1-1-1975

Mutual Savings and Loan Associations: Rehabilitation of Membership Rights

David W. Yancey

Follow this and additional works at: http://digitalcommons.law.scu.edu/lawreview

Part of the Law Commons

Recommended Citation
David W. Yancey, Mutual Savings and Loan Associations: Rehabilitation of Membership Rights, 15 SANTA CLARA LAWYER 635 (1975).
Available at: http://digitalcommons.law.scu.edu/lawreview/vol15/iss3/3

This Article is brought to you for free and open access by the Journals at Santa Clara Law Digital Commons. It has been accepted for inclusion in Santa Clara Law Review by an authorized administrator of Santa Clara Law Digital Commons. For more information, please contact sculawlibrarian@gmail.com.
MUTUAL SAVINGS AND LOAN ASSOCIATIONS: REHABILITATION OF MEMBERSHIP RIGHTS

David W. Yancey*

INTRODUCTION

Customers who deposit their savings dollars in mutual savings and loan associations are called "members." The law provides that members in mutually organized savings and loan associations shall possess mutually shared rights of control and ownership of their savings institutions. Because of legislative inaction, poor agency supervision, regressive case law and public unawareness, however, mutual members in fact enjoy few of these membership rights and, in most instances, the members lack the powers necessary to enforce the rights they do possess. As a result, members have only minimal control over the management of their savings and loan associations. Because association managements are subjected to only minimal control by members and because government regulation frequently has been inadequate, managements have been virtually free from supervision in many cases. The lack of supervision often has resulted in the emergence of conflicts of interest within association managements.

* B.A. 1970, J.D. 1974, Stanford University; member, California Bar. The author is engaged in private practice in San Francisco.

1. See note 24 infra.
3. This contrasts with industry heritage. Before the turn of the century each member customer in a mutual savings and loan association was intimately involved with his association, playing simultaneously the roles of saver, prospective borrower and owner. The association was small, highly localized and responsive to membership and community needs. Members attended and voted at regular monthly meetings and also contributed their services to the operation of the association. They were fully informed of association activities and operations. A. Teck, MUTUAL SAVINGS BANKS AND SAVINGS AND LOAN ASSOCIATIONS: ASPECTS OF GROWTH 23 (1968). As associations increased in size, however, membership participation in association activities decreased. Today, most decisions concerning an association's activities are made exclusively by the management with little input from members.
The harm caused to a savings and loan association by these conflicts of interest may vary in degree. At the extreme such conflicts may result in insolvency and eventual collapse of the association, but more frequently, they may cause a gradual decay of association efficiency, service and responsiveness to membership needs.\footnote{5}

An in-depth examination of the conflict problem is a difficult task beyond the scope of this article. Most of the information regarding management conflicts is found only in the private sector and is unavailable for public scrutiny. Even government supervisory authorities do not have full access to relevant information.\footnote{6} In addition, the Federal Home Loan Bank Board (FHLBB) considers the information it does have in its possession regarding “problem” associations to be confidential and will not release it freely.\footnote{7} Undoubtedly, most savings and loan officials are of the highest integrity and competence. Nevertheless, there appears to be some room for improvement.\footnote{8} In the only extensive study of the conflicts of interest problem to date,\footnote{9} it was concluded that

\footnote{[a]lthough conflict of interest is a pervasive characteristic of private (and public) enterprise, it is perhaps more deeply in-beded and institutionalized in the savings and loan business than in most industries.\footnote{10}}

In all probability the conflicts within association managements and resultant debilitating effects would be minimized if members had greater control over management activities. After a description of the industry, this article undertakes a three-part analysis of the present deficiencies in the membership rights of association members. The lack of effective control rights is con-

\footnote{loan associations create situations where their personal interests and those of the association conflict with one another. Conflicts are normally characterized by self-dealing by directors or officers when acting in behalf of the association. Conflicts of interest may spring from willful violation of the law, or mere negligence or incompetency. Common examples of conflicts are where officers and directors engage in the unauthorized sale of association control; where ancillary tie-in business activities exists; where nepotism exists among directors, officers and employees; or where loans are made to friends or relatives of officers and directors. Herman, at 771-73, 798-801, 803-86, 891-92, 945.\footnote{5}}

\footnote{Herman, \textit{ supra} note 4, at 943.\footnote{6}}

\footnote{Id. at 764.\footnote{7}}

\footnote{T. MARVELL, \textit{THE FEDERAL HOME LOAN BANK BOARD} 153 (1969) [herein-after cited as MARVELL].\footnote{8}}

\footnote{Although the degree of abuse is difficult to quantify, clearly some savings and loan officials are capitalizing on available conflict situations. Wall Street Journal, Dec. 31, 1971, at 16, col. 1.\footnote{9}}

\footnote{Herman, \textit{ supra} note 4, at 941; \textit{HOUSE AND HOME}, Oct. 1970, at 10.\footnote{10}}

\footnote{Herman, \textit{ supra} note 4, at 941. This passage refers to the savings and loan industry as a whole, including both mutual and stock associations. In fact it would appear that for various reasons some types of conflicts are more prevalent in stock associations than in mutuals. \textit{Id.} at 944. An analysis of conflicts and reform within the stock association is beyond the scope of this article, however.\footnote{10}}
sidered, as are the procedural obstacles preventing effective implementation of existing membership rights. In addition, weaknesses in the information-dissemination structure are examined. Throughout the analysis, numerous proposals for reform are suggested.

I. DESCRIPTION OF THE INDUSTRY

A. Size and Purpose

The significance of the lack of effective supervision of mutual savings and loan associations by members is best appreciated if viewed in light of the importance of the industry itself. The savings and loan industry has experienced tremendous growth in recent years. Industry assets presently exceed $272 billion, having recently surpassed the total assets of the insurance industry, to make savings and loan associations the second largest of the nation's financial intermediaries. In addition, the industry now serves 55 million savers and 12.2 million borrowers, and employs 151,400 persons.

The primary objectives of savings and loan associations are to encourage thrift through the establishment of savings accounts and to provide for the economical financing of homes. In fulfilling the latter objective, savings and loans have become the nation's leading source of residential credit.

The rapid growth and substantial size of the industry, particularly in the area of home financing, illustrates the significance of savings and loan associations in today's economy. This also illustrates the potential for waste and abuse if association management are not properly supervised.

11. From 1960 to 1970, total industry assets climbed 104.7 billion dollars. UNITED STATES SAVINGS AND LOAN LEAGUE, 1973 SAVINGS AND LOAN FACT BOOK 53 (1973). From 1970 through 1973, the assets of the savings and loan business increased by 96.2 billion dollars, to produce a growth rate greater than that of any other major type of financial intermediary. UNITED STATES SAVINGS AND LOAN LEAGUE, 1974 SAVINGS AND LOAN FACT BOOK 54 (1974) [hereinafter cited as 1974 FACT BOOK].


13. Commercial banks rank first. In addition to commercial banks, savings and loans and life insurance companies, financial intermediaries also include credit unions, mutual savings banks (not to be confused with mutual savings and loan associations), and finance and investment companies. 1974 FACT BOOK, supra note 11, at 53-54.

14. The term financial intermediary means in essence a money merchant. Like other types of merchants, financial intermediaries buy money at wholesale prices (interest paid on depositor accounts) and sell at retail prices (interest received upon loans made). In return for providing services and bearing a risk, they realize a profit.

15. 1974 FACT BOOK, supra note 11, at 34, 53, 108.


17. 1974 FACT BOOK, supra note 11, at 34.
B. Corporate Structure

Although the savings and loan industry is dominated by a mutual form of corporate ownership, several states allow savings and loan associations to have either a mutual or stock form of ownership structure.

