STATE OF MICHIGAN

DEPARTMENT OF COMMERCE

FINANCIAL INSTITUTIONS BUREAU

IN RE: REQUEST BY MICHIGAN BANKERS' ASSOCIATION FOR A DECLARATORY RULING ON THE APPLICABILITY OF MCLA 490.1, et seq; MSA 23.481, et seq, TO SHARE DRAFTS OFFERED BY CREDIT UNIONS

DECISION

Statement of Facts

Beginning in October, 1974, credit unions began offering share drafts to their members through the cooperation of the Credit Union National Association (CUNA) and the Michigan Credit Union League (MCUL). The federal agency charged with supervising federally chartered credit unions, the National Credit Union Administration (NCUA), pursuant to Regulation 721.3, 12 CFR 721.3, permitted federally chartered credit unions to participate in share draft programs on an experimental basis. The Financial Institutions Bureau (FIB), upon inquiry by state chartered credit unions, took the position that it would not object to state chartered credit unions offering share draft programs if certain minimum standards were followed. Since that time, a number of credit unions, both state and federal, have begun and are continuing to offer share draft programs to their members. The burgeoning use of credit union share drafts is demonstrated by the uncontroverted statistics contained in the MCUL brief, wherein at page 5 it is stated:

> "Since their introduction in 1974, share-draft accounts have been extremely well received by credit union members. Member use of share-drafts has grown dramatically and steadily since that time.
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> "During the month of November, 1976, for example, 79 state and 67 federal credit unions in Michigan processed share-drafts written by their members. These share-drafts were written upon a total of 44,236 accounts, 25, 397 in state credit unions and 18,839 in federals. The total number of drafts processed during that month was 452,543,

> 212,988 written by members of state credit unions in a total face amount of $9,398,331.82 and 239,555 written by federal credit union members in a total face amount of $13,678,068.00. The average draft is running about $50.00, and about 10 drafts per month are cleared through the average share-draft account. It is anticipated by ICU Services Corporation, the sponsor of the share-draft form in most common use, that Michigan credit union members will be writing 1,000,000 share drafts per month before the end of 1977, particularly since many additional Michigan credit unions are now in various stages of implementing their own programs."

By letter dated October 11, 1976, the Michigan Bankers' Association (MBA) requested a declaratory ruling on the legality of share drafts and on the applicability of the Michigan Credit Union Act, 1925 PA 285, as amended, MCLA 490.1 et seq; MSA 23.481 et seq, to share drafts. The declaratory ruling was requested pursuant to Section 63 of the Administrative Procedures Act, 1969 PA 306, § 63, MCLA 24.263; MSA 3.560(163), which provides in pertinent part as follows:

> "On request of an interested person, an agency may issue a declaratory ruling as to the applicability to an actual state of facts of a statute administered by the agency or of a rule or order of the agency...."

Concurrent with the letter requesting the declaratory ruling, the MBA submitted a memorandum of law discussing the applicable law.

Richard J. Francis, Commissioner of the Financial Institutions Bureau, declared his intent to issue a ruling on the question presented by the MBA at a meeting held in the offices of the Financial Institutions Bureau on December 13, 1976. Present at that meeting were representatives of the MBA, the MCUL, the Michigan Association of Credit Unions (MACU), the Michigan Consumers Council, and the FIB. At that meeting the Commissioner asked the representatives of the credit unions to prepare a memorandum of law discussing the issues and responding to the MBA request.

Subsequently, on January 20, 1976, the Commissioner heard oral arguments on the issues and allowed further time to file written supplementary briefs. The MBA filed a supplemental memorandum of law

on January 31, 1977, and the MCUL responded by its supplemental memorandum of law on February 4, 1977.

Although not an issue in this case, it is instructive to describe the share draft program presently utilized by the credit unions and their members. When a credit union member desires to use the share draft, he or she fills it out in substantially the same manner that a check or other draft is prepared. The draft directs the credit union to pay to the order of a named payee from the member's account the amount written on the draft. The draft is payable through a bank to facilitate "clearing". The process after the draft is delivered to the payee is similar to that of a check except for the draft being "payable through" a bank instead of "payable at" a bank, as in the case of a check.

