indicate the considerable public confidence, as well as private savings, that is placed in these institutions. Throughout their 157-year history, in fact, savings banks have traditionally maintained as their primary purposes the functions of

¹ The figures provided were estimated for 1970. Conference of State Bank Supervisors, A Profile of State-Chartered Banking 207 (Dec. 1971) [hereinafter cited as Banking Profile].

² Banks consist of three principal types: commercial banks, savings banks, and trust companies. Commercial banks and trust companies may be chartered under either state or federal law, but savings banks (which are virtually always *mutual* in nature, see below) are always state-chartered. Prentice-Hall Encyclopedic Dictionary of Business Finance 48-49 (1960).

Savings and loan associations are not considered to be banks, but rather "[d]epositor-owned savings associations that have been established to enable their members to finance the purchase, construction, and repair of homes more easily." *Id.* at 548. They may be state or federally chartered. *Id.*

Savings banks are either mutual savings banks or stock savings banks. *Id.* at 549. As defined by federal law:

The term "mutual savings bank" means a bank without capital stock transacting a savings bank business, the net earnings of which inure wholly to the benefit of its depositors after payment of obligations for any advances by its organizers.

12 U.S.C. § 1813(f) (1970).

Stock savings banks are "state chartered banking corporations owned by individual stockholders, which accept only interest-bearing savings deposits Few such banks exist today." Prentice-Hall Encyclopedic Dictionary of Business Finance 585 (1960).

This comment will deal solely with mutual savings banks. The terms "savings bank" and "mutual savings bank" will therefore be used interchangeably.

Under Massachusetts law, a "savings bank" is defined merely as "a savings bank, institution for savings or savings institution incorporated as such in this commonwealth." Mass. Ann. Laws ch. 168, § 1 (1971). However, incorporated in this definition is the concept that all Massachusetts savings banks are mutual in nature: "There are and can be no shares of stock in a Massachusetts savings bank. Such a bank is a purely mutual institution without stock." *Jefferson v. Cox*, 246 Mass. 495, 497, 141 N.E. 493, 494 (1923). See also *People v. Franklin Nat'l Bank*, 305 N.Y. 453, 461, 113 N.E.2d 796, 799 (1953), *rev'd on other grounds sub nom. Franklin Nat'l Bank v. New York*, 347 U.S. 373 (1954), in which the court said: "[I]n New York . . . savings banks are mutual institutions"

³ Mutual savings banks are authorized to operate in the following states: Alaska, Connecticut, Delaware, Indiana, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Vermont, Washington, and Wisconsin. They also operate in Puerto Rico. National Ass'n of Mutual Savings Banks, *Directory and Guide to the Mutual Savings Banks of the United States* v (1969-70).

encouraging savings and of investing these savings "safely and productively."⁴ For these reasons, savings banks have enjoyed substantial benefits not shared by commercial banks.⁵

Recently, the Supreme Judicial Court of Massachusetts rendered an opinion which may be a significant step in breaking down the traditional barriers between mutual savings banks and commercial banking institutions. In *Consumers Savings Bank v. Commissioner of Banks*,⁶ the court upheld the right of Massachusetts savings banks to permit their depositors to make withdrawals by means of negotiable withdrawal orders.⁷ The plan set up by the Consumers Savings Bank to implement this new type of withdrawal procedure is known as the "Negotiable Order of Withdrawal" (NOW) account.⁸ It enables the savings bank customer to maintain a single account that not only earns for him a higher rate of interest than is normally available in a savings account at a commercial bank, but also permits him to transfer money to third parties, as he would from a conventional checking account, through the use of negotiable instruments drawn on his account. The NOW accounts have been referred to as being "virtually checking accounts with interest payments"⁹—a description that, as will be shown, is not entirely accurate.

It will be seen that the *Consumers* decision does not rest on any consideration of the commercial characteristics of the NOW account or its potential effect on the competitive balance between savings and commercial banks. However, the significant impact which the decision is likely to have on these areas urges an examination of the current state of relevant banking regulation. It is the purpose of this comment to examine the potential effect of the NOW account on the banking industry. After a brief look at the history of mutual savings banks and the federal banking legislation of the 1930's, the comment will

⁴ Hearings on H.R. 5700, H.R. 3287 & H.R. 7440 Before the House Comm. on Banking & Currency, 92d Cong., 1st Sess., pt. 2, at 663 (1971) (Prepared Statement of Harlan J. Swift) [hereinafter cited as Swift].

⁵ See text at notes 108-10 *infra*.

Commercial banks are banks that specialize in demand deposits (checking accounts) and short-term commercial loans, and usually endeavor to attract business enterprises, rather than individual savers, as their principal customers. See *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348, 360 (E.D. Pa. 1962).

⁶ — Mass. —, 282 N.E.2d 416 (1972).

⁷ *Id.* at —, 282 N.E.2d at 417-18. "The negotiable withdrawal orders would be drawn on a no passbook account and would be payable through a commercial bank or the Federal Reserve Bank. The orders would be presented to the bank for payment in a daily clearing, and payment would occur at its offices. The bank would make returns on stop payment orders, overdrafts, and so forth, and would handle signature verifications." *Id.* at —, 282 N.E.2d at 417. In short, the negotiable withdrawal orders would be processed in the same manner as conventional checks.

⁸ Although other Massachusetts savings banks are offering this type of account under other names, such as the "All-in-One" account and the "Two-Way" account, this comment will refer to them collectively as the NOW account, the name adopted by the Consumers Savings Bank.

⁹ *Boston Globe*, Jan. 25, 1973, at 47, col. 3.

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examine the existing federal regulation that appears pertinent to the authority of mutual savings banks to offer NOW accounts. The legislative background in Massachusetts leading up to the *Consumers* decision will then be discussed, with particular emphasis on the decision itself. Next, an analysis will be made of the potential impact of the decision, both on the competitive balance between savings banks and commercial banks and on the traditional concepts of sound banking practice. Finally, suggestions will be offered as to how best to deal with the problems occasioned by the institution of the NOW account.

I. HISTORICAL BACKGROUND OF MUTUAL SAVINGS BANKS

From the establishment of the first two mutual savings banks in 1816, savings banks have filled the need of the less-than-affluent citizen for a safe depository for his hard-earned savings. The working man who saved at a mutual savings bank was not only confident that his money was preserved in a reliable institution managed by men who inspired public trust, but he also enjoyed the benefits of periodic dividends, or interest, on his deposits.¹⁰

From these early efforts to preserve and enhance the savings of the average citizen there has grown a modern network of mutual savings banks. There are currently nearly 500 mutuals with over 1,500 offices in eighteen states,¹¹ but their fundamental purpose remains the same:

Mutual savings banks are service institutions with two essential functions . . . a responsibility to encourage habits of thrift and provide convenient, safe facilities to care for the community's savings . . . [and] a responsibility to invest those funds productively with maximum benefit to the community and economy consistent with necessary liquidity and safety, as well as a good return to their depositors.¹²

The funds received as deposits in mutual savings banks have traditionally been channeled into areas of community development. In particular, nearly three-fourths of savings bank resources are invested in residential mortgages.¹³ Among the other community facilities in which savings banks hold mortgages are hospitals, shopping centers, religious institutions, and nursing homes. In addition to extending credit in their immediate communities, they have poured billions of dollars into mortgage programs in non-savings bank states.¹⁴

¹⁰ Swift, *supra* note 4, at 663.

¹¹ These figures are as of December 31, 1970. Banking Profile, *supra* note 1, at 87.

¹² J. Lintner, *Mutual Savings Banks in the Savings and Mortgage Markets* 211 (1948).

¹³ Swift, *supra* note 4, at 664.

¹⁴ *Id.* Swift provides a convenient summary of the nationwide impact of these programs:

While oriented fundamentally to local community needs in the 18 states where they exist, savings banks do place their excess funds in capital-shortage

Since their inception, the record of mutual savings banks has been one of stability, reliability, and public trust. Even during the depression years of the 1930's, the savings bank industry continued to grow; few of its institutions collapsed,¹⁶ while failures spawned by the economic crisis were not uncommon among other types of deposit institutions.¹⁶ It is not surprising, therefore, that financial historians have reflected with admiration on the success of the savings bank industry:

Savings banks have generally succeeded in offering a rather extraordinary degree of safety, . . . reflect[ing] credit on the soundness of the organization of the system and its ability to enlist the continuing interest and support of able, public-spirited men as officers and trustees¹⁷

II. THE LEGISLATIVE BACKGROUND: FEDERAL BANKING LEGISLATION OF THE 1930's

Despite the strength of the savings bank industry, Congress was forced to respond to the financial crisis brought on by the Depression. Thus the 1930's saw the enactment of a great deal of federal banking legislation. Many of the regulatory measures passed during those years are still in force today in substantially the same form that they had some forty years ago.

In actual fact, the wave of legislation began before the Depression, when, in 1927, Congress passed the McFadden Act.¹⁸ Section 16 of that Act amended section 24 of the Federal Reserve Act¹⁹ to prohibit national banks from exceeding the maximum interest rate payable on savings deposits under state law:

Any [national bank] . . . may continue hereafter as heretofore

areas throughout the nation. In some particularly fast growing non-savings bank areas, savings banks have . . . provided for more FHA-insured and VA-guaranteed loans than have local commercial banks and savings and loan associations.

California, Texas and Florida residents have benefited especially from the availability of mortgage credit from mutual savings banks. Our industry today holds over \$8 billion of mortgage loans in these three non-savings bank states. Billions of dollars of savings bank mortgage credit have also been channeled into . . . other non-savings bank states.

Reflecting the orientation of mutual savings banks to people and communities our industry has compiled a notable record in financing low- and middle-income housing and community facilities. This record is evidenced, in part, by the leading position of savings banks in FHA and VA mortgage programs, which concentrate on financing the nation's middle-income families.

Id.

¹⁵ Id.

¹⁶ Between 1934 and 1940, a total of 448 banks, with deposits of \$477 million, were forced to close because of financial difficulties. These failures represent some 71% of the 625 bank closings between 1934 and 1970. Banking Profile, *supra* note 1, at 198.

¹⁷ Lintner, *supra* note 12, at 25.