Stock associations. Under a stock form of corporate ownership, individuals contribute the permanent capital to the savings and loan association in exchange for an ownership interest evidenced by the association's issuance of stock certificates to those contributing capital. These shares, which are transferable and may be traded in the open market, represent the stockholder's pro rata ownership in the association. In contrast to the mutual association, these stockholders need not be savers in the association. In most cases, the savers in a stock association are merely customers, having no rights of association control or ownership.

Thus the structure and ownership of a stock association is identical to that of an ordinary corporation, the primary purpose of which is to maximize growth and profit for the owners.

Mutual associations. Under a mutual corporate structure, the capital of an association is contributed by its depositors. The individual depositors become "members" or partial owners of the association and, as such, have the right to vote on association actions and affairs. Thus, unlike a stock association, a mutual association issues no capital stock and ownership is in the hands of savers and not stockholders.

Numerous rights and interests accrue to individuals who become depositors in a mutual savings and loan association. In addition to the right to vote, all savers in a mutual association have the right to share in the earnings and assets of the association in propor-

18. Mutually owned associations represent 87.1 percent of all associations and hold 78.2 percent of total industry assets. 1974 Fact Book, supra note 11, at 60.
19. See notes 33-34 and accompanying text infra.
20. ABA Handbook of Savings and Loan Law 12 (1973) [hereinafter cited as ABA Handbook].
21. Id.
22. See Herman, supra note 4, at 763, 782.
24. 12 C.F.R. § 544.1(a)(4) (1974). In a corporation that issues capital stock, the owners buy shares and are called stockholders. If a corporation has no capital stock—a mutual—its owners are called members rather than stockholders and occupy the dual roles of both customer and owner of the corporation. See Black's Law Dictionary 1588 (4th ed. 1968).
25. It should be noted that borrowers from the mutual association are also "members" with voting rights but they have none of the additional "ownership" rights which accrued to the savers or depositors. 12 C.F.R. § 544.1(a)(4) (1974).
tion to the amount of their savings on deposit. Federal law provides that a mutual association's board of directors may declare earnings dividends to be paid to its depositors, not to exceed present interest rate ceilings. The Code of Federal Regulations further provides that in the event of voluntary or involuntary solvent dissolution of a mutual association, all depositors are entitled to a share of the association's net assets, prorated to the value of their savings on deposit.

This mutually shared form of business enterprise is intended specifically to promote a cooperative self-help effort among members within the association, and to maximize service and convenience to the association’s members.

This article focuses on the mutual—as opposed to the stock—savings and loan association and discusses the present deficiencies in membership rights of member savers in this type of enterprise.

C. Regulation

Although savings and loan associations are privately managed, their formation and operation are subject to extensive government regulation and supervision. Associations may be chartered by authority of either a state or the federal government. At present, 22 states charter both stock and mutual associations. All other states and, until recently, the federal government charter

25. ABA HANDBOOK, supra note 14, at 34.
28. Id. §§ 526.1 to 526.5-1.
29. Id. § 544.1(a)(10).
30. See M. Bodfish & A. Tieobald, SAVINGS AND LOAN PRINCIPLES 4 (1940); K. Scott, supra note 18; Herman, supra note 4, at 95; Hearings on S. 1671 Before the Subcomm. on Housing and Urban Affairs of the Senate Comm. on Banking and Urban Affairs, 92d Cong., 1st Sess., at 224 (1971) [hereinafter cited as 1971 Hearings].
31. For example, all federal savings and loan associations are regulated by the Federal Home Loan Bank Board. The Board has promulgated numerous rules and regulations concerning the organization and operation of an association. Among other things, the regulations prescribe the type of savings accounts which an association may accept, the loans it may make, and the other investments it may enter into. 12 C.F.R. § 545.1-.11 (1974).
32. A charter is essentially an approval, by the appropriate state or federal governmental authority, of an association's articles of incorporation.
33. The 22 states are: Arizona, Arkansas, California, Colorado, Hawaii, Idaho, Illinois, Indiana, Kansas, Maryland, Michigan, Mississippi, Nevada, New Mexico, Ohio, Oregon, South Dakota, Texas, Utah, Virginia, Washington, and Wyoming. 1971 Hearings, supra note 30, at 111.
34. Until recently the federal government chartered only mutual savings and loan associations. 12 C.F.R. § 1464(a) (1974). This scheme has now been modified to allow federally chartered mutual associations to convert to federally
only mutual associations. As in the commercial banking field, both federally chartered and state chartered savings and loan institutions operate side by side in the local community.

The savings and loan industry is regulated by a complicated web of overlapping state and federal laws and supervisory authority. State savings and loans are subject to their respective state supervising agencies. The primary regulatory agency for federal associations is the Federal Home Loan Bank Board (FHLBB). By act of Congress, the FHLBB is given broad discretion to prescribe rules and regulations for the organization, incorporation, examination, operation, and regulation of federal savings and loan associations. Other duties of the FHLBB include overseeing the twelve Federal Home Loan Banks and the Federal Savings and Loan Insurance Corporation (FSLIC).

chartered stock associations in states where the laws authorize the operation of state chartered stock associations, or in states where all associations are federally chartered. 12 U.S.C. § 1725 (1974). The effects of the new legislation are yet to be observed. Some commentators fear, however, that widespread conversions of savings associations from mutual to stock forms of organization will degrade the service quality of the industry to the detriment of the saving public. Note, Mutual-to-Stock Conversions and the Federal Home Loan Bank Board, 82 Yale L.J. 559 (1973).

35. The Federal Home Loan Bank Board is an independent agency in the executive branch of the federal government. It is headed by a three-member, bipartisan board, whose members are appointed by the President and confirmed by the Senate for 4-year terms. The Board's operations are independently financed by its member institutions, although Congress does determine expense ceilings on operations each year. Fed. Home Loan Bank Board J., Apr. 1972, at 2.


37. Current regulations for the federal savings and loan system are codified at 12 C.F.R. §§ 541-556.6 (1974).

38. Section 5(a) of the Home Owner's Loan Act of 1933, 12 U.S.C. § 1464 (a) (1970) states:

In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal Savings and Loan Associations" and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.

39. Federal Home Loan Banks are central credit facilities and sources of secondary liquidity for member savings and loan associations. Federal Home Loan Banks regulate the rate of interest paid and the liquidity of its members. Marvel, supra note 7, at 126. Membership in the federal home loan bank system is mandatory for federal associations and optional for state associations. Member associations hold over 97.7 percent of all savings and loan assets in the United States. 1974 Fact Book, supra note 11, at 111-12.

40. Members of FSLIC are subject to a voluminous set of regulations. 12 C.F.R. §§ 561-572.3 (1974). The function of FSLIC is discussed at notes 178 and 184 infra.
Because federal savings and loan associations clearly dominate the mutual sector of the savings and loan industry, this article will concern itself primarily with federal regulatory law associations and will make reference to state law only where appropriate.

II. DEFICIENCIES IN MEMBERSHIP RIGHTS: THE NEED FOR REFORM

In theory, depositor members in mutual savings and loan associations own the assets and earned surpluses of their associations. In practice, however, these ownership rights are largely illusory. Members do not possess many normal incidents of ownership, such as rights of control over association activities and operations and effective procedures to enforce these rights. As a result, members are unable to supervise and control effectively the actions of association managements. As noted earlier, this lack of membership supervision can result and has, in many instances, resulted in a high incidence of conflict of interest within association managements. This author submits that a number of reforms in the mutual savings and loan industry are necessary to strengthen the membership rights of member savers.