The fact that the payee of the share draft may be someone other than a member, some third party, is the basis for the question presently before the FIB.

Issues

The MBA argues that:

1. The power of a credit union to allow its members to issue share drafts drawn upon the member's share or deposit account must be based on expressed statutory authority.

2. The Michigan Credit Union Act, in Section 4(m) gives a credit union power to disburse funds from a member's account to third parties upon the member's written order only for expressly specified expenses of the member.

3. A credit union does not have the incidental or implied power to utilize share draft accounts in carrying out its statutory purpose.

Statutes

The statutory language at issue in this decision is the Michigan Credit Union Act, 1925 PA 285, as amended, MCLA 490.1 et seq;

MSA 23.481 et seq, and the Credit Union Multiple-Party Accounts Act, 1968 PA 41, MCLA 490.51 et seq; MSA 23.510(1) et seq.

Section 4 of the Credit Union Act, MCLA 490.4; MSA 23.484, deals with the powers of credit unions. Subsection (m) of Section 4 deals specifically with the issue at hand. Section 4(m) provides that credit unions shall have the power:

> "To disburse from the share or deposit account of the member funds as the member may direct in writing for the following purposes only: Insurance premiums, mortgage, land contract and rent payments, utility bills, debt management disbursements, and support and alimony payments and payments made pursuant to an order or judgment of a court."

Sections of the Credit Union Multiple-Party Accounts Act relevant to this issue are Section 1 and 10, with appropriate portions set forth below. 1968 PA 41, § 1, MCLA 490.51; MSA 23.510(1), provides in pertinent part the following definitions:

> "(c) 'Demand' means a request for withdrawal or for payment according to an order therefor in compliance with all conditions of the account and bylaws of the credit union.
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> * * *
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> "(f) 'Party' means a person who, alone or in conjunction with another, by the terms of the account or as a surviving beneficiary of a trust account, has a present right of withdrawal in a multiple-party account. Unless the context indicates otherwise, it includes a guardian, conservator-trustee, personal representative, or assignee, including an attaching creditor, of a party. It also includes a person identified as a trustee of an account for another whether or not a beneficiary is named, but it does not include any named beneficiary, unless he has a present right of withdrawal.
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> "(g) 'Payment' of sums on deposit includes withdrawal and payment on directive of a party.
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> * * *
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> "(k) 'Withdrawal' includes payment to a third person pursuant to directive of a party."

Section 10 of the Multiple-Party Accounts Act, MCLA 490.60; MSA 23.510(10), reads in pertinent part as follows:

> "A credit union may enter into multiple-party accounts to the same extent that they may enter into single-party accounts. Any multiple-party account may be paid, on demand, to any 1 or more of the parties unless the terms of the account expressly stipulate that joint signatures are required. No credit union shall be required to inquire as to the source of funds received for deposit to a multiple-party account or to inquire as to the proposed application of any sum withdrawn from an account...."

Discussion of Law

Neither the MBA nor the MCUL dispute the right or ability of a member to personally withdraw funds from his or her account. Both parties correctly point out that this right is so fundamental as to render unnecessary any statutory reference to the right of withdrawal by a member. In its initial brief, the MBA argued that "the power of a credit union to allow its members to issue drafts drawn on their share or deposit accounts must be based upon an expressed statutory authority." See brief of MBA, page 2, October 11, 1976. Related to this argument, the MBA further argued that "a credit union does not have the incidental power to create and use share drafts as an activity of power incidental to carrying out its statutory purpose." See brief of MBA, page 9, October 11, 1976. However, in its subsequent brief, the MBA took the position that a credit union has, in the same manner as a bank or other financial institution, the implied power to honor third party payment requests. At pages 1 and 2 of its supplemental brief, dated January 28, 1976, the MBA stated as follows:

> "It [sic "If"] the parties agree in their contract that payment will be made by the debtor to third parties on orders from the creditor, such payments can be made. This is exactly what banks do pursuant to their contracts covering checking accounts. And this is what a credit union can do by its contracts with its members, if it has the power to enter into such contracts. This is the only issue: Do credit unions have the power to enter into such contracts with their members?
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> "While an argument can be made to the contrary, we can assume for the purpose of this proceeding that they have this power to contract unless it

> has been taken away from them by statute. Clearly, the Michigan statute regulating credit unions has taken away this power to contract."