¹⁸ Act of Feb. 25, 1927, ch. 191, 44 Stat. 1224 (codified in scattered sections of 12 U.S.C.).

¹⁹ Act of Dec. 23, 1913, ch. 6, § 24, 38 Stat. 273, as amended, 12 U.S.C. § 371 (1970).

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to receive time and savings deposits and to pay interest on the same, but the rate of interest which such association may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such association is located.²⁰

During the 1920's, however, there had been no prohibition against the payment of interest on demand deposits, although such a proposal acquired widespread support.²¹ The primary concern of those who advocated this proposal was that unbridled competitive interest rates would lead to increased operating costs, forcing the banks to maintain dangerously low reserve levels while engaging in speculative loans and investments.²²

The efforts of the opponents of interest payments on demand deposits reached fruition in 1933, when this type of banking practice was made the subject of regulatory action under the Banking Act of 1933.²³ This Act, unquestionably motivated by the urgent need to stabilize the banking industry amid the economic turbulence of the 1930's, sought to impose direct federal regulation of interest rates on both time and demand deposits. In pertinent part, it amended section 19 of the Federal Reserve Act²⁴ to provide that: "No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand . . ."²⁵ The 1933 Act also empowered the Board of Governors of the Federal Reserve System to "prescribe rules governing the payment and advertisement of interest on deposits, including limitations on the rates of interest which may be paid by member banks on time and savings deposits."²⁶

The provisions of this amendment, originally enacted to apply only to member banks of the Federal Reserve System, were extended by the Banking Act of 1935²⁷ to cover all federally insured banks. In addition, this Act gave the Federal Reserve Board broader powers to classify

²⁰ 12 U.S.C. § 371 (1970), formerly ch. 191, § 16, 44 Stat. 1233 (1927).

²¹ See authorities cited in Prochnow, *Time Deposit Banking*, 82 *Banking L.J.* 941, 943-44 nn.6-11 (1965).

²² *Id.* at 944.

Studies of the monetary collapses of the early part of the century indicated that a considerable volume of funds had flowed from interior banks to New York City and other cities for speculative purposes. These funds [were] attracted by the offer of interest payments on demand deposits . . .

Id. (footnote omitted).

²³ Act of June 16, 1933, ch. 89, 48 Stat. 162 (codified in scattered sections of 12 U.S.C.).

²⁴ Act of Dec. 23, 1913, ch. 6, § 19, 38 Stat. 270, as amended, ch. 89, § 11(b), 48 Stat. 181 (1933).

²⁵ 12 U.S.C. § 371a (1970), formerly ch. 89, § 11(b), 48 Stat. 181 (1933).

²⁶ 12 U.S.C. § 371b (1970), formerly ch. 89, § 11(b), 48 Stat. 182 (1933).

²⁷ Act of Aug. 23, 1935, ch. 614, § 101, 49 Stat. 702 (codified at 12 U.S.C. § 1828(g) (1970)).

deposits by type and to regulate the rates of interest paid on each type. Under certain circumstances, such as those pertaining to deposits payable outside the United States, limitations on interest payments were not imposed at all.²⁸

A fourth major piece of federal banking legislation enacted during this period was the Federal Deposit Insurance Act,²⁹ which in 1933 authorized the creation of the Federal Deposit Insurance Corporation (FDIC). Perhaps more than any other enactment of Congress during those troubled years, this Act was designed, through its use of deposit insurance, to restore public confidence in banking institutions.³⁰ The Act required all banks organized under federal law to become insured by the FDIC,³¹ and set forth the method by which state-chartered banks could become insured if they so desired.³² Those state banks that did become so insured automatically became subject to all rules and regulations set down by the Board of Directors of the FDIC.³³

Thus, although mutual savings banks are always state-chartered,³⁴ they may voluntarily become members of the Federal Reserve System³⁵ or insured by the FDIC.³⁶ If they elect either of these options they will of course be subject to the applicable federal law. It appears, however—as will be submitted below³⁷—that federal law will prevent them from offering the NOW account only if they elect to become member banks of the Federal Reserve System.

III. CURRENT FEDERAL REGULATION OF BANK DEPOSITS

Congress has conferred upon the Board of Governors of the Federal Reserve System broad powers under which the Board may regulate bank deposits. In addition to the authority to regulate the payment and advertisement of interest on deposits,³⁸ the Board is also given the power:

²⁸ Act of Aug. 23, 1935, ch. 614, § 324(c), 49 Stat. 714 (codified at 12 U.S.C. §§ 371a, b (1970)).

²⁹ The Federal Deposit Insurance Act was originally enacted as section 12B of the Federal Reserve Act, Act of June 16, 1933, ch. 89, § 8, 48 Stat. 168. In 1950 it was made a separate act to be known as the Federal Deposit Insurance Act, Act of Sept. 21, 1950, ch. 967, 64 Stat. 873 (codified at 12 U.S.C. §§ 1811 et seq. (1970)).

³⁰ "Its obvious intent was, by insuring deposits, to prevent runs on banks by depositors, to preserve solvency of insured banks, and thus to keep open the channels of trade and commercial exchange." *Weir v. United States*, 92 F.2d 634, 636 (7th Cir. 1937).

³¹ Act of Sept. 21, 1950, ch. 967, § 2, 64 Stat. 875 (codified at 12 U.S.C. § 1814(b) (1970)).

³² Act of Sept. 21, 1950, ch. 967, § 2, 64 Stat. 876 (codified at 12 U.S.C. § 1815 (1970)).

³³ *Weir v. United States*, 92 F.2d 634, 637 (7th Cir. 1937); *United States v. Doherty*, 18 F. Supp. 793, 794-95 (D. Neb. 1937), *aff'd*, 94 F.2d 495 (8th Cir. 1938).

³⁴ See note 2 *supra*.

³⁵ 12 U.S.C. § 333 (1970).

³⁶ 12 U.S.C. § 1815 (1970).

³⁷ See text at notes 64-67 *infra*.

³⁸ 12 U.S.C. § 371b (1970).

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to define . . . terms used in . . . this title, to determine what shall be deemed a payment of interest, to determine what . . . shall be deemed a deposit, and to prescribe such regulations as it may deem necessary to effectuate the purposes of such sections [of this title] and to prevent evasions thereof.³⁹

It was under this authority that the Federal Reserve Board in 1933 issued Regulation Q,⁴⁰ applicable to member banks of the Federal Reserve System.⁴¹ It is within this regulation that the Board sets forth its definitions and regulations concerning the classification of deposits,⁴² the payment of interest on deposits,⁴³ and the manner of withdrawal of savings deposits.⁴⁴

Regarding the classification of deposits, the Board has defined the terms "time deposits," "savings deposits," and "demand deposits."⁴⁵ The definitions relating to "time deposits," together with the footnotes to them, indicate that where the bank specifically requires its depositor to give written notice of at least thirty days before any withdrawal is made, as opposed to merely reserving the right to require such notice, the deposit will be classified as a "time deposit."⁴⁶

A "savings deposit," on the other hand, is defined by Regulation Q as a deposit

(1) Which consists of funds 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 in which the entire beneficial interest is held by one or more individuals or by such a corporation, association, or other organization; and

(2) With respect to which the depositor is not required by the deposit contract but may at any time be required by the bank to give notice in writing of an intended withdrawal not less than 30 days before such withdrawal is made, and which is not payable on a specified date or at the expiration of a specified time after the date of deposit.⁴⁷

In addition to reserving to the bank the right to impose a thirty-day notice requirement on any withdrawal, the Federal Reserve Board

³⁹ 12 U.S.C. § 461(a) (1970).

⁴⁰ 12 C.F.R. §§ 217.0-.7 (1972).

⁴¹ *Id.* at § 217.0(b).

⁴² *Id.* at § 217.1.

⁴³ *Id.* at §§ 217.2, .3, .7.

⁴⁴ *Id.* at § 217.5.

⁴⁵ *Id.* at § 217.1.

⁴⁶ *Id.* at §§ 217.1(b)-(d) & nn.1, 3. Since the terms of the notice requirement clearly exclude the NOW account from classification as a "time deposit," a description of the other elements of a "time deposit" is not useful to this discussion.

⁴⁷ *Id.* at § 217.1(e) (footnotes omitted).

has also restricted the manner in which savings deposits may be withdrawn:

(c) *Manner of payment of savings deposits.* (1) Subject to the provisions of subparagraph (2) of this paragraph, a member bank may permit withdrawals to be made from a savings deposit only through payment to the depositor himself (but not to any other person whether or not acting for the depositor)⁴⁸

Exceptions to this provision permit savings withdrawals to be paid to individuals other than the depositor in the following cases only: to a person presenting the passbook; to a fiduciary; to a person who has extended credit secured by the savings deposit; pursuant to a court order; upon the death of the depositor; or upon written instructions to pay interest.⁴⁹

While this provision of Regulation Q does not address itself directly to the problems raised by the NOW account, it is submitted that its requirement that savings withdrawals be paid only to the depositor himself would effectively prevent the use of negotiable withdrawal orders payable to third parties as a valid method of withdrawing funds from savings accounts.⁵⁰ In this regard, the Federal Reserve Board has indicated to member banks that accounts—at least those classified as "savings" accounts—would not be permitted to offer third-party payment services through the use of negotiable drafts drawn by a depositor. This would be so, regardless of whether the deposit agreement contains a specific "30 day written notice of withdrawal" provision or whether such a requirement is merely reserved to the bank.⁵¹

The third term, "demand deposits," is defined by Regulation Q as follows:

(a) *Demand Deposits.* The term "any deposit which is payable on demand", hereinafter referred to as a "demand deposit", includes every deposit which is not a "time deposit" or "savings deposit", as defined in this section.⁵²

No provision is made in Regulation Q relating to the manner of withdrawal of demand deposits, as is done in the case of savings deposit withdrawals. However, another provision, applicable solely to demand deposits, declares that "no member bank of the Federal Reserve System shall, directly or indirectly, by any device whatsoever, pay any interest on any demand deposit."⁵³ This latter provision of Regulation Q is

⁴⁸ Id. at § 217.5(c)(1) (footnote omitted).

⁴⁹ Id. at §§ 217.5(c)(1)(i)-(vi).