A. Control Rights

In general. Members of mutual savings and loan associations possess the basic right to vote on certain corporate affairs. In theory, this franchise right provides members with several methods of controlling the association and its operations. First, members may meet annually to elect a board of directors from among their membership. Since the board is charged with general management authority, including selection of officers and determination of association policies and operations, the right to elect the board provides member savers with a means of indirectly affecting association operations. In addition to their right to elect directors, members may vote to amend association by-laws. Members also must be consulted and their approval obtained before certain fundamental structural changes in the association may be made.
One important right of control, however, is not available to members. Association managements are not required to seek membership approval for proposed mergers except upon special demand from the FHLBB. When an association enters into a merger, frequently a new management assumes control. If the new management lacks competency or is not committed to providing adequate services and conveniences to members, the decision to merge may result in a reduction of benefits enjoyed by association members. Since a merger could thereby affect membership interests adversely, membership approval should be a prerequisite to any decision to merge.

**Director removal.** Another power necessary for full membership control of an association is the right to remove directors from office prior to the expiration of their terms. At common law the doctrine of "amotion" provided that shareholders in a private corporation had the right to remove any director from office for cause. Clearly, the directors of a financial corporation, such as a mutual savings and loan association, entrusted with substantial cash assets, should be subject to standards of scrutiny and discipline which are at least as rigorous as those applied to directors of other private corporations. Thus, sound policy dictates that the "amotion" doctrine be extended to mutual savings and loan associations.

In a number of states the doctrine has been extended to savings and loans by statutes providing for the removal of directors with or without cause by a vote of the membership. Federal statutes and regulations, however, are silent in this area. To remove any

---

50. This is true at the state level as well. Attempts to require a membership vote on this issue have been unsuccessful. See, e.g., McGill v. Leverington-Roxborough Sav. & Loan Ass'n, 44 Pa. 483, 282 A.2d 280 (1971).


52. For an example of this abuse, see Wall Street Journal, Dec. 31, 1971, at 16, col. 1.


54. 19 C.J.S., Corporations, § 738. See also Campbell v. Loew's, Inc., 36 Del. Ch. 563, 572, 134 A.2d 852, 858 (1957), where the Delaware Court of Chancery concluded:

'There is no provision in our statutory law providing for the removal of directors by stockholder action. . . . Considering the damage a director might be able to inflict upon his corporation, . . . the doubt must be resolved by construing the statutes and by-laws as leaving untouched the question of director removal for cause. This being so, the Court is free to conclude on reason that the stockholders have such inherent power. I therefore conclude that as a matter of Delaware corporation law the stockholders do have the power to remove directors for cause.


doubt on the question, the FHLBB should issue regulations giving member savers in federal associations the power to remove directors from office.

At present, the FHLBB retains the power to remove directors for serious misbehavior while in office.\(^{56}\) This remedy, however, is not satisfactory for two reasons. First, the remedy can be initiated only by the FHLBB, and members have only informal methods with which to stimulate FHLBB action.\(^{57}\) Second, grounds for FHLBB action must be based not only upon a violation of the law or of a fiduciary duty by a director, but also on such personal dishonesty as places the financial integrity of the association in jeopardy.\(^{58}\) In many instances members of a mutual savings and loan association may have good reason to seek the removal of a director (if, for example, the director is incompetent or uncooperative), but because the director's actions are not technically dishonest, his removal is not possible.

Members of federal savings and loan associations can have no meaningful control over the operations of the association if the power to remove directors from office remains solely in the hands of the FHLBB. Steps must be taken by the Board to extend this power to the member savers.

**Loss of membership status.** It is plain that the right to retain one's membership status is essential to the effective exercise of membership rights. Nevertheless, under federal charter provisions, the board of directors of a federal savings and loan association has the power to redeem all or any part of the association's members' savings accounts at any time sufficient funds are on hand.\(^{59}\) When an association exercises its redemption power, it

---


> Whenever, in the opinion of the Board [The Federal Home Loan Bank Board], any director or officer of an association has committed any violation of law, rule, or regulation, or of a cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with the association, or has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer, and the Board determines that the association has suffered or will probably suffer substantial financial loss or other damage or that the interests of its savings account holders could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty, and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer, the Board may serve upon such director or officer a written notice of its intention to remove him from office.

See Miami Beach Fed. Sav. & Loan Ass'n v. Callander, 256 F.2d 410 (5th Cir. 1958).

57. Such methods would include little more than writing letters and making telephone calls to the FHLBB. See notes 109-14 and accompanying text infra, for a discussion of this procedural deficiency.


59. Redemption is subject to some limitations: (1) 30 days notice must be given; (2) redemption must not impair association capital; (3) at the time of re-
buys back a member's account by paying that member the full withdrawal value of the account. The redemption power is absolute and may be exercised by the board of directors at its complete discretion.\(^{60}\)

The effect of the redemption power upon membership control rights is readily apparent. As noted earlier, maintenance of a savings account is essential to maintenance of membership status in a mutual savings and loan association.\(^{61}\) It follows naturally that to vest absolute power in the board of directors to terminate a member's account and, therefore, his membership can be a powerful deterrent or complete bar to the exercise of meaningful membership control. Members who wish to vote for a new management or substantially alter an association policy, contrary to the board's wishes, may simply be eliminated from association membership without cause by the redemption of their savings account.\(^{62}\)

There is another way that the redemption power can be abused by a self-serving board of directors. Association membership is a prerequisite to board membership, "and a director . . . cease[s] to be a director when he ceases to be a member."\(^{63}\) It is easy to see that through the power of redemption, a dissident board member—duly elected by the association's membership—could be removed without cause by a simple majority vote of the board of directors.\(^{64}\) Such unrestrained discretion by the board could easily strangle minority opinion and membership control in an association.

Neither the FHLBB nor the courts have acted to prevent such arbitrary termination of membership rights. In Daurelle v. Traders Federal Savings and Loan Association,\(^{65}\) the association's board of directors redeemed a member's account for the sole purpose of preventing his participation in the association's annual elections and

---

\(^{60}\) In practice these requirements place virtually no restraint upon arbitrary redemption by the board of directors. 12 C.F.R. § 544.1(a)(7) (1974).

\(^{61}\) Id.

\(^{62}\) See notes 13-14 and accompanying text supra.

\(^{63}\) In the opinion of one observer, a member in a mutual savings and loan association "has a vote until he cares to exercise it, and then he ceases to have a vote, if the board so decides." Statement by P. Riordan, general counsel for the National Association of Mutual Savings Banks in Hearings on H.R. 258 Before the Subcomm. on Banking Supervision and Insurance of the House Comm. on Banking and Currency, 88th Cong., 1st Sess., at 206 (1963).

\(^{64}\) Redemption, like all other actions of the board of directors, requires a mere simple majority vote. Id. § 544.5(4).

\(^{65}\) 143 W. Va. 674, 104 S.E.2d 320 (1958).
his candidacy for a position on the board. The court held that no good faith reason for such termination need be shown.\textsuperscript{66} The \textit{Dau- relle} court found the redemption to be “in all respects regular and valid.”\textsuperscript{67}

The rights incident to membership will remain meaningless if directors of associations are allowed to continue silencing criticism or opposition by members simply by redeeming the members' accounts. Redemption, if permitted at all, should be subjected to rigorous standards of business necessity and good faith.