Similarly, I would conclude that a credit union, like any other financial institution, may honor orders to pay third parties even in the absence of express legislative authorization. Judicial support for this proposition can be found in several cases involving the authority of savings banks to offer checking accounts., See: Hudson County National Bank v Provident Institution for Savings, 44 NJ 282, 208 A2d 409 (1965); Savings Bank of Baltimore v Banking Commissioner, 248 MD 461, 237 A2d 45 (1968); Consumers Savings Bank v Commissioner of Banks, 282 NE2d 416, 64 ALR 3d 1310 (Mass. 1972). Furthermore, I note that the Legislature has not expressly authorized banks to offer checking accounts to their customers. It can therefore only be concluded that the power to offer checking accounts is incidental to the express grant of power to receive the deposit of funds by the public since an illegal action is not legitimatized by the passage of time. The authority of a credit union to permit share drafts is similarly incidental to its power to receive deposits which although latent until 1974, exists unless abrogated by the Legislature. The question that remains, therefore, is whether the Legislature has taken away the power of credit unions to offer drafts drawn upon a member's account payable to a third party.

There is no language in either the Credit Union Act or the Multiple-Party Accounts Act which specifically deals with the subject of share drafts. Section 4 of the Credit Union Act, supra, sets out the powers of a credit union. Briefly, Section 4 grants to a credit union the powers to receive deposits, make loans, to make deposits and investments, to borrow money, to own certain real estate and personal property, to enter into certain contracts, and to disburse from member's share accounts or from the proceeds of a loan as set out in that section. Specifically, subsection 4(m) grants a credit union the power "To disburse from the share or deposit account of the

member funds as the member may direct in writing for the following purposes only: Insurance premiums, mortgage, land contract and rent payments, utility bills, debt management disbursements, and support and alimony payments and payments made pursuant to an order or judgment of a court." This power and the limitations on the power relate to the power of a credit union to disburse directly to a creditor of the credit union member as the member directs in writing. In contrast, there is no limitation upon the power of a credit union to disburse the proceeds of a loan as the borrower directs in writing and as set forth in subsection 4(n).

The MCUL argues that the power of a credit union to receive deposits of its members as specifically set forth in subsection 4(a) of the Credit Union Act, supra, impliedly grants the credit union the power to honor a member's request for withdrawal. The MCUL would distinguish a share draft from a third party payment limited in subsection 4(m) of the Credit Union Act by characterizing a share draft as a withdrawal as opposed to a disbursement from a member's funds under subsection 4(m).

This interpretation is based first on a distinction of the responsibilities and liabilities of the credit union itself on a share draft form of withdrawal and a third party disbursement. Share drafts require that the member issue a separate writing or authorization each time a withdrawal is made. The credit union is not liable for payment of the draft on the member's account until it accepts the draft upon proper presentment, and the member initiates each transaction. In contrast, a third party disbursement requires only a single initial authorization by a credit union member. The credit union assumes the risk for nonpayment in the event of loss, misdirection, or ignored bills. The authorized payment of disbursements may change without the knowledge of the member and the transaction is initiated by the creditor sending a notice of payment due to the credit union or by some indication contained in the credit union's own files.

Since the risks to the credit union, and consequently to its members, are substantially greater in the case of preauthorized payment, the power to make such disbursements directly to third parties is strictly limited by statute.

The basis for the distinction of a withdrawal by a member from a disbursement from a member's account by the credit union is reinforced by the definitions contained in Section 1 of the Multiple-Party Accounts Act, supra, of "demand", "payment", and "withdrawal", as well as the provisions of Section 10, wherein it is clearly set forth that a credit union may enter into a multi-party account to the same extent that it may enter into a single-party account. The most enlightening of these definitions is that of "withdrawal", provided at Section 1(k) of the Multiple-Party Accounts Act, supra. Since there is no logical basis on which to conclude that a withdrawal from a multiple-party account would be different from a withdrawal from a single-party account, at least with respect to third party payments, it must be concluded that any withdrawal from a credit union account contemplates payment to a third party.