⁵⁰ This conclusion relies on the premise that NOW account deposits are categorized as savings deposits, and not as demand deposits. For an analysis of this problem, see text at notes 92-94 *infra*.

⁵¹ 12 C.F.R. § 204.105 (1972).

⁵² Id. at § 217.1(a).

⁵³ Id. at § 217.2(a).

essentially the same as the interest prohibition in section 19 of the Federal Reserve Act.⁵⁴ As was stated earlier,⁵⁵ the reason for the prohibition against interest payments on demand deposits stems from the dangers that would arise if banks were permitted to compete for demand deposits by offering high rates of interest. The increased costs of maintaining the deposits, as well as the substantial amounts of interest to be paid, might keep reserve levels too low to accommodate unexpected rises in the numbers and amounts of withdrawals. Since by the very nature of demand deposits banks are obligated to pay them on demand, the purpose to be served by the prohibition of interest payments is the reduction of risk to both banks and depositors in the event of a sudden run on the bank.

As a result of the prohibition against interest payments on demand deposits, it is apparent that if the NOW account were to be classified as a true checking account—in other words, as a demand deposit account—then, despite its “savings account” label, the payment of interest would be prohibited under Regulation Q. It is doubtful that the NOW account could be so classified.⁵⁶ However, that question appears academic, since, as has already been shown, if the NOW account is classified as a savings account it is violative of the prohibition against payment of withdrawals to third persons. On that ground alone, then, it appears likely that the NOW account will be held invalid should a member bank of the Federal Reserve System introduce it.

In a further effort to promote the safety of bank deposits, Congress has required all member banks of the Federal Reserve System to maintain reserves against deposits; the minimum levels of such reserves are to be determined by the Federal Reserve Board, within certain limitations set by Congress.⁵⁷ It is notable that the minimum reserve ratios for time and savings deposits are substantially lower than the ratio applicable to demand deposits.⁵⁸ This disparity evidently stems from the greater susceptibility of demand deposits to instantaneous withdrawals.

While the Board of Governors of the Federal Reserve System is empowered to regulate the classification, withdrawal, and payment of interest only on deposits of member banks, authority has been granted to the Board of Directors of the FDIC to regulate deposits of all banks that are FDIC-insured and are not members of the Federal Reserve System. The enabling legislation provides that:

The Board of Directors shall by regulation prohibit the payment of interest or dividends on demand deposits in insured nonmember banks and for such purpose it may definite

⁵⁴ See text at note 25 *supra*.

⁵⁵ See text at note 22 *supra*.

⁵⁶ See text at notes 92-94 *infra*.

⁵⁷ 12 U.S.C. § 461(b) (1970).

⁵⁸ According to the Federal Reserve Board's Regulation D, the current applicable reserve requirements are 3% of a member bank's savings deposits, 3-5% of its time deposits, and either 12½-13% (for banks not in a reserve city) or 17-17½% (for reserve city banks) of its demand deposits. 12 C.F.R. § 204.5(a) (1972).

[sic] the term "demand deposits" The Board of Directors may from time to time . . . prescribe rules governing the payment and advertisement of interest on deposits, including limitations on the rates of interest or dividends that may be paid by insured nonmember banks (including insured mutual savings banks) on time and savings deposits The Board of Directors is authorized . . . to define the terms "time deposits" and "savings deposits", to determine what shall be deemed a payment of interest, and to prescribe such regulations as it may deem necessary to effectuate the purposes of this subsection and to prevent evasions thereof.⁵⁹

Under this authority the FDIC Board has promulgated regulations essentially the same as those contained in Regulation Q.⁶⁰ In particular, (1) the FDIC's definitions of "time deposits," "savings deposits," and "demand deposits" are essentially the same as those of the Federal Reserve Board;⁶¹ (2) the payment of interest on demand deposits by FDIC-insured banks is prohibited;⁶² and (3) withdrawals from savings deposits in FDIC-insured banks may be made only to the depositor himself and not to a third party, except in certain specified cases.⁶³

However, notwithstanding the many similarities between Regulation Q and its parallel FDIC regulation, the latter is limited in scope by the following clause:

Except as provided in §§ 329.7 and 329.8 the provisions of this part do not apply to mutual savings banks or to guaranty savings banks operating in the State of New Hampshire so long as said guaranty savings banks operate substantially under and pursuant to the laws of the State of New Hampshire pertaining to mutual savings banks and do not engage in commercial banking.⁶⁴

It is submitted that this provision must be read as exempting mutual savings banks generally from the FDIC equivalent of Regulation Q. Although the regulatory language is admittedly unclear as to whether the stated exemption applies only to mutual savings banks and guaranty savings banks in New Hampshire, or whether it includes all mutual savings banks everywhere—that is, whether the limiting phrase

⁵⁹ 12 U.S.C. § 1828(g) (1970).

⁶⁰ 12 C.F.R. §§ 329.0-.10 (1972).

⁶¹ Compare *id.* at § 329.1 with *id.* at § 217.1. The only substantive differences in these sections pertain to time certificates of deposit and to promissory notes and other obligations, neither of which is relevant to this discussion.

⁶² *Id.* at § 329.2(a); compare *id.* § 217.2(a).

⁶³ *Id.* at § 329.5(c); compare *id.* § 217.5(c).

⁶⁴ *Id.* at § 329.0. Section 329.7 prescribes maximum rates of interest for mutual savings banks. Section 329.8 regulates the advertising of interest on deposits.

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"operating in the State of New Hampshire" applies to the words "mutual savings banks or to guaranty savings banks," or simply to the words "guaranty savings banks"—this comment adopts the latter interpretation as the more plausible. Convincing support for the latter interpretation is afforded by the fact that the Petition for Relief filed in response to the *Consumers* decision by the commercial bankers of Massachusetts and New Hampshire adopts *arguendo* the same interpretation.⁶⁵ Since this interpretation is clearly against the interests of the Massachusetts commercial banks, it is doubtful that the drafters of the Petition felt that the alternative interpretation, which would restrict the application of the clause to New Hampshire, could be maintained.

It appears, then, that the stated exemption removes mutual savings banks that are FDIC-insured from application of the prohibition against interest payments on demand deposits and the restriction against payment of savings deposit withdrawals to third parties.⁶⁶ Hence mutual savings banks will be subject to the prohibition against interest payments and the withdrawal restrictions only if they are members of the Federal Reserve System. It is this exemption provision that makes the *Consumers* decision so important; without it the NOW account would be merely an oddity resulting from the unique Massachu-

⁶⁵ Massachusetts Bankers Association and New Hampshire Bankers Association, Petition for Relief with Respect to Third Party Withdrawal Orders Offered by Mutual Savings Banks, at 15 (Oct. 20, 1972) [hereinafter cited as Petition for Relief].

⁶⁶ It should be noted that savings and loan associations are subject to both restrictions. Under enabling legislation similar to the statutes conferring regulatory authority upon the Federal Reserve Board and the FDIC Board, the Federal Home Loan Bank Board (FHLBB) has been granted regulatory powers relating to savings and loan associations. 12 U.S.C. §§ 1461 et seq. (1970). In addition to providing for the "organization, incorporation, examination, operation, and regulation of . . . Federal Savings and Loan Associations," 12 U.S.C. § 1464(a) (1970), Congress has provided that:

Except as may be otherwise authorized . . . the payment of any savings account shall be subject to the right of the association to require such advance notice, not less than thirty days, as shall be provided for by the charter of the association or the regulations of the Board . . . Savings accounts shall not be subject to check or to withdrawal or transfer on negotiable or transferable order or authorization to the association, but the Board may by regulation provide for withdrawal or transfer of savings accounts upon nontransferable order or authorization.

12 U.S.C. § 1464(b)(1) (1970).

Under this authority, the FHLBB has issued regulations effectively prohibiting the institution of third-party payment accounts in all federal savings and loan associations. 12 C.F.R. § 545.4-1(a) (1972).

The impact of the NOW account on the savings and loan industry is treated in Negotiable Withdrawal Orders Legal for Massachusetts Savings Banks, 38 Legal Bulletin—The Law Affecting Savings Associations 384 (1972). It is stated therein that thirteen states currently permit state-chartered savings and loan associations to make limited third-party payment transfers, but that "federal savings associations, as well as most state-chartered associations [in nine of the thirteen states], can use only nonnegotiable and non-transferable payment orders." *Id.* at 386. The conclusion is drawn that "[u]nder the present law and regulations savings associations do not have the power to compete effectively with the Massachusetts savings bank plan" *Id.* at 387.

setts savings bank insurance system that permits most Massachusetts savings banks to forego FDIC insurance.⁶⁷ With it, however, the NOW account becomes a potential banking practice in every state in which non-Federal-Reserve-member mutual savings banks are not subject to state laws comparable to Regulation Q.

IV. THE *Consumers* DECISION

The preceding sections of this comment have advanced the contention that a mutual savings bank which is not a member of the Federal Reserve System, even though it is FDIC-insured, is not precluded by federal law from offering the NOW account to its depositors. The only limitation upon such a bank would have to be found in state law. Although a survey of the banking laws of the various states is beyond the scope of this comment, it will be instructive to examine briefly the *Consumers* decision, since it is the only case to date which has dealt with the legality of the NOW account under state law.

In order to place *Consumers* in proper perspective, the unique regulatory scheme in Massachusetts will first be discussed, followed by a treatment of the opinion of the Supreme Judicial Court.

A. *The Regulatory Scheme in Massachusetts*

It would not be improper to say that mutual savings banks in Massachusetts enjoy a freedom from federal regulation unknown in other states. This freedom arises from the fact that except for eight FDIC-insured savings banks, Massachusetts mutuals are neither member banks of the Federal Reserve System nor insured by the FDIC.⁶⁸ While Massachusetts savings banks may apply for Federal Reserve membership⁶⁹ and FDIC insurance,⁷⁰ very few have chosen to do so, preferring to utilize instead an advantage unique to Massachusetts: a state-organized deposit insurance fund for mutual savings banks.

The Massachusetts regulatory scheme dates back to the creation of the FDIC in 1933. At that time, the Massachusetts Commissioner of Banks reported: "The privilege of participation [in the FDIC] was also extended to mutual savings banks, but no Massachusetts savings bank has applied for admission because of the excessive expense and because the provisions of the plan do not appear adaptable to savings banks."⁷¹

Although there were practical dollars-and-cents reasons for the reluctance of savings banks to become federally insured,⁷² the decision

⁶⁷ See discussion in text at notes 78-82 *infra*.