One solution to the problem of the abuse of redemption power would be to require that all redemptions be accomplished through a method of pro rata redemption or redemption by lot. Under pro rata redemption, if a management determined that redemption of accounts was necessary, it could redeem only a pro rata portion of each member's account. Under redemption by lot, the management could redeem only those accounts which were chosen randomly by drawing lots. If association managements were required to use either of these methods in their redemption procedure, they would be prevented from selectively redeeming the accounts of members who have expressed opposition to management or its policies.

\textit{Summary.} In the foregoing section we have examined the ownership control rights presently available to members in mutual savings and loan associations. Like most corporations, the mutual savings and loan association, is, in theory, a representative democracy. Ultimate control is vested in the members, who elect representatives to manage and operate the business. It has become apparent, however, that the mere possession of these rights has not given association members adequate control over the operation of their savings and loan associations. It is therefore essential that effective enforcement procedures to implement these rights and powers also be made available to members savers. Without such procedures, the few ownership and control rights which members do possess are rendered meaningless. Unfortunately, the procedures presently available to implement membership rights are woefully inadequate.

\textbf{B. Procedural Inadequacies}

In many crucial areas of membership control, the law either is silent or provides only general guidance concerning the procedures available to enforce the few rights possessed by mutual savings and loan members. It is left to association managements to create spe-

\textsuperscript{66} \textit{Id.} at —, 104 S.E.2d at 336.
\textsuperscript{67} \textit{Id.}
cific rules regarding such procedures. While acting entirely within the law, it is possible for managements to create procedural requirements which render ownership and control rights feeble and ineffective.

At the heart of ownership control is the member's voting right, the source of both initiative and veto powers within the association's purportedly democratic structure. Certain management practices have made it extremely difficult for members of an association to exercise effectively their right to vote, whether individually or collectively, and voting procedures presently available to members have neither prevented nor limited these practices.

**Notice requirements.** A member of a mutual savings and loan association cannot effectively exercise his right to vote unless he receives timely notice of the association's annual meetings. The present notice requirements under the federal regulations are too lenient and subject to management manipulation. The basic notice provision for federal associations requires only that notice of each annual meeting be published in a local newspaper of general circulation once a week for the two successive calendar weeks immediately preceding the week in which the meeting is to be held. In the alternative, notice may be mailed to members at their homes. The "loophole" provision for management is that these notice requirements may be completely waived by membership consent. Similar notice provisions required for special meetings can also be waived. The significance of the waiver "loophole" is illustrated by the fact that a waiver provision could be included by the management among the materials signed by a member saver at the time he opens his account with the association.

---

68. See notes 44-52 and accompanying text supra.
69. For example, it is only through the voting power that members can initiate the election of directors, removal of directors, and amendment of by-laws.
70. Likewise, it is only through the voting power that members can express their approval or disapproval of charter amendments, conversions, and voluntary dissolutions.
71. See notes 72-78 and accompanying text infra.
73. Id. The form of the notice need only include the name of the association and the place and time the meeting is to convene. There is no requirement that matters to be voted upon at the meeting be included in the notice.
74. Id. In either case, a similar notice must also be posted conspicuously in the association's office during the 14 days immediately preceding the date of the meeting.
75. Id.
76. Id. § 544.5(3)(b). The sole difference is that notice of special meetings, if not waived, must include a statement of the purpose or purposes for which the special meeting is called. Id.
77. It should be noted, however, that such a clause in the materials signed
depositors agreed to such a provision, the management would be required to give no public notice of meetings.

Thus, the federal regulations provide association management with an easy method of avoiding entirely the requirement of giving notice to members of annual or special meetings of the association.\(^7\) To strengthen the voting rights of association members, the waiver provision should be eliminated, and a provision requiring notice by mail should be enacted.

The present federal regulations respecting notice clearly favor the management. Unlike the members, who in most cases know little or nothing about association meetings unless they actively seek such information,\(^7\) management can insure itself advance notice of any membership initiative which might arise at an association meeting. Under an optional provision authorized by the FHLBB, the association's by-laws may require that any new business to be taken up at an annual meeting be stated in writing and filed with the association's secretary at least thirty days prior to the meeting date.\(^8\) The optional provision may further provide that no other proposals may be acted upon at the meeting.\(^8\) By including such a provision in the by-laws of the association, management may always be forewarned of potential surprise or opposition. An additional advantage management may gain over members stems from the fact that association meetings have no minimum quorum requirements. There is no requirement that a certain percent of the members be present at association meetings. The federal regulations provide that any number of members present at a meeting constitutes a quorum.\(^8\) Therefore, meetings may be held, and binding decisions made regarding association affairs, with only a handful of association directors and officers participating, further reducing any incentive management may have to encourage membership attendance.\(^8\)

A member's right to vote has little meaning unless he is able to

---

by the member saver might be attacked as constituting an adhesion contract provision.

\(^7\) There are perhaps two exceptions to this "loophole" mechanism. Actions to convert an association from federal to state charter and actions to change a state-chartered mutual institution to a stock type institution require formal notice of special meetings to vote on such proposals. 12 C.F.R. §§ 546.5, 563.22-1(d) (1974). Opportunity for waiver is not specifically mentioned, as it is in the general notice provisions for special meetings. \(\textit{Id.} \) § 544.5(3)(b). By negative inference it might be concluded that notice for these types of special meetings cannot be waived. Waiver is not specifically precluded, however, and the section is sufficiently ambiguous to be interpreted either way.

\(^7\) For examples of this problem see Herman, \textit{supra} note 4, at 791.

\(^8\) 12 C.F.R. § 544.6(b) (1974).

\(^8\) \textit{Id.}

\(^8\) \textit{Id.} § 544.1(a)(4).

\(^8\) For examples of this abuse see Herman, \textit{supra} note 4, at 794.
exercise that right. To insure that the right to vote can be exercised, it is imperative that the federal regulation allowing waiver of notice requirements through membership consent be eliminated. In addition the regulations should be amended to require a minimum quorum at association meetings.\textsuperscript{84}

\textit{Director elections.} The Code of Federal Regulations provides only general guidance concerning procedures for the independent nominations of directors for election by association members.\textsuperscript{85} Association managements are free to create their own nominating procedures. Under present regulations it is a simple task for managements to promulgate burdensome nominating procedures so as to minimize the nomination of opposition candidates by the membership. For example, an association, acting quite legally, could provide in its by-laws that director nominations may be made only by a nominating committee which is appointed by the association president, or that a candidate's name may not be placed in nomination unless a certain percent of all eligible voters, perhaps ten percent or more, support the candidate. Such provisions could preclude many members from effectively participating in the election of association directors. The FHLBB should devise specific regulations to limit the ability of association managements to establish such procedural rules.

\textit{Proxies.} Because voting by members of an association may be conducted in person or by proxy,\textsuperscript{86} the procedures established for the use of proxies are a central part of an association's voting process. Until 1971, the FHLBB provided for the use of proxies for membership voting,\textsuperscript{87} but gave no guidance as to proxy form or manner of use.\textsuperscript{88} By default, such matters were left to managements or multifarious state laws\textsuperscript{89} for determination.\textsuperscript{90} Finally, in

\textsuperscript{84} For example, the regulations could be amended to provide that the presence, in person or by proxy, of a majority of the members at an association meeting constitutes a quorum.

\textsuperscript{85} An optional by-law provides for nomination by a committee appointed by the association's president. In addition, independent nominations may be made by members who file with the association in writing at least 10 days prior to the date of the meeting. 12 C.F.R. § 544.6(a) (1974).

\textsuperscript{86} \textit{Id.} § 544.1(a)(4). A member saver of an association may, through an instrument called a proxy, authorize another person to vote for him on association matters. The person substituted by the member to represent him at association meetings is called a proxy holder.