Further support for this distinction is gained from reference to the recent amendments to subsection 4(a) of the Credit Union Act. 1976 PA 156, effective June 17, 1976, amended subsection 4(a) by deleting the requirement of written approval of the Commissioner to establish various classes of share accounts by credit unions by specifically providing that:

> "A credit union may have 1 or more classes of share or deposit accounts in the classifications and in the form and under the terms and conditions as authorized by its board of directors." (emphasis added)

1976 PA 156 also made technical amendments to subsection 4(m). It must be assumed that the Legislature was aware of the provisions of the Multiple-Party Accounts Act and the share draft controversy when it deliberated on the amendments to Section 4. The Legislature could easily have indicated its intent to prohibit the share draft program

at that time. Instead, the Legislature deliberately broadened the power of a credit union to offer various classes of share or deposit accounts "under the terms and conditions as authorized by its board of directors". In readopting the grant of authority to credit unions to establish various classes of share and deposit accounts and to set the terms and conditions of such accounts, the Legislature authorized the use of share draft accounts. Section 4(m) does not deal with the creation of any special accounts, but it only concerned with pre-authorized direct disbursements to third parties for special reoccurring purposes. Such payments do not require the use of drafts and are the result of a blanket authorization given by a member. Such payments are functionally and legally distinguishable from the use of a draft to effectuate a withdrawal.

The MBA and the MCUL have both discussed the alleged conflict between the Credit Union Act and the Mutliple-Party Accounts Act in regard to the power to offer share draft withdrawals for multiple-party accounts and the restrictions of single-party accounts as set forth in subsection 4(m) of the Credit Union Act. Based on the above interpretation, there is no conflict perceived by the Financial Institutions Bureau in this respect. The one provision, subsection 4(m), deals with the power of a credit union to disburse member's funds, while the Multiple-Party Accounts Act deals with the form of withdrawals by a credit union member.

Much of the oral presentation made on January 20, 1977, dealt with the legislative history of the present subsection 4(m) of the Credit Union Act. The MBA's letter of November 5, 1976 and their argument refers to statements made by former Commissioner Robert P. Briggs and Alfred S. Siegert, then President of the Michigan Credit Union League, concerning legislative intent.

Without question, these statements indicated that a credit union's power to make third party payments should be limited. The context of the debate at that time was not in terms of the withdrawal

functions of a member, but in terms of the disbursement by a credit union of member's funds to a third party pursuant to the member's directions. Much of the MBA argument on this issue can be countered by other statements made at the time amendatory legislation was being considered.

In a prepared statement for the Senate Committee on Corporations and Economic Development regarding Senate Bills 1209 and 1419 of 1970, George R. LaChapelle, President of the Michigan Credit Union League offered the following:

> "However, we are prepared to incorporate in the law a prohibition against establishing checking accounts for members, should this be deemed necessary."

In March, 1972, the Michigan Credit Union League prepared testimony for the same Senate Committee on Corporations and Economic Development, in regard to Substitute Senate Bill No. 992 of that year. Discussing the proposed amendment to subsection 4(m) the MCUL indicated that it has always had the right to make third party payments. Citing the Mutliple-Party Accounts Act, section 1(k) defining withdrawals, the MCUL argued that this power exists for single party accounts, and asked the Legislature to "clear up this confusion". The MCUL went on to say:

> "We reemphasize that we are not looking for the privilege of providing checking accounts for our members, even under the restrictive provisions of the Rhode Island statute. It would be impossible for us to do this, since we do not have access to the Federal Reserve System for check clearing, and setting up an independent system on a national basis would be prohibitive."

The above clearly indicates that subsection 4(m) deals with third party disbursement powers of a credit union.