⁶⁸ Petition for Relief, *supra* note 65, at 17.

⁶⁹ 12 U.S.C. § 321 (1970).

⁷⁰ 12 U.S.C. § 1815 (1970).

⁷¹ 1933 Mass. Comm'r of Banks Ann. Rep., pt. 1, at ii.

⁷² A 1933 commission study showed that during the 115 years preceding the first two temporary bank closings in February 1932, the total losses, after liquidation, of mutual savings banks in Massachusetts amounted to only \$2,549,868. The commission

of the Massachusetts mutuals to decline the FDIC's program was based as well upon a desire to diminish the effects of federal regulation on state-chartered banks. This desire is reflected in further comments by the Commissioner at that time:

This is apparently, by indirection, the beginning of the unification of the banking system of the country and its supervision by Federal authorities. . . . Any general expansion of this procedure will, in effect, supersede state authority over all banks which are members of the Federal Reserve System or of the Federal Deposit Insurance Corporation.⁷³

In order to avoid greater federal intrusion into the regulation of state-chartered banks, the Massachusetts legislature undertook to create its own deposit insurance fund. A special commission was established and charged with devising a means for the protection of deposits in state-chartered banks⁷⁴—in effect, an alternative to the FDIC. The commission's study concluded that the Massachusetts mutual savings banks were too strong to be subject to the federal assessment.⁷⁵ More importantly, the commission concluded, the FDIC was created without regard to the needs or conditions of mutual savings banks. Such banks, they felt, were included merely as an afterthought.⁷⁶ Accordingly, the commission recommended that it would not be in the best interests of the mutual savings banks of Massachusetts to have their deposits federally insured.⁷⁷

Consequently, in 1932, the Massachusetts legislature established the Mutual Savings Central Fund, Inc. (MSCF).⁷⁸ The assets of the MSCF, obtained by periodic assessments imposed upon member banks and by legislatively prescribed investments, are divided into two funds—the Liquidity Fund, to aid member banks in need of cash, and the Deposit Insurance Fund,⁷⁹ created in 1934, which, as its name implies, protects the depositors' money in a fashion similar to that of the FDIC.⁸⁰ Under current state law, all savings banks in Massachusetts

noted that membership in the FDIC program, which at the time offered temporary six-month insurance protection, required each insured bank to be assessed one percent of its total deposits not exceeding \$2,500. The total assessment of all Massachusetts mutuals would be roughly \$14,000,000. If they entered the FDIC program, the commission concluded, the savings banks would be assuming a liability nearly six times as great as their entire loss to depositors over the 115-year period—and this for only six months' worth of insurance coverage! Report of the Special Commission for Investigation and Study of the Banking Structure, Mass. Sen. Doc. No. 100, at 23-24 (1934) [hereinafter cited as *Banking Structure Report*].

⁷³ 1933 Mass. Comm'r of Banks Ann. Rep., pt. 1, at ii-iii.

⁷⁴ *Banking Structure Report*, supra note 72, at 5.

⁷⁵ See note 72 supra.

⁷⁶ *Banking Structure Report*, supra note 72, at 24.

⁷⁷ *Id.* at 25-26.

⁷⁸ See Mass. Ann. Laws ch. 168 App., §§ 1-1 et seq. (1971).

⁷⁹ See Mass. Ann. Laws ch. 168 App., § 1-1 (1971).

⁸⁰ Compare 12 U.S.C. §§ 1821-23 (1970) with Mass. Ann. Laws ch. 168 App., §§ 2-3A to 2-6 (1971).

are automatically subject to membership in the MSCF,⁸¹ although procedures are specified by which a savings bank may choose instead to become insured by the FDIC.⁸²

Thus, with the exception of eight FDIC-insured mutual savings banks, Massachusetts savings banks are subject neither to Regulation Q nor to its parallel FDIC regulation. The eight FDIC-insured banks are subject to the FDIC regulation, but because of their status as mutual savings banks are apparently exempted, by operation of the exemption discussed above, from the savings deposit withdrawal restrictions and the demand deposit interest prohibition.⁸³ Consequently, regardless of which Massachusetts savings bank first presented the NOW account question for judicial examination, the Supreme Judicial Court of Massachusetts was limited to an examination of applicable state law.

B. *The Court's Opinion*

On July 28, 1970, the Consumers Savings Bank of Worcester (Consumers) transmitted to the Massachusetts Commissioner of Banks a plan for the transfer of funds from savings accounts through the use of negotiable withdrawal orders. Except for the feature of negotiability, these withdrawal orders were to be no different from the ones currently in use by Consumers in their standard savings accounts. To insure that these new accounts would continue to be classified as savings accounts, each depositor would be required to sign an agreement setting forth the rules of operation of the new withdrawal orders, such agreement to include the provision that their withdrawals are subject to statutory notice requirements.⁸⁴

On September 28, 1970, the Commissioner wrote Consumers, stating her opinion that the use of such withdrawal orders, unaccompanied by passbooks, would be impermissible under Massachusetts law.⁸⁵

Following the Commissioner's rejection of the plan, Consumers filed a bill in equity for declaratory relief, seeking a judicial determina-

⁸¹ See Mass. Ann. Laws ch. 168 App., § 1-1 (1971).

⁸² See Mass. Ann. Laws ch. 168 App., §§ 2-12, -13 (1971).

⁸³ See text at notes 64-67 *supra*.

⁸⁴ Mass. Ann. Laws ch. 168, §§ 26(2)-(3) (1971) provides:

2. *Ninety Day Notice*.—The treasurer or other authorized officer of such corporation [a savings bank] may at any time require a depositor to give a written notice of his intention to withdraw the whole or any part of his deposit . . . such notice to be for a period not exceeding ninety days. . . .

3. *Six Months' Notice*.—Whenever . . . there is an unusual demand for withdrawals the corporation may with the approval of the commissioner, and whenever in the opinion of the commissioner there is such an unusual demand the corporation shall upon his order, require a depositor to give written notice of his intention to withdraw the whole or any part of his deposit . . . such notice to be for such period, not exceeding six months, as may be determined by the commissioner, which period may in his discretion be extended, but not beyond one year from the date of such notice

⁸⁵ *Id.* Brief for Petitioner at 3, *Consumers Savings Bank v. Commissioner of Banks*, — Mass. —, 282 N.E.2d 416 (1972) [hereinafter cited as *Brief for Petitioner*].

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tion that a mutual savings bank has the authority, under Massachusetts law, to arrange for the transfer of savings account funds via negotiable withdrawal orders.⁸⁰ The case was reported without decision by the

⁸⁰ The problem faced by the *Consumers* court was in some respects not a new one. The question of the authority of mutual savings banks to offer checking accounts had already been the subject of judicial decisions in three states. As a result of these decisions, mutual savings banks in Maryland and New Jersey are now permitted to maintain *non-interest-bearing* checking accounts. *Savings Bank v. Bank Comm'r*, 248 Md. 461, 237 A.2d 45 (1968); *Hudson County Nat'l Bank v. Provident Inst. for Savings*, 80 N.J. Super. 339, 193 A.2d 697 (Super. Ct., Ch. Div. 1963), *aff'd per curiam*, 44 N.J. 282, 208 A.2d 409 (1965). Compare *Androscoggin County Savings Bank v. Campbell*, 282 A.2d 858 (Me. 1971). It should be noted at the outset, however, that the New Jersey court classified the accounts as demand deposit accounts and that the Maryland case dealt with an account wherein the bank retained its right to require advance notice of withdrawal. Furthermore, in neither case did the bank pay interest on the account in question.

In *Hudson County*, the court upheld the right of New Jersey mutual savings banks to offer non-interest-bearing checking accounts on the basis of a state statute granting the authority "to receive money on deposit . . . according to the usual custom of savings banks." N.J. Stat. Ann. § 17:9A-26(1) (1963). The court noted that it had been the practice of a substantial number (but not a majority) of the state's savings banks to maintain demand deposit accounts, a practice dating back at least thirty years prior to the institution of this suit. This practice was known to both the Legislature and the Commissioner of Banking and Insurance, neither of whom took steps to curtail it. Consequently, the court concluded, the "usual custom of savings banks" included the authority to accept demand deposits subject to withdrawal by check. 80 N.J. Super. at 356, 193 A.2d at 706.

A similar fact situation existed in *Savings Bank*, in which the authority of mutual savings banks in Maryland to provide checking accounts was upheld. Under a statute similar to the one upon which the *Consumers* court based its opinion, see note 90 *infra*, the Maryland court found that the manner of withdrawal of savings bank deposits is left to the bylaws of each bank, and is not prescribed by statute. 248 Md. at 471-72, 237 A.2d at 50-51. Compare Md. Ann. Code art. 11, § 41(a) (1968) with Mass. Ann. Laws ch. 168, § 26 (1971). The bylaws in question specifically authorized the receiving of deposits in checking accounts, under the provisions that: (1) no interest be paid on any checking account, and (2) the bank may require thirty days notice of intent to withdraw. While upholding the bank's right to continue to maintain checking accounts, the court specifically ruled that the notice requirement "negates the assumption that deposits made in accounts subject to withdrawal by check can be characterized as demand deposits." 248 Md. at 475, 237 A.2d at 53. The sole restriction imposed by the court upon the authority granted, other than those already contained in the bank's bylaws, was that the funds deposited in the checking accounts be invested or loaned out according to state law. 248 Md. at 472-73, 237 A.2d at 51. The Maryland court, using language later quoted in *Consumers*, — Mass. at —, 282 N.E.2d at 417, concluded that the use of checks for the withdrawal of funds would not change the characterization of the funds from savings deposits to demand deposits:

If . . . a depositor of the Bank, on making a withdrawal, has the option of requesting cash, or a treasurer's check, or of purchasing a money order, . . . according him a fourth option of drawing a check on his own account . . . is a distinction without a difference.