\textsuperscript{87} \textit{Id.}

\textsuperscript{88} Until 1968, no information was regularly collected by supervisory authorities on the subject of proxy holdings and use. Herman, \textit{supra} note 4, at 799 n.35.

\textsuperscript{89} For an extensive discussion of individual state laws regarding proxy use see \textsc{United States Savings and Loan League XXII Legal Bulletin}, 99-103 (1956).

\textsuperscript{90} For examples of how various courts have handled the proxy issue, see Federal Home Loan Bank Bd. v. Greater Del. Valley Fed. Sav. & Loan Ass'n,
1971, federal regulations regarding potential holders of proxies as well as definition, form, and solicitation of proxies were issued. These regulations standardized proxy procedures and dramatically extended supervision into an area long left vacant by federal regulation and the courts.

The FHLBB failed, however, to provide sufficiently detailed guidelines on the important questions of proxy form and content. Under present federal law there are no restrictions on the breadth of authority which can be granted to a proxy holder by a proxy. A carefully drafted proxy could grant extremely broad voting power to its holder. For example, there is no requirement that proxies be confined only to ordinary questions such as director elections. A single proxy may grant its holder authority to vote on all matters, including extraordinary actions such as charter amendments, conversion, voluntary dissolution and merger. The FHLBB should develop guidelines limiting the contents of proxies so that proxy holders may be granted authority to vote only on questions of ordinary importance. A separate solicitation of the membership should be required on such questions as charter amendments and mergers.


92. 12 C.F.R. § 569.3 (1974). Proxies may designate as holders only living natural persons, with the following exceptions: (1) the proxy may designate a specified title or office, if a natural person; (2) the proxy may designate a committee composed solely of natural persons, including a committee composed solely of the board of directors.
93. Id. § 569.1.
94. Id. § 569.2. Federal regulations now specify three form requirements. First, the proxy must be revocable at will by the member giving it. Second, the proxy may not be part of any other document. This prevents the management from concealing proxy provisions together with other contractual provisions signed by a member at the time he opens his account. Finally, the proxy must be clearly labeled "Revocable Proxy" in large, bold face type.
95. Id. § 569.4. Solicitation provisions (a) require that proxies be dated exactly as of the date of signing by the security holder, and (b) preclude any proxy solicitation that (1) contains any false or misleading statement with respect to any material fact or (2) omits to state any material fact necessary to prevent any solicitation from being false or misleading.
96. Without direction from the FHLBB, courts had been timid to enter into the proxy area. The result has been frustrating for association members. See Federal Home Loan Bank Bd. v. Greater Del. Valley Fed. Sav. & Loan Ass'n, 277 F.2d 437, 441 (3d Cir. 1960).
97. Some state courts have applied at least a modicum of restraint to the breadth of proxies employed by state savings and loan associations. McKee v. Home Sav. & Trust Co., 122 Iowa 731, 98 N.W. 609 (1904); Fidelity Bldg. & Loan Ass'n v. Thompson, 25 S.W.2d 247 (Tex. Civ. App. 1930).
The FHLBB also has failed to provide guidelines on the question of proxy duration. Present federal law places no restraint upon the length of time a proxy may remain valid. Some state laws restrict proxy duration to six months, while other states permit proxies of unlimited duration.\(^9\) These "perpetual proxies," although revocable at will,\(^9\) provide added security for existing management, and further insulate management from membership control. To enhance the participation and control of association members, proxy solicitations should be required annually. Such a requirement would not unduly burden managements since the proxy solicitation could be included, easily and inexpensively, in other association mailings.

Until recently, the power of substitution, by which a proxy holder may grant to another his proxy powers, also was left largely uncontrolled.\(^10\) Without controls, proxy holders, usually the directors or officers of an association, have at times treated proxies as their personal property and have sold their control to the highest bidding surrogate holder.\(^10\) In 1973, after eleven years of litigation, an association and its members finally succeeded in attacking this practice of sale of proxy control for personal gain.\(^10\)

In *Beverly Hills Federal Savings and Loan Association v. Federal Home Loan Bank Board*,\(^10\) a federal savings and loan association sought relief from an allegedly illegal transfer of the control of the Association by the defendants, who were holders of proxies. For many years, at the request of the Association’s management, depositors and borrowers in the Association had signed proxies appointing the defendants to vote in their behalf. While these proxies were in effect, the defendants were able to exercise complete control over the Association. The court found that as officers, directors and proxy holders, these defendants "stood in a position of trust and confidence with the Association’s members and owed them those obligations commonly associated with fiduciaries. . . ."\(^10\) Further, the court held that the transfer of control of the Association by these defendants constituted a breach of their common law duty of good faith,\(^10\) rendering

---

98. See note 89 supra.
99. See note 94 supra.
100. The FHLBB merely required that the substitute qualify as a living natural person. 12 C.F.R. § 569.3 (1974).
101. The fact that such abuses exist is well documented in Herman, *supra* note 4, at 798-801. *See also* Beverly Hills Fed. Sav. & Loan Ass’n v. Webb, 406 F.2d 1275 (9th Cir. 1969); Reich v. Webb, 336 F.2d 153 (9th Cir. 1964), cert. denied, 380 U.S. 915 (1965).
103. *Id.*
104. *Id.* at 314.
105. *Id.*
them liable for the transfer even though their conduct did not violate any specific regulation of the Federal Home Loan Bank Board. 106 The court explained that the illegality of the transfer was not premised upon an express violation of FHLBB regulations, but arose from a breach of implied common law duties of fair dealing, disclosure and trust. 107 At present, Beverly Hills is the only case which has addressed the problem of federal association proxy transfers. The decision reached by the court in that case was no doubt the correct one, and hopefully it will be received favorably by other jurisdictions.

Inadequate proxy regulation allows unscrupulous managements to sell proxies for personal gain or to attain autonomous, self-perpetuating positions in savings and loan associations. 108 To eliminate these abuses, it is imperative that the FHLBB strengthen its present proxy regulations.

Grievance Procedures. The FHLBB has issued no regulations setting forth formal procedures by which association members, having become aware of management abuses, may urge the FHLBB to take action against an association. Many members have brought actions against association managements on their own, only to be informed by the courts that they must exhaust their administrative remedies with the FHLBB before the courts will hear their case. 109 In most instances such court decisions have put a stop to members' attempts to attack abusive practices by management, because neither the courts nor the FHLBB have explained satisfactorily what administrative remedies must be exhausted. Lacking specific formal procedures to initiate disciplinary action, 110 members are left with nothing but informal methods to initiate FHLBB action. 111 Such informal requests only infrequently result in Board action against an association. Although some courts have been critical of this lackadaisical exercise of power by the FHLBB, most have been unwilling to intervene in an area preempted by governmental regulation. 112

106. Id. at 316-17.
107. Id.
108. Marvell, supra note 7, at 14; Herman, supra note 4, at 798-800.
111. Such informal methods might range from letters and telephone calls to the FHLBB, to camping in the halls of the FHLBB in Washington, D.C.
To resolve this dilemma the FHLBB either should provide association members with effective administrative remedies or, in the alternative, it should make clear to the members of associations and to the courts that in fact there are no administrative remedies available for the members to exhaust. Such a pronouncement by the FHLBB would open the courtroom doors to suits initiated by associations and their members. These privately initiated suits would serve to supplement the regulatory activities of the FHLBB. While the FHLBB is and should remain the primary regulatory agency for federal savings and loan associations, it has not been particularly successful in defending members' rights. Thus, additional regulation through the courts by association members is necessary. Such enforcement of government agency regulations by private individuals is not a new idea. Private actions are presently allowed in the area of securities fraud violations to supplement the regulatory activities of the Securities and Exchange Commission.\textsuperscript{113}

Until the FHLBB acts, however, the courts should take cognizance of the lack of realistic administrative remedies available to savings and loan members and should readily grant standing to associations and members in a derivative capacity to pursue their judicial remedies. Only in the Beverly Hills\textsuperscript{114} case and in Murphy v. Colonial Federal Savings & Loan Association\textsuperscript{115} have the courts taken a progressive view and rejected the long accepted argument that members and associations lack standing because the field of association regulation is preempted by the regulatory activity of the FHLBB.