Thus, the Legislature has been aware of this alleged conflict between the Credit Union Act and the Multiple-Party Accounts Act for a number of years. The question remains as to why the Legislature did not see fit to clearly decide the issue of third party payments, withdrawals and the confusion caused by the alleged

conflict of these acts. Did the Legislature think a prohibition was not necessary because a credit union can have only those powers expressly granted to it or did it think that the issue of third party disbursements under subsection 4(m) was substantially different from a member's method of withdrawing incidental to depositing funds in a credit union?

A clue is found in the Michigan Savings and Loan Association Act of 1964, 1964 PA 156, MCLA 489.501 et seq; MSA 23.540(101) et seq. This law dealing with another creature of statute, savings and loan associations, has several sections dealing with savings accounts. Section 305 specifically lists the types of savings accounts an association may issue, including in subsection (g):

> "Savings accounts of such classifications and in such form and under such terms and conditions as may be authorized by the board of directors." MCLA 489.705(g); MSA 23.540(305)(b)

Note that this language is nearly identical to subsection 4(a) of the Credit Union Act. However, unlike the Credit Union Act, the Savings and Loan Association Act provides in section 325, in part:

> "...A member shall not have on file in any 1 association more than 1 application [for withdrawal] at a time....An association cannot obligate itself to pay withdrawals on any plan other than as provided in this act." MCLA 489.725; MSA 23.540(325)

Thus, the Savings and Loan Association Act places strict limitations on withdrawals. Furthermore, the Savings and Loan Association Act, in section 326, provides:

> "Notwithstanding the provisions of section 325, upon application to and approval by the supervisory authority, an association, the accounts of which are insured by the federal savings and loan insurance corporation, may provide for contractually created periodic withdrawal plans and transfer of funds from a savings account or savings deposit to third parties and such third party transfer orders shall be non-negotiable. An association may charge a fee for its services in making any payment or transfer pursuant to this section."

It is important to note that in Section 326, supra, the Legislature permitted savings and loan associations to provide for the "transfer of funds from a savings account or savings-deposit to third parties." However, in expressly authorizing third party payments by savings and loan associations, the Legislature defeated their commercial utility by directing that "such third party transfer orders shall be non-negotiable." The express authorization to offer third party payment accounts was necessitated by the limitations contained in Section 325 of the Savings and Loan Act, supra, which prohibit a savings and loan association from providing any other withdrawal plan other than as expressly authorized in the act.

Since the Legislature had previously enacted the Savings and Loan Association Act, if it had intended to limit a credit union member's withdrawals as the MBA argues, it could have used similar language limiting the negotiability of third party orders, especially since the withdrawal issue was placed before it on numerous occasions.

I find it persuasive in determining the intent of the Legislature that it had the previously enacted statutory language of the Savings and Loan Association Act available if it intended to limit a credit union member's right to withdraw and the manner thereof.

Since the Legislature did not choose to place any limitations on the credit union member's right to withdraw, it must be assumed that "withdrawal" and "payment" as defined in the Multiple-Party Accounts Act would apply to all member share or deposit accounts. The Legislature affirmed this intent by providing in section 10 of the Multiple-Party Accounts Act that a credit union may enter into multiple party accounts to the same extent that it may enter into single party accounts.

This interpretation of the Credit Union Act and the Multiple-Party Accounts Act distinguishes the member's right to withdraw from the credit union's power to disburse and removes the "conflict" which arises if subsection 4(m) is determined to apply to "withdrawal".

Although not determinative of the issues involved in this declaratory ruling, it is interesting to note that while share drafts are here being challenged as being illegal, banks are participating and are indeed necessary parties since share drafts are "payable through" a bank. As indicated above, credit unions did not seek checking account powers because they had no entry to the clearing process. Yet banks have provided that entry to the clearing mechanism which enables a credit union's member to utilize share drafts.

Finally, it must be understood that the Financial Institutions Bureau has continuously monitored the development of the share draft programs of credit unions and will take appropriate action if it becomes necessary to protect the share or deposit accounts of the members of the credit unions or to insure the safety and soundness of the credit unions.

For the reasons set forth, I find that state chartered credit unions are not prohibited from allowing their members to utilize share drafts.

RICHARD J. FRANCIS
Commissioner
Financial Institutions Bureau