248 Md. at 475, 237 A.2d at 53.

But see *Androscoggin*, in which the Maine court held that savings banks were not authorized by statute to offer checking accounts. The court distinguished both *Hudson County* and *Savings Bank* on the ground that, unlike those in New Jersey and Maryland, mutual savings banks in Maine had never before offered checking services to any customer, nor had any tacit consent ever been given in this regard by any state banking authority. 282 A.2d at 863-65.

Superior Court to the Supreme Judicial Court of Massachusetts for its determination. The high court, in a brief opinion, held that the bank was entitled to go ahead with its plan in the case stated.⁸⁷

The court apparently rejected the respondent's contention⁸⁸ that the NOW account was, in effect, a demand deposit account.⁸⁹ The court then proceeded to note that the relevant state statutes prescribed the types and conditions of permitted accounts, but did not prescribe withdrawal procedures. Rather, formulation of such procedures was left to the individual banks, subject to the statutory notice requirement.⁹⁰ Accordingly, the court held, Consumers' bylaw permitting withdrawals "by presentation of deposit book, other evidence of deposit or other written instrument, by the depositor, his legally appointed representative or another on written order" was not prohibited by state law, and by its terms authorized withdrawal by negotiable order.⁹¹

Although the *Consumers* court failed to analyze in depth the argument that the NOW account represents maintenance of a demand deposit account by a savings bank, and is thereby prohibited by state banking statutes, it is submitted that this classification question is crucial to the court's holding, which rests upon the premise that the NOW account is a savings account. Hence an examination of the soundness of that premise appears in order.

While the NOW account operates very nearly as does a traditional checking account, it is, strictly speaking, *not* a checking account, because the bank retains the statutory authority to impose upon the depositor a requirement of ninety days written notice of intent to withdraw.⁹² Therefore—theoretically at least—the deposits are not demand deposits.

In practice, however, it is clear that NOW account withdrawal orders will be paid on demand, just as regular savings account withdrawals are traditionally paid on demand. In fact, rarely during the

In addition to the Maryland and New Jersey precedents, Indiana savings banks have maintained checking accounts since their founding. Brief for Petitioner, *supra* note 85, at 22. "The savings bank statutes in Indiana are substantially similar to those in Massachusetts and contain no express provision allowing deposits to be subject to negotiable order." *Id.* However, they are still permitted to offer demand deposit accounts.

⁸⁷ *Consumers Savings Bank v. Commissioner of Banks*, — Mass. —, 282 N.E.2d 416, 417-18 (1972).

⁸⁸ Brief for Respondent at 6-7, *Consumers Savings Bank v. Commissioner of Banks*, — Mass. —, 282 N.E.2d 416 (1972).

⁸⁹ Although never expressly referring to the Commissioner's argument that the NOW account represented the initiation of demand deposit accounts by savings banks, the court did state that: "We do not agree with the commissioner that use of the negotiable withdrawal order creates a new account not authorized by [the state banking statutes]." — Mass. —, 282 N.E.2d at 417. Furthermore, throughout its opinion the court referred to the issue at hand as being that of the validity of this method of withdrawal from a depositor's *savings* account.

⁹⁰ Mass. Ann. Laws ch. 168, § 26 (1971) provides in part that deposits "may be withdrawn at such time and in such manner as the by-laws direct"

⁹¹ — Mass. at —, 282 N.E.2d at 417.

⁹² See Mass. Ann. Laws ch. 168, § 26(2) (1971), quoted in note 84 *supra*.

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long history of the savings bank industry in Massachusetts has the ninety-day notice requirement been imposed, and in the case of *Consumers* it has never been operative.⁹³ Nevertheless, what is crucial to classification as a savings deposit is the *authority* of a bank to impose a requirement of written notice of intent to withdraw, and not the actual imposition of the notice requirement. Thus, although NOW account withdrawal orders are, for all intents and purposes, payable on demand, the funds in the account retain their identity as savings deposits. Were the test otherwise—one that inquired whether or not a notice requirement was actually imposed—then even a regular savings account would be deemed a demand deposit account, since in practice savings withdrawals are paid on demand.

Alternatively, the crucial factor in classifying an account as a demand deposit account is "not . . . whether checks may be drawn against it, but . . . whether the unconditional right to withdraw exists."⁹⁴ In a regular checking account, the drawee bank is obligated to honor all checks properly drawn by the depositor against sufficient balances. The NOW account's notice requirement, however, is a condition potentially affecting the right of the depositor to withdraw. Thus, from a technical definitional standpoint, the NOW account is not a checking account at all, but rather a savings account, and the position of the *Consumers* court on the classification issue, and hence its decision on the ultimate issue of the legality of the NOW account, appear well-founded.

Despite the technical precision of the *Consumers* court's response, there are important considerations of competition and sound banking practice to which the court did not address itself and in light of which the decision should be considered. In holding that Massachusetts mutual savings banks may permit their depositors to make withdrawals by means of negotiable withdrawal orders, the court has in effect permitted the introduction into savings banks of interest-bearing third-party payment accounts. In theory, the decision has merely authorized the implementation of a new method of savings withdrawal, but its practical effect has sparked the ire of commercial bankers, who see the *Consumers* decision as the means by which savings banks may invade an area long the exclusive domain of commercial banks.

V. THE IMPACT OF THE NOW ACCOUNT ON THE BANKING INDUSTRY

As a result of the *Consumers* decision, Massachusetts mutual savings banks may now compete with commercial banks in the area of third-party payment accounts. The decision authorizes the implementation of a new device which, at the very least, is potentially capable of giving to savings banks a substantial competitive advantage in a state

⁹³ Brief for Petitioner, *supra* note 85, at 15.

⁹⁴ Koplów, *Massachusetts Legal Decision Confuses Savings Bank Status*, *American Banker*, Sept. 25, 1972, at 17, col. 1.

which already may well have the strongest savings bank industry in the United States.⁹⁵ At its worst, "[t]he entry of savings banks into the checking account business is potentially disastrous for commercial banks in the commonwealth."⁹⁶ Whether this statement exaggerates the potential effect of the NOW account on the future of banking in Massachusetts and across the nation is, of course, not yet known. Nevertheless, the *Consumers* decision and the resulting implementation of NOW accounts have come under recent attack by the commercial banks of Massachusetts and New Hampshire.⁹⁷ The commercial banks have launched what is basically a two-pronged attack. First, they emphasize the traditional balance of power that has long existed between commercial banks and savings banks, and express the fear that the additional powers recently granted to savings banks, of which the NOW account is but one, will upset the balance in favor of the savings banks. Secondly, they stress the failure of the *Consumers* court to consider the potentially dangerous effect of the NOW account on traditional concepts of sound banking practice.

A. *Impact on the Competitive Balance*

The legislative and regulatory background relating to bank deposits is indicative of the validity of the statement by the Massachusetts Commissioner of Banks that:

There is a delicate balance of power between commercial banks and thrift institutions. Different statutory and regulatory provisions over the years, at both the state and Federal level, have been designed to maintain this equilibrium, in the interest of the banks, and, ultimately, of the public. Every expansion of the powers of one segment of the banking industry must have an adverse effect on other types of institutions unless some accommodation is made to extend their powers as well.⁹⁸

It is evident from the long and successful history of the savings bank industry that that type of institution is worth preserving, particularly in regard to its principal functions of serving the savings and mortgage markets. Just as surely, no one can dispute the need for commercial banks to serve the commercial borrower and the corporate depositor, who require a higher degree of bank liquidity than do the savings customer and the long-term mortgage borrower. Both types of institutions

⁹⁵ According to the Massachusetts Commissioner of Banks: "Massachusetts is, very possibly, the only state in which savings bank assets exceed those of commercial banks." *Id.* at 27, col. 1.

⁹⁶ *Id.* at 17, col. 4.

⁹⁷ See Petition for Relief, *supra* note 65. The commercial banks of New Hampshire have joined in the fight because of the recent introduction of NOW accounts into that state by the New Hampshire Savings Bank in Manchester. See *Boston Sunday Globe*, Feb. 11, 1973, at 63, col. 5; *American Banker*, Sept. 18, 1972, at 2, col. 3.

⁹⁸ Koplów, *supra* note 94, at 17, col. 4.

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serve useful ends, and to increase the profitability of one at the expense of the other would tend, if proper controls were not exercised, to frustrate these ends.

The difficulty in fashioning such controls arises from the current uncertainty regarding what customer reaction to the NOW account will be, and how that reaction, in combination with other new trends in banking, will affect the position of the savings banks vis-à-vis commercial banks. Were the NOW account, for example, not so potentially attractive to typical consumers, including those who now utilize checking accounts in commercial banks, the commercial banks might feel less threatened than in the existing situation, in which customers of the 29 savings banks now offering this service in Massachusetts have already opened some 12,000 NOW accounts with an estimated aggregate balance of \$15,000,000.⁹⁹ The commercial banks apparently foresee the likelihood of their customers being "lured" to the savings banks by these attractive new services. On the other hand, the savings banks contend that they are not attempting to upset the competitive balance, but are merely trying to provide their own customers with a service they desire to have.¹⁰⁰

Despite the substantial funds deposited in NOW accounts during the first few months of their operation, it appears doubtful that the NOW account alone will cause much of a drain on commercial bank customers. In the first place, as implemented by the Consumers Savings Bank, NOW accounts are presently offered only to individual depositors and not to business or corporate customers. Since corporate, rather than personal, checking accounts are the mainstay of the commercial banks' deposit business, the NOW accounts would present relatively little competition in this area. Furthermore, under the current setup of the NOW accounts, even an individual depositor has little to gain by transferring his money from a commercial bank checking account into a savings bank NOW account, since the standard charge of fifteen cents per withdrawal order serves to diminish the dividends earned by his deposits. Unless the depositor maintains large balances and writes few withdrawal orders, he could actually end up *losing* money instead of earning it.¹⁰¹

Whether or not the institution of third-party payment accounts of the type recently implemented in Massachusetts would in itself con-

⁹⁹ Petition for Relief, *supra* note 65, at 23. A more recent report states that "[s]ince [NOW accounts] were first offered, they have generated 17,000 new accounts and deposits of \$30 million in New England. More depositors are signing up at the rate of 100 a day." Time, Jan. 15, 1973, at 71. Another recent report indicates that the number of Massachusetts mutual savings banks offering NOW accounts has increased to between 50 and 55. See Boston Sunday Globe, Feb. 11, 1973, at 63, col. 2.