C. Membership Information and Disclosure

Procedural reforms in the areas of notice, director elections, proxies and membership grievances are necessary to enforce the membership rights of association members. Such reforms will have meaning, however, only if members are made aware of their existence. Thus, improved methods of informing members of their rights are necessary before such procedural reforms will be helpful.

Traditionally, one of the strengths of the mutual savings and loan association was a well-informed, actively participating membership.\textsuperscript{116} Today, in contrast, membership ignorance of associa-

\textsuperscript{115} 388 F.2d 609 (2d Cir. 1967). In Murphy dissident members of a federal association were granted independent standing in an action brought to obtain a membership list from the management.
\textsuperscript{116} A. Teck, MUTUAL SAVINGS BANKS AND SAVINGS AND LOAN ASSOCIATIONS: ASPECTS OF GROWTH 23 (1968). See note 3 supra.
tion activities is the general rule. Members seldom know enough about association affairs to exercise intelligently their membership voting rights and, in fact, many members are unaware they possess such rights.\textsuperscript{117} Ignorance of this magnitude can breed apathy among members and discourage membership participation in the operation of associations to the ultimate detriment of the saving public. Effective membership control of management activities will occur only if association members are aware of their rights.

A major factor contributing to this information gap has been the increased size and complexity of the savings and loan industry. Modern mutuals demand sophisticated management techniques, specialized skills, efficient operation, and full time salaried personnel.\textsuperscript{118} The informal methods of disseminating information previously used by association managements are no longer adequate.\textsuperscript{119} It is practically impossible for the average member, whose time and resources are limited, to inform himself of his association's operations. Improved methods of disclosure are needed to insure intelligent voter participation by association members. The means of disclosure presently required by the FHLBB and state supervisory agencies have not kept pace with industry growth and are grossly insufficient.

\textit{Inspection rights.} If a member is to make intelligent voting decisions regarding the leadership and the direction his association is to take, it is important that records of the association be made available to him, so that he can measure the association's performance. In addition, voter lists are necessary to facilitate communication among eligible voters in the association. These provide the opportunity for those favoring or disfavoring one policy or another to amass support from fellow members. Unfortunately, because of the present confusion surrounding a member's right to inspect association books and records, this information is not readily obtainable.

It has long been settled that in the absence of a statute to the contrary, a shareholder in a corporation has the inherent right to inspect the financial records of that corporation, so long as the inspection is for a "proper purpose"\textsuperscript{120} and is undertaken at a reasonable time and place.\textsuperscript{121} This rule applies with equal force to bank-

\begin{itemize}
\item[117.] Marvell, \textit{supra} note 7, at 14.
\item[118.] See notes 11-17 and accompanying text \textit{supra}.
\item[119.] See note 3 \textit{supra}.
\item[120.] Proper purpose has been held to include the determination of the existence of mismanagement, 5 W. Fletcher, \textit{Private Corporations} §§ 2213, 2219, 2253.1 (1967), and ascertainment of names and addresses of other shareholders in order to communicate with them concerning corporate affairs, \textit{Id.} § 2225.
\item[121.] In Guthrie v. Harkness, 199 U.S. 148, 153 (1905), the Supreme Court granted a shareholder of a national bank the right to inspect books and records.
\end{itemize}
ing corporations as well as other corporations. Since mutual savings and loan associations are merely specialized banking corporations, it would appear that members of such associations should have the right to inspect association records.

In the absence of a state statute to the contrary, some state courts interpreting state law have held that association members are entitled to inspect association records. Other courts, however, have interpreted state statutes as denying membership access to such records. Those state courts which have denied inspection rights to members have based their decisions on what they often call the "quasi-public" nature of savings and loan associations. They note that savings and loan associations are not private corporations, but rather are subject to extensive supervision and control by state agencies. Thus, the courts reason that membership inspection rights are pre-empted by the administrative authority of the government agencies, and sole responsibility for the protection of membership interests rests in the hands of these agencies. Such court decisions have placed an unnecessary restraint upon the ability of association members to safeguard their interests in the association. State administrative agencies cannot be expected to protect adequately all the interests of association members. Thus, it is important that members be entitled

122. Id. at 154.
123. It appears that the Supreme Court would require that members be allowed to inspect the books for such purposes as compiling lists of the membership but would not require that completed membership lists be compiled or furnished to the members on request. Id.
125. State ex rel. Cotonio v. Italo-American Homestead Ass'n, 177 La. 766, 149 So. 449 (1933); Ulmer v. Falmouth Loan & Bldg. Ass'n, 93 Me. 302, 45 A. 32 (1899); DeFazio v. Haven Sav. & Loan Ass'n, 22 N.J. 511, 126 A.2d 639 (1956); State ex rel. Wicks v. Puget Sound Sav. & Loan Ass'n, 8 Wash. 2d 599, 113 P.2d 70 (1941); State ex rel. Schomberg v. Home Mutual Bldg. & Loan Ass'n, 220 Wis. 649, 265 N.W. 701 (1936), all of which deny members access to voter lists. See also Sanders v. Neely, 19 So. 2d 424, 429 (Miss. 1944), where the court in dicta implied that savings and loan members in Mississippi had no inspection rights.

To the contrary, however, some state courts, relying on a state statute, have specifically granted members the right to inspect association records. See, e.g., White v. Smith, 256 N.C. 218, 123 S.E.2d 628 (1968), where the Supreme Court of North Carolina, interpreting a state statute, upheld the right of members of a savings and loan association to obtain a list of the names and addresses of the members of the association for the purpose of discussing with, campaigning among, and soliciting proxies from other members in preparation for an association meeting.
127. See, e.g., id. at 517, 126 A.2d at 644.
128. See, e.g., id.
to inspect association records and voter lists so they may obtain information necessary to safeguard their own interests.

Until recent years the federal law has been unclear as to whether members of federal savings and loan associations have the right to inspect association books. Federal statutes and regulations are silent on the subject of inspection, and the courts have infrequently addressed the question.

The Supreme Court of Appeals of West Virginia held, in 1958, that in the absence of a statute or rules and regulations which confer the right of inspection upon a member of a federal savings and loan association, an individual member of such association has no common law or statutory right to inspect association books and records.\(^\text{120}\) The *Daurelle* court denied members access to records and effectively precluded members from obtaining a list of the names and addresses of association members.\(^\text{180}\) This decision virtually eliminated any opportunity for members to communicate among themselves concerning association matters. Following the *Daurelle* case, all that remained of the inspection rights of members of federal associations in West Virginia was a narrow exception allowing access by individual members to their own accounts.