¹⁰⁰ Reply Brief for Petitioner at 19-20, *Consumers Savings Bank v. Commissioner of Banks*, — Mass. —, 282 N.E.2d 416 (1972).

¹⁰¹ However, there appear to be no legal requirements preventing the savings banks from dropping or limiting the fifteen-cent charge, in a manner similar to the "no charge" or "minimum balance" checking accounts available at many commercial banks.

stitute a threat to the traditional role of commercial banking, the real impact of these accounts can best be determined by viewing them in the context of other recent developments in banking. Recent years have seen, on the one hand, the growth of savings deposits in commercial banks and the development of "full-service" or "one-stop" banking, and, on the other hand, the expansion of savings banks in some states into the checking account and credit card business. Each of these developments adds a weight to the competitive scale, and it is only when all the weights are added together that it is possible to see which way the scale tips.

The last decade has seen a tremendous increase in the amount of savings deposits in commercial banks. In fact, the recent report of the President's Commission on Financial Structure and Regulation (commonly known as the Hunt Commission) has indicated that during the 1960's, time and savings deposits in all insured commercial banks in the United States increased more than threefold, from 73.3 billion dollars in 1960 to 233.0 billion dollars in 1970.¹⁰² No doubt this increase is due largely to the popular concept of "full-service" banking. Many customers consider the convenience of being able to transact all their banking business at one bank more important than the extra interest their savings deposits would earn at a savings bank, and are willing to take the "loss" of interest for the added convenience of "one-stop" banking. In states permitting savings bank checking accounts, however, the convenience of one-stop banking would be realized as well at a savings bank as at a commercial bank, with no corresponding loss of interest. Moreover, the Massachusetts NOW account permits the consumer to enjoy an even greater convenience—a single account combining the best features of both a savings account and a checking account. Accordingly, the granting of authority to savings banks to offer third-party payment accounts will apparently put a damper on the one-stop banking concept that has been a prime drawing attraction of commercial banks.

While the "convenience" argument drawn above would be applicable in any state adopting savings bank "checking accounts," there are several factors unique to Massachusetts that bear on the competitive balance between commercial banks and savings banks. Of fundamental importance in this regard is the MSCF. Under the statutory provisions relating to the MSCF, all deposits in Massachusetts savings banks are insured in full, up to the limit of \$40,000 per depositor.¹⁰³ This is twice the maximum amount of insurance coverage provided by the FDIC to each depositor.¹⁰⁴ In fact, in the case of the eight

¹⁰² Report of the President's Commission on Financial Structure & Regulation 140-41 (1971) [hereinafter cited as Hunt Commission].

¹⁰³ Mass. Ann. Laws ch. 168, §§ 21, 22 (1971) permit an individual or joint account holder to deposit up to \$40,000 in a Massachusetts savings bank. Mass. Ann. Laws ch. 168 App., § 2-1 (1971) established a fund under the MSCF "for the insurance of deposits in all savings banks established under the laws of the commonwealth." *Id.*

¹⁰⁴ 12 U.S.C. § 1821(a) (1970). "The maximum amount of the insured deposit of any depositor shall be \$20,000." *Id.* See 12 C.F.R. §§ 330.1-10 (1972).

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FDIC-insured Massachusetts savings banks, the MSCF even provides insurance coverage for all deposits in excess of the FDIC's \$20,000 limit.¹⁰⁵ Since there is no state insurance fund in Massachusetts that protects commercial bank deposits, their coverage is limited to the FDIC maximum of \$20,000.¹⁰⁶ For this reason, depositors maintaining balances in excess of \$20,000 will be fully insured in a Massachusetts mutual savings bank, but not in a commercial bank.

In addition to the extended deposit insurance coverage, Massachusetts savings banks have recently benefited by the enactment of legislation authorizing them to issue credit cards.¹⁰⁷ As in the case of checking accounts, credit cards have traditionally been part of the exclusive preserve of the commercial banks, and in light of the increasing popularity of credit cards, it is likely that this additional power conferred upon savings banks will serve as an attraction to consumers.

In view of all these considerations, the total impact of the broadening of the powers of Massachusetts savings banks appears to weigh heavily in favor of the savings banks. As the picture stands now, the typical Massachusetts customer can transact all his banking business at a savings bank—savings account (with higher interest rates than are paid at commercial banks), "checking" services (the NOW account), credit card (recently granted to savings banks), and personal and mortgage borrowing. Furthermore, not only have savings banks been afforded new privileges, but they have been given them without any corresponding relinquishment of the traditional benefits enjoyed exclusively by savings banks. Moreover, it must be stressed that the benefits conferred upon savings banks are by no means unique to Massachusetts. They vary from state to state, but in many respects they have placed savings banks in a preferred position as compared with commercial banks. The benefits include: (1) the higher interest rates allowable on time and savings deposits under federal law;¹⁰⁸ (2) certain tax advantages over commercial banks;¹⁰⁹ and (3) lower required reserve levels.¹¹⁰

¹⁰⁵ Mass. Ann. Laws ch. 168 App., § 2-17 (1971) provides:

The portions of the deposits of all member banks which shall have become members of the Federal Deposit Insurance Corporation, in excess of . . . [the maximum amount] . . . covered by the [FDIC] insurance . . . shall continue to be insured in full by the Deposit Insurance Fund . . .

(Footnote omitted.)

¹⁰⁶ See note 104 *supra*.

¹⁰⁷ Act of June 7, 1972, ch. 381, § 1, Mass. Ann. Laws ch. 168, § 37B.

¹⁰⁸ The federal regulations governing the rates of interest provide that savings banks may pay 5% on regular savings accounts, compared to the maximum of 4½% which may be paid by commercial banks. On "ninety-day notice" accounts the maximum interest rates are 5¼% for savings banks and 5% for commercial banks. In Massachusetts, the differences are even greater, since savings banks in that state may pay 5¼% on regular savings and 5½% on ninety-day notice accounts. Koplów, *supra* note 94, at 17, col. 3.

¹⁰⁹ Compare 26 C.F.R. §§ 1.581-584 (1972), with *id.* at §§ 1.591-594.

¹¹⁰ While the Federal Reserve Board's Regulation D does not distinguish between commercial banks and savings banks, it does require lower reserve levels on time and savings deposits than it does on demand deposits. See note 58 *supra*. Since savings banks

In addition, the expansion of savings bank powers is likely to affect branch banking laws on the state level. In the typical case, banks are restricted from operating branch offices in towns or cities in which they would be competing directly with other banks already established there.¹¹¹ The obvious reason for these restrictions is to protect the competitive position of the smaller banks. In Massachusetts, for example, the competitive element between savings banks and commercial banks was for many years considered to be minimal, and consequently these types of institutions were permitted to operate branches in the same communities.¹¹² Today, however, with savings banks offering NOW accounts and credit cards, the competition has been made more direct, so that the competitive position of a small commercial bank in a rural or suburban area of the state is likely to be endangered by the mutual savings bank down the street. As has been pointed out by the Massachusetts Commissioner of Banks: "This policy [of permitting savings banks and commercial banks to operate branches in the same communities] will definitely have to be re-evaluated in the light of recent developments."¹¹³

B. *Effect on Traditional Banking Practices*

In addition to its effect on the competitive balance, the impact of the NOW account on traditional notions of sound banking practice poses a variety of problems. It is the contention of commercial bankers that the institution of third-party payment accounts in savings banks constitutes a threat to the safety and integrity of the total banking structure.¹¹⁴ In this regard, consideration must be given to the specific problems created by the NOW account.

1. *Reserve Requirements*

A principal source of potential danger is the fact that reserve requirements are considerably lower for savings deposits than for demand deposits.¹¹⁵ The reason behind this disparity is that demand deposits are more susceptible to sizable withdrawals at any given moment than are savings deposits. The nature of the deposits indicates why this is so. Savings accounts are generally used by depositors in order to safeguard their residual savings, while demand deposit balances are usually maintained at levels sufficient to cover estimated bills and other expenses. The very idea behind demand deposits is to permit the customer to

have most of their deposits in time and savings accounts while commercial banks carry mostly demand deposit accounts, the net effect of this regulation is lower reserve requirements for savings banks.

¹¹¹ See, e.g., Conn. Gen. Stat. Rev. § 36-59 (Supp. 1972-73), § 36-129 (1969); N.H. Rev. Stat. Ann. § 384-B:2 (1968).

¹¹² Koplow, *supra* note 94, at 27, col. 1.

¹¹³ *Id.*

¹¹⁴ Petition for Relief, *supra* note 65, at 2.

¹¹⁵ See note 58 *supra*.

make immediate withdrawals, while the basis of a savings account is to encourage the accumulation of savings through maximal deposits and minimal withdrawals. Thus, in the normal course of operations, the emphasis in checking accounts will be on withdrawals, and in savings accounts on deposits. For this reason, the Federal Reserve Board has imposed substantially higher reserve requirements on demand deposits, in order to protect the banks and their customers from any unusually heavy demand for withdrawals. Theoretically, at least, the demand for savings withdrawals will never be as great on any given day as the demand for checking withdrawals.

But when "checking" withdrawals are permitted to be made from savings accounts, as is presently the case in Massachusetts savings banks offering the NOW account, the situation changes. Withdrawals from these accounts are likely to increase substantially, yet there is no corresponding requirement imposing higher reserve levels. In fact, as things now stand, Massachusetts savings banks, by virtue of their not being member banks of the Federal Reserve System, are not even subject to the limited reserve requirements applicable to savings deposits.¹¹⁶ Thus, while commercial banks must maintain a federally prescribed ratio of cash and highly liquid securities in order to cushion the effects of greater-than-average checking transactions, savings banks are under no such obligation, and their freedom to keep on hand low reserve levels poses a potential threat to the safety of deposits.

2. *Problems of Negotiability*

The subtle distinction between the NOW account withdrawal order and a conventional check poses problems of a different nature. The distinction referred to is, of course, the fact that although on their faces the two instruments may be identical, the check is payable on demand while the withdrawal order is subject by agreement to the imposition of a ninety-day notice requirement.

What happens, then, to the maker, payee, or holder of the withdrawal order if the bank decides to impose the notice requirement? Obviously, there are many variations on this situation. The maker may name himself as payee and be refused payment. He may name someone else as payee who has never heard of the NOW account and believes the instrument to be a conventional "payable on demand" check; or the payee may be well aware of the limitations imposed on the instrument, but may indorse it over to a third party who takes without notice of the restrictions. And what of the order of these occurrences? Is there a distinction to be drawn between the depositor who, after being notified by the bank that the notice requirement has been imposed, nevertheless continues to write withdrawal orders in disregard of the bank's author-

¹¹⁶ According to Petition for Relief, *supra* note 65, at 12, the closest thing to a reserve requirement on Massachusetts mutual savings banks is the mandatory assessment imposed by the MSCF which may be as little as 1% of deposits.

ity, and the one who, after properly executing several withdrawal instruments, is notified that the bank has chosen not to honor them for ninety days.¹¹⁷

It must be remembered that in the vast majority of cases the bank is not likely to impose any notice requirement, and none of the problems listed above is apt to occur.¹¹⁸ Should one occur, however, the fundamental consideration in assessing the problem must be what appears on the face of the instrument. "The negotiability of an instrument is always to be determined by what appears on the face of the instrument alone, and if it is negotiable in itself a purchaser without notice of a separate writing is in no way affected by it."¹¹⁹ The face of the NOW account withdrawal order currently in use is virtually identical with that of a conventional check, whose negotiability no one disputes. So too is the NOW account withdrawal order a negotiable instrument under the Uniform Commercial Code.¹²⁰ Furthermore, the withdrawal order appears to fit the Code's definition of a "check," since it is drawn on a bank and is payable on demand.¹²¹

Where the face of the NOW account withdrawal order and the face of a regular check are exactly alike, it is difficult to imagine that a holder of the former who takes without notice of the "condition"

¹¹⁷ It is not within the scope of this comment to attempt to answer all of these questions. They are posed merely to suggest the range of problems presented by the NOW withdrawal order.

¹¹⁸ See text at note 93 *supra*.

¹¹⁹ Uniform Commercial Code § 3-119, Comment 5. Although § 3-119 is directed toward "other writings" which are part of the same transaction as the negotiable instrument, this language from Comment 5, read in light of other Code sections, appears to be applicable to all agreements which ostensibly affect the negotiability of the instrument. Cf. U.C.C. §§ 3-108, 3-109. [All citations to the Uniform Commercial Code will be to the 1972 Official Text.]

¹²⁰ The instrument contains all the attributes of negotiability set forth in U.C.C. § 3-104, since it:

- (a) . . . [is] signed by the maker or drawer; and
- (b) contain[s] an unconditional promise or order to pay a sum certain . . . ; and
- (c) . . . [is] payable on demand or at a definite time; and
- (d) . . . [is] payable to order or to bearer.

U.C.C. §§ 3-104(1)(a)-(d).

¹²¹ A negotiable instrument is "a 'check' if it is a draft drawn on a bank and payable on demand . . ." U.C.C. § 3-104(2)(b). A negotiable instrument is "a 'draft' . . . if it is an order. . . ." U.C.C. § 3-104(2)(a). "An 'order' is a direction to pay and must be more than an authorization or request . . ." U.C.C. § 3-102(1)(b). "Instruments payable on demand include . . . those in which no time for payment is stated." U.C.C. § 3-108.

A distinction should be drawn between those instruments that are "payable on demand" under the Uniform Commercial Code and those deposits that are classified as "demand deposits" under Regulation Q and its FDIC counterpart. It will be recalled that "demand deposits" are defined as those deposits that are not classified as time or savings deposits. See text at notes 52, 61, 92-94 *supra*. They are defined with respect to the depositor-bank relationship, and not to the Code's "payable on demand" concept that is associated with negotiable instruments. Thus, a bank account whose deposits are withdrawable via negotiable instruments that are payable on demand under the U.C.C. is not necessarily a demand deposit account.

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should have fewer rights than a holder of the latter. Accordingly, it would appear that under the Uniform Commercial Code the NOW withdrawal order will be treated as a "check," and a payee or indorsee will be a holder in due course.¹²² However, should the bank refuse to pay the order on demand, the rights of the holder will lie only against the maker of the order.¹²³ This puts the holder of a dishonored NOW account "check" in the position of seeking payment "on demand" from the depositor-drawer, who himself probably cannot make a withdrawal until the notice period has run because he, like his payee, is subject to the notice provision in the account agreement.

Banks issuing NOW account withdrawal orders should be well aware that such instruments are likely to find their way to all parts of the country and to a great number of people who have never heard of a NOW account. A bank which refuses to honor such an instrument presented for payment by a holder in good faith does a disservice to the typical payee or indorsee who accepts the instrument as what it appears to be—a check that is payable on demand.

Furthermore, while the contention can be made that a person always accepts a check subject to certain implied conditions upon which payment may be refused, such a contention lacks merit insofar as it is offered as a means of resolving problems implicit in the NOW withdrawal order's resemblance to a check. While it is true that a bank may refuse payment for a variety of reasons (forgery, alteration, insufficient funds, payment stopped, missing indorsement or signature, etc.),¹²⁴ such reasons are based upon improper or negligent conduct on the part of the maker, and not on any fault attributable to the bank. To say that the statutory authority to impose a notice requirement affecting withdrawals is but another justifiable reason for refusal to pay is untenable, because it is the conduct of the bank, insofar as it controls the format of the withdrawal order, and not that of the depositor, upon which this particular justification would rest.

It is submitted, therefore, that so long as the NOW account withdrawal orders continue to resemble conventional checks, the reserved authority of a bank to impose a notice requirement upon withdrawals should not, as a matter of fairness, be permitted to defeat the rights of a payee who takes without notice of such authority. However, in states such as Massachusetts whose banking statutes provide savings

¹²² See U.C.C. § 3-302.

¹²³ U.C.C. § 3-409(1) provides: "A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it." "Acceptance" is defined in § 3-410 as "the drawee's signed engagement to honor the draft as presented." Taken together, these two sections provide that the holder has no cause of action against the payor—i.e., the bank—unless and until the bank expressly agrees to pay as directed by the maker. Section 3-122(3) of the Code provides: "A cause of action against a drawer of a draft . . . accrues upon demand following dishonor of the instrument. Notice of dishonor is a demand."

¹²⁴ See U.C.C. § 3-510, Comment 2.

banks with the right to require ninety days notice of withdrawal from their accounts,¹²⁵ it would appear that a payee would not be permitted to compel payment on demand.

In recognition of this problem, the suggestion has been made that disclosure of the bank's reserved authority to require notice of intent to withdraw ought to be made mandatory by the use of a legend appearing on the face of each withdrawal order.¹²⁶ Such a requirement would assure banks issuing these instruments that all payees and subsequent holders would be held to be aware of the notice condition. But just as surely, such a requirement would pose a threat to the acceptability of these instruments to the general public.¹²⁷

3. *The Check Collection Process*

In addition to the possibility of public reluctance to accept NOW account withdrawal orders, the disclosure of the notice requirement on the face of the instrument might affect the internal operations of the check collection process.¹²⁸ Although checks and other items may be processed through a bank clearinghouse system or through a Federal Reserve Bank, the Federal Reserve procedure is often chosen because of the "direct, expeditious, and economical"¹²⁹ nature of its operation. Thus, despite the fact that a mutual savings bank, which is state-chartered, may not be a member of the Federal Reserve System, and hence will not be subject to Regulation Q, it will nevertheless be subject to the Federal Reserve Board's Regulation J¹³⁰ if it sends items for collection through a Federal Reserve Bank.¹³¹ Regulation J "govern[s] the collection of checks and other cash items and the collection of non-cash items by the Federal Reserve banks."¹³²

Under current procedures, NOW account withdrawal orders are processed as "cash items," in the same manner as checks.¹³³ However,

¹²⁵ See Mass. Ann. Laws ch. 168, § 26(2) (1971), quoted in note 84 supra.

¹²⁶ Koplow, *supra* note 94, at 27, col. 1.

¹²⁷ *Id.*

¹²⁸ For a detailed treatment of the check collection process and related material, see B. Clark & A. Squillante, *The Law of Bank Deposits, Collections and Credit Cards* (1970).

¹²⁹ 12 C.F.R. § 210.3 (1972).

¹³⁰ *Id.* at §§ 210.1-.16.

¹³¹ *Id.* at § 210.1.

¹³² *Id.* at § 210.1(a).

¹³³ Regulation J defines the terms "item," "cash item," and "noncash item" as follows:

(a) The term "item" means any instrument for the payment of money, whether negotiable or not, which is payable in a Federal Reserve district, is sent by a sender or a nonbank depositor to a Federal Reserve bank for handling . . . and is collectible in funds acceptable to the Federal Reserve bank of the district in which the instrument is payable

. . . .

(i) The term "cash item" means:

(1) Any check other than a check classified as a noncash item in accordance with paragraph (j) of this section; or

(2) Any other item payable on demand . . . which the Federal Reserve bank

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the Federal Reserve Banks have the authority to determine at their own discretion what items shall be handled as cash items and what items as noncash items.¹⁸⁴ In this regard, the Federal Reserve Bank of Boston has issued an operating letter containing the following language:

We reserve the right, in our discretion, to return or to handle as a noncash item any item which has previously been dishonored or if special conditions require that it be handled as a noncash item, and this bank shall decide whether such special conditions exist.¹⁸⁵

It seems clear, then, that the Federal Reserve Banks have the authority to deem the NOW account withdrawal order a "noncash item" and to process it as such, especially if the "condition" relating to notice of intent to withdraw were to be included on the face of the instrument. Were these instruments to be treated as noncash items, their collection process would be delayed considerably, since noncash items generally "do not contain the full potential of payment ordinarily associated with cash items,"¹⁸⁶ and are therefore processed less quickly, resulting in greater "uncollected" balances in the bank accounts of depositors who accept them. This delay in collection might, therefore, pose another threat to the acceptability of NOW account withdrawal orders by the public. Consequently, it is apparent that the Federal Reserve Board's power to regulate the collection process gives it the potential "to head off [the] NOW [account] at the clearing house."¹⁸⁷

of the district in which the item is payable may be willing to accept as a cash item.