In 1966, the New York Court of Appeals arrived at a different result from that reached by the *Daurelle* court. In *Ochs v. Washington Heights Federal Savings and Loan Association*,\(^\text{131}\) the court held that a "member"\(^\text{132}\) of a federally chartered savings and loan association, who possessed the right to vote in the annual election of board of directors, also possessed the right to inspect the association's membership list.\(^\text{133}\)

The court emphasized that unless members have the right of inspection, their statutory rights under the charter are reduced to "idle gestures."\(^\text{134}\) Recognizing the need to protect the confidential fiduciary relationship between the savings and loan association and its members, however, the *Ochs* court placed some restrictions on the right of inspection.\(^\text{185}\) In order both to insure the privacy of individual accounts and to preserve the essential ele-

\(^{130}\) Id.
\(^{132}\) The *Ochs* court qualified the term "member" to mean a member in good standing who exhibits good faith and proper purpose. Id. at 88, 215 N.E.2d at 489, 268 N.Y.S.2d at 298. In practice, of course, any member who tries to inspect records will first be required to litigate his "qualifications."
\(^{133}\) Id. at 87, 215 N.E.2d at 488, 268 N.Y.S.2d at 298.
\(^{134}\) Id.
\(^{135}\) Id.
ments of membership inspection, membership lists were restricted to "the names and addresses of the borrowers and depositors, not identified as such, and with no reference to the amount borrowed or on deposit or to the number of votes possessed" by each member.\(^{136}\)

Since the *Ochs* decision, the federal courts have resolved some of the confusion concerning a member's right to inspect membership lists by following and extending the holding in that case. In 1967 the United States Court of Appeals, in *Murphy v. Colonial Federal Savings and Loan Association*,\(^{137}\) addressed the question of whether members in a federal savings and loan association have a right of access to voter lists. The court held that

an election of directors in which the opposition is deprived of any reasonable opportunity to ascertain the names and addresses of electors known to the management was unfair under federal law.\(^{138}\)

Citing *Ochs* with approval, the court noted that it seemed quite appropriate to adopt as "federal common law" the principle that members of federal savings and loan associations have the right to inspect membership lists.\(^{139}\) Noting the existence of numerous corporate shareholder voting list statutes throughout the country, the court granted to members of federal savings and loan associations the right to inspect records for the purpose of compiling voter lists.\(^{140}\) Further, the court gave members the option of either having lists furnished to them or paying the cost of making such lists.\(^{141}\) At present, *Murphy* represents the federal common law in the area of membership inspection rights.

The *Murphy* case is one of the few progressive court decisions involving the rights of savings and loan association members. It is apparent that the *Murphy* court recognized not only the absurdity of members having no membership rights, but also the wisdom of a dual system of control of association managements—where the external supervision of an association management by a government agency is supplemented by internal supervision through membership surveillance.\(^{142}\)

It should be noted, however, that neither the *Murphy* case nor federal statutes specifically preclude the use of general charter or

---

136. *Id.* at 88, 215 N.E.2d at 488, 268 N.Y.S.2d at 298.
137. 388 F.2d 609 (2d Cir. 1967).
138. *Id.* at 612.
139. *Id.* at 612 n.2.
140. *Id.*
141. *Id.*
142. See note 184 and accompanying text infra.
by-law provisions to deny federal savings and loan association members access to voter lists. In fact, present FHLBB regulations provide for the optional use of a provision in association by-laws which allows a member to inspect only those records pertaining to his personal accounts. Additionally, this optional provision provides for a feeble mechanism whereby members may communicate with the membership, using the management of the association as the intermediary. Any such communications between members must first be submitted to the association's management for its approval. If the communications are approved, the management will mail them at the member's expense. The possibilities for abuse and delay by an uncooperative management under such a system are obvious.

Statutory embodiment of the Murphy decision is needed to eliminate doubt on the inspection issue. Inspection rights of members should be fully legitimized to encourage membership surveillance of association affairs. Only by making more information available to members of mutual associations will mutual democracy serve its purpose.

General disclosure requirements. Although extensive disclosure regulations are prescribed by the Securities and Exchange Commission (SEC) for many corporations, because of specific exemption provisions most SEC disclosure requirements do not apply to mutual savings and loan associations.

When an association opens an account for a new customer, the FHLBB allows the use of an extremely simple form of savings or investment certificate. No indication of voting, dividend, withdrawal, or other membership rights need to be included in the certificate. When a saver opens an account with an association,

143. 12 C.F.R. § 544.6(g) (1974).
144. Id.
145. Id.
146. Id.
150. Id. Disclosure requirements demand only that savings certificates display
he makes a choice between the available savings and loan associations competing for the use of his dollars. The associations should be required to make more information available to a prospective saver so that he can make an intelligent selection. It should be the affirmative obligation of the savings and loan association to disclose fully not only the terms of the savings contract, but also the existence of membership voting rights, and the mechanics for exercising these rights. In addition, a financial statement should be made available along with any material facts which might evidence the insecurity of the association. Finally, a statement inviting requests for additional information and explaining the proper method for making such a request should be displayed.

Annual reporting requirements of the FHLBB are also surprisingly inadequate for membership needs. An annual "Statement of Conditions," which may be mailed to each member or merely published in a newspaper of general circulation, is all that is required. The FHLBB requires that the statement contain only the most superficial financial data. Some associations voluntarily include additional information, but mention of ownership or voting rights normally is avoided.

provisions relating to interest paid, amount of minimum balance, renewal, and other terms of the savings contract. Id. § 563.3-1(c).

151. For example, the statement should include any prior or existing sanctions imposed upon the association by the FHLBB, existence of any significant legal proceedings, and defaults of indebtedness by the association.

152. Under present FHLBB regulations, upon request an association must provide to any member a true copy of its charter and by-laws. 12 C.F.R. § 563.1 (1974). There is no requirement, however, that members be informed of their right to make such a request.

153. Id. § 545.23.

154. A simple balance sheet is all that is required. Assets are reported in eight categories: mortgage loans, other loans, real estate owned, loans and contracts made to facilitate sale of real estate, cash on hand, investments and securities, fixed assets, and other assets. Only the following liability entries are required: savings accounts, advances from Federal Home Loan Banks, other borrowed money, loans in process, other liabilities, specific reserves, general reserves, and surpluses. Information taken from the FHLBB "Statement of Conditions" form received by the author from the San Francisco Federal Home Loan Bank pursuant to a request under 12 C.F.R. § 545.23 (1974).

155. Additional information, if included at all, is usually limited to a brief "pep talk" statement by the executive vice-president. Usually included is news of asset increases over the previous year, the opening of new offices or the remodeling of old ones, a list of officers and directors, and a reassurance that the coming year will be a period of expansion and progress. Some associations include a brief balance sheet from the previous year so that individual categories of assets and liabilities may be compared with present financial balances. A few also state that more complete financial statements will be made available upon request. This indication that further information is available to a member is the only statement from the management that even remotely suggests to the saver that he might also possess certain membership rights. Information taken from sample association statements of condition collected by the author on his visits to savings and loan associations in California.
Clearly, it should be the affirmative obligation of an association to provide more detailed information in its annual statement. The statement should include the time, date and place of upcoming annual meetings, and an explanation of the member's voting initiative rights, including the mechanics of proxy and in-person voting. Financial statements should be more thorough, to include an income statement, a flow of funds statement, and a balance sheet for at least the preceding fiscal year. The use of generally accepted accounting principles should be required and the accuracy of the statements should be certified by the association's chief financial officer. In addition, the annual statement should include a list and organizational chart of the relationship of the association to all its affiliates, a description of material changes in business during the fiscal year, the names of principal holders of existing proxies, biographical information concerning the present directors of the institution, and management's compensation.

In attempting to obtain the information that FHLBB disclosure requirements fail to provide, aggrieved members have sought aid from the courts. Unfortunately, the courts have been noticeably timid in providing remedies to members, and actions to require more information from management have been uniformly unsuccessful.