(j) The term "noncash item" means any item which the receiving Federal Reserve bank, in its operating letters, shall have classified as an item requiring special handling and any item normally received by the Federal Reserve bank as a cash item if such bank decides that special conditions require that it be handled as a noncash item.

Id. at §§ 210.2(a), (i), (j) (footnote omitted).

¹⁸⁴ Regulation J provides in part:

Each Federal Reserve bank shall issue operating letters . . . governing the details of its operations in the handling of cash items and noncash items Such letters may, among other things, classify cash items and noncash items

Id. at § 210.16.

¹⁸⁵ Federal Reserve Bank of Boston, Operating Letter No. 6, § 2, cited in Massachusetts Bankers Association and New Hampshire Bankers Association, Petition for Relief with Respect to Third Party Withdrawal Orders Offered by Mutual Savings Banks, at 13 (Oct. 20, 1972) [hereinafter cited as Petition for Relief].

¹⁸⁶ Petition for Relief, *supra* note 135, at 27. Items are dealt with in bulk as "cash" items on the assumption that they will be honored in the overwhelming majority of cases; provisional credits are entered immediately for [them] . . . at all stages of the collection process and automatically become final without further action upon payment by the drawee bank. . . .

Farnsworth, Documentaries Drafts Under the Uniform Commercial Code, 22 Bus. Law. 479, 482 (1967).

Items "are handled as 'collection' [noncash] items and dealt with individually, rather than in bulk, . . . [when] no assumption is made that they will be honored, [and] no credits, not even provisional credits, are given until the item has been paid" Id.

¹⁸⁷ Time, Jan. 15, 1973, at 71.

In sum, the NOW account needs to be viewed in relation both to the competitive balance between savings banks and commercial banks and to recent developments in traditional banking methods. When so viewed, it is submitted, the institution of the NOW account poses a variety of problems not considered by the *Consumers* court. It appears likely, however, that the *Consumers* decision will not long remain the only authority bearing on the legality of the NOW account. On the state level, in the wake of an unenacted bill that would have authorized Massachusetts savings banks to accept demand deposits,¹⁸⁸ a special legislative commission has been established to study the situation relating to savings bank checking accounts.¹⁸⁹ On the federal level, the recent Hunt Commission report indicates that a broad-based reform of federal banking regulation may be forthcoming.¹⁴⁰

Despite the existence of factors that point toward the potential dangers of the NOW account, it is highly unlikely that consumer-minded legislators will overturn the *Consumers* decision by enacting legislation designed to prohibit entirely the offering of third-party payment services by savings banks.¹⁴¹ Rather, some form of compromise

¹⁸⁸ Mass. House Bill No. 1986 (1971).

¹⁸⁹ Mass. House Bill No. 5455 (1971). Among the areas under investigation are:

- (a) the availability of funds for home financing;
- (b) the economic effect on the banking industry;
- (c) the economic effect on the citizens of Massachusetts;
- (d) the effects on taxation;
- (e) the effects on reserve requirements;
- (f) the report of the Hunt Commission;
- (g) the experience of other states.

¹⁴⁰ See Hunt Commission, *supra* note 102. The Hunt Commission report is likely to be a basis for future legislative action in the area of banking reform. The Commission was charged with the duty to "review and study the structure, operation, and regulation of the private financial institutions in the United States, for the purpose of formulating recommendations that would improve the functioning of the private financial system." *Id.* at 1 (quoting President Nixon).

The Commission advanced a number of proposals affecting all areas of the banking industry. In assessing the current state of federal banking law, it remarked that "the changes that have occurred in private institutions and in the markets they serve reflect efforts by the financial system to adapt to fundamental economic changes in a regulatory climate that has not adapted to these new conditions." *Id.* at 12. For this reason, if the recommendations offered by the Commission are implemented, they would constitute a broad-based reform of the American banking structure, and by their nature would result in a system of freer competition among financial intermediaries.

Specific recommendations affecting mutual savings banks and indicative of the Hunt Commission's desire to relax the regulation of banking institutions include proposals:

- (1) that the Federal Reserve Board's power to set interest rate ceilings on time and savings deposits be exercised on a standby basis only, but that the prohibition against the payment of interest on demand deposits be retained, *id.* at 23, 27;
- (2) that mutual savings banks be given greater loan and investment powers, *id.* at 31;
- (3) that mutual savings banks be granted the authority to offer a wider range of time and savings deposits, certificates of deposit, and third-party payment services, *id.* at 33; and
- (4) that federal charters be available to thrift institutions that desire them, *id.* at 59.

¹⁴¹ However, a bill to this effect has been filed in the Massachusetts House of

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proposals are likely to be adopted.¹⁴² It is urged that legislators considering how far to broaden the functions of mutual savings banks should take into account the mutuals' fundamental objectives of serving the savings and mortgage markets. If savings banks now desire to offer what are in essence commercial services, then they may be starting to retreat from the traditional bases upon which they were founded. With savings institutions nibbling at the temptation to expand into commercial territory, the interests of the savings and mortgage markets, as well as those of the public at large, might best be served by affixing a price tag to the granting of the authority to engage in such activities. Thus, it would seem sensible to require savings banks to relinquish at least a portion of their benefits, such as their higher interest rates, in exchange for the added competitive advantage that third-party payment accounts now afford them.¹⁴³

CONCLUSION

The institution of the NOW account marks an effort to broaden the functions of savings banks in Massachusetts. In this regard, there is reason for concern over its "potential for disrupting the financial

Representatives by the Massachusetts Independent Bankers Association, Boston Sunday Globe, Jan. 14, 1973, at 34-B, col. 6.

¹⁴² The Massachusetts Bankers Association and the New Hampshire Bankers Association, representing the commercial banks in those states, have suggested four alternative solutions to the problems created by the NOW account. These proposals, in the order of preference to the commercial banks, are: (1) the complete prohibition of third-party payment accounts in savings banks; (2) the prohibition of any interest payments on such accounts; (3) the granting to commercial banks of the authority to offer this type of account, and the setting of a maximum interest rate of 1-2% on all such accounts; or (4) the granting to all banks, commercial as well as savings, of the authority to offer such accounts, with the 5¼% interest rate applicable to all banks. Petition for Relief, supra note 135, at 25-26.

In addition, the commercial banks have petitioned the following agencies and officials, requesting: (1) that the Federal Reserve Board classify the NOW account withdrawal orders as noncash items, or, in the alternative, permit commercial banks to pay 5¼% interest on their demand deposits; (2) that the FDIC Board subject mutual savings banks to the same restrictions imposed on other insured banks, by eliminating their exemption under 12 C.F.R. § 329.0 (1972) (see text at note 64 supra); (3) that the Massachusetts Commissioner of Banks issue a regulation similar to Regulation Q, to be applicable to all Massachusetts savings banks; (4) that the MSCF prohibit its member banks from offering third-party payment accounts; and (5) that the Attorney General of Massachusetts petition the Supreme Judicial Court for a rehearing of the *Consumers* case, and that he investigate the possibility that the failure of the savings banks to indicate either on their withdrawal orders or in their advertisements that each bank may require up to ninety days written notice of withdrawal constitutes an unfair or deceptive practice under Mass. Ann. Laws ch. 93A, § 2 (1971). Petition for Relief, supra note 135, at 27-31.

¹⁴³ An alternative proposal would be to permit all banks, commercial as well as savings, to offer the NOW account, although in light of Regulation Q such a proposal would appear to be unworkable unless the federal regulatory scheme is substantially revised.

stability' of the banking structure"¹⁴⁴ not only in Massachusetts, but in other states where mutual savings banks may attempt to introduce it. It appears that any mutual savings bank that is not a member of the Federal Reserve System, and thus not subject to Regulation Q, is potentially able to offer a service similar to the NOW account, so long as its state-granted charter and the state regulatory laws permit it to do so. Membership in the FDIC alone will not inhibit it. However, the granting of such new and potentially disruptive powers to savings banks ought to be exercised with the greatest degree of caution and foresight, and be accompanied by changes, or at least by proposals for changes, that would alleviate disruption and promote the long-range benefits of the new development.

The *Consumers* decision, while accurate in its reasoning that Massachusetts law permits savings bank deposits to be withdrawn by means of negotiable withdrawal orders, supplies neither the caution, nor the foresight, nor the proposals for change that are necessary to protect banks and depositors from the potential problems that are presented by the expansion of savings banks into commercial areas. Indeed, had the court attempted to consider the many complex financial and economic problems presented by the NOW account, it would arguably have been overstepping its judicial boundaries and invading the legislative province. As a result, the questions left unanswered by the court's decision indicate the urgent need for legislative action to supplement the initial groundwork laid down by the *Consumers* case.

To this end, it is necessary that state and federal authorities channel their efforts toward a comprehensive analysis of the problems involved in instituting essentially commercial services, such as third-party payment accounts, in savings banks. Every new power granted to these institutions will have an impact upon the competitive balance between commercial banks and thrift institutions, and it is the responsibility of banking authorities to insure that the balance is not upset. Nor is it wise to permit expanded services to threaten the safety of bank deposits, as where deposits that are in essence payable on demand are not backed by sufficient reserve levels. It is hoped that future legislative action in this area will reflect those considerations that are vital to the safety and stability of the banking industry.*

ALAN J. KAPLAN

¹⁴⁴ Boston Globe, Oct. 6, 1972, at 37, col. 6 (statement of Frank Morris, President of the Federal Reserve Bank of Boston).

* As this comment went to press, two bills pertaining to the NOW account were introduced in Congress. H.R. 4070 is "[a] bill . . . to prohibit depository institutions from permitting negotiable orders of withdrawal to be made with respect to any deposit or account on which any interest . . . is paid." H.R. 4070, 93d Cong., 1st Sess., reprinted in 119 Cong. Rec. H874 (daily ed. Feb. 7, 1973). S. 1008 is "[a] bill . . . to make clear that Federal banking statutes do not prohibit depository institutions from offering negotiable order of withdrawal services in connection with certain interest-bearing deposits." S. 1008, 93d Cong., 1st Sess., reprinted in 119 Cong. Rec. S3212 (daily ed. Feb. 26, 1973).