In *Pearson v. First Federal Savings and Loan Association*, plaintiffs, who were members of the association, charged that at the inception of their membership in the association, they had been required to sign a signature card containing a continuing proxy in favor of the seven directors. The plaintiffs also alleged that the ma-

---

156. These material changes might include: changes in control of the association, acquisition or disposition of association assets, updates on legal proceedings or sanctions applied by the FHLBB or other supervisory agencies, defaults of indebtedness by the association, material modifications in the voting structure or mechanism of the association, changes in the investment portfolio, and revaluations of assets of the association or its affiliates.

157. Persons or groups holding more than 10 percent of voting proxies should be listed in the annual statements with their addresses and the number of proxies held.

158. For example, the directors' names, the expiration dates of their terms, their ages, and a list of the positions and offices they presently hold in the association should be included in the annual statement. In addition the directors' principal occupations and their employers should be noted. Also, the financial interest of each director in affiliates doing business with the association or its customers should be included in the statement.

159. Executive compensation in mutuals is generally greater than in stock associations. Herman, *supra* note 4, at 897.


161. See, e.g., cases cited in note 163 supra.

162. 149 So. 2d 891 (Fla. Ct. App. 1963).
jority of the members were unaware of their own voting rights in the association, and that they were not told how the directors and officers were selected. The plaintiffs further charged that by virtue of the continuing proxies, the Board of Directors of the association were in a strategic position to perpetuate their existence in office and manipulate the association to their own personal gain. In their prayer for relief the plaintiffs sought to have the directors ousted from office and to have the proxies which had been signed by the members declared invalid. The court summarily dismissed the complaint for failure to state a cause of action.

In Federal Home Loan Bank Board v. Greater Delaware Valley Federal Savings and Loan Association, the FHLBB brought an action to have a particular proxy solicitation declared invalid, claiming that certain crucial information concerning management's motivation for the solicitation involved had been omitted from the proxy statement. The court held that the shareholders had been given no erroneous or misleading information, and in the absence of a "stated or formal requirement of law," an omission of this sort did not give rise to a cause of action.

Pearson and Delaware Valley illustrate the general reluctance of the courts to break new ground in the specialized, highly regulated area of savings and loan associations. Normally, due to a court's lack of specialized competency, the reluctance would be acceptable; but considering the FHLBB's record of regulatory failure, it is time the courts began interpreting membership rights more liberally in an effort to fill the regulatory gaps.

III. Opposition to Reform

The reform proposals which have been suggested in this article would broaden and protect the ownership rights incident to membership in a mutual savings and loan association. Before concluding that these measures should be adopted, however, arguments opposing such reform must be considered.

163. Id. at 893.
164. Id.
165. Id.
166. Id. at 896.
167. 277 F.2d 437 (3d Cir. 1960).
168. Id. at 438.
169. Id. at 441. Not until eleven years after Delaware Valley did the FHLBB finally prescribe expanded disclosure requirements that prevent the use of proxy solicitations which contain material omissions. 12 C.F.R. § 569.4(c) (1974). Thus, Delaware Valley would probably be decided differently today, since it dealt specifically with proxy solicitation.
171. It is probably not mere coincidence, nor is it surprising, that the major
It is arguable that (1) change would increase costs; (2) even if members had broader membership rights, there would be no incentive to exercise these rights because of the present system of insured accounts and interest rate ceilings; and (3) reform would create instability and upheaval in the industry, eroding public confidence in savings institutions.

A. Increased Costs

It is true that additional expenses would be incurred by association managements if the reforms proposed in this article were adopted.\textsuperscript{172} Initiating reforms in the areas of notice,\textsuperscript{173} proxy solicitation,\textsuperscript{174} and annual reporting\textsuperscript{175} would require the association managements to expend additional time and money in the preparation and mailing of necessary materials.

Any cost increase would be minimal, however, since associations already are required to provide annual statements of condition\textsuperscript{176} to their memberships and additional disclosure information could easily be included in the same mailings. Thus, it appears that the possibility of increased costs poses an insignificant obstacle to membership reform.

B. Lack of Incentive to Exercise Rights

A second and more persuasive argument leveled against reform in the savings and loan industry is that under the present system, savers neither want nor need extensive membership rights. On first analysis it may appear that interest rate ceilings\textsuperscript{177} and insured savings accounts\textsuperscript{178} remove all incentives for exercising member-

\textsuperscript{172} Herman, supra note 4, at 790 n.16.
\textsuperscript{173} See notes 72-83 and accompanying text supra.
\textsuperscript{174} See notes 86-108 and accompanying text supra.
\textsuperscript{175} See notes 153-59 and accompanying text supra.
\textsuperscript{176} See notes 153-55 and accompanying text supra.
\textsuperscript{177} 38 Fed. Reg. 18459 (1971).
\textsuperscript{178} The Federal Savings and Loan Insurance Corporation (FSLIC) insures depositors' savings accounts of up to $40,000 against loss. 12 U.S.C. § 1724(b) (1974). The FSLIC functions much like any insurance company. Participating savings and loan associations sign insurance contracts with the FSLIC who, in the event of association failure, pays association savers for the loss of their savings. Associations pay the FSLIC insurance premiums for this coverage. If an association fails, a receiver is appointed for purposes of liquidation, and usually within 10 days FSLIC officials are on hand with cash to compensate account holders for losses suffered. Marvell, supra note 7, at 84, 272. Participating members of the FSLIC program account for 97.2 percent of all savings and loan industry assets. 1974 Fact Book, supra note 11, at 74, 125.
ship prerogatives. With financial interests of savers well protected under the present system, additional reform, so the argument goes, would be merely an academic exercise yielding no measurable practical benefits.

Although economic incentives to exercise membership rights have been greatly reduced, they have not been eliminated, and incentives of both a direct and indirect nature remain. It is true that to the extent association earnings exceed present interest rate ceilings, surplus profits cannot be returned as cash dividends to the membership.$^{170}$ This limitation, however, should not weaken membership concern with association mismanagement. First, some experts believe that interest rate ceilings lack a rational basis and will not continue indefinitely.$^{180}$ If interest rate ceilings are eliminated, members of mutual savings and loan associations would be eligible for cash dividend payments, and the incentive to demand honest and efficient association management would be increased.

Second, although the return of cash dividends to members presently is restricted, there still remains the opportunity for return of "soft" money dividends to members in the form of incidental services.$^{181}$ The mutual form of association is uniquely suited to serving the saving public due to its cooperative customer ownership structure. If membership rights were reformed association members would be better able to direct the efforts of association managements away from obtaining management benefits and toward improving the services provided for member savers.

Third, since deposit amounts in excess of $40,000 are not totally covered by insurance, some members can suffer a financial loss if mismanagement results in a failure of the association.

---

Three states, Maryland, Massachusetts and Ohio, operate independent savings insurance programs. Marvell, supra note 7, at 86.


180. Haywood & Linke, The Regulation of Deposit Interest Rates 15, 16 & n.6 (1968); Report of the President's Committee on Financial Institutions, Chapter III (1963).

181. Incidental services can be offered in many forms: payroll savings programs, postage-paid save-by-mail services, convenient office hours, drive-in windows, night deposit facilities, free safe deposit boxes, traveler's checks, notary services, free checking accounts at banks, trust deed and note collection services, free income tax preparation, group insurance plans, and group travel and entertainment discounts. Information collected from United States Savings and Loan League, XXV Legal Bulletin 145 (1959), and direct inquiry at various savings and loan associations.

The present legal authority of a federal mutual savings and loan association to provide such incidental services is derived from the "objects and powers" clause of its charter as prescribed by the FHBB: "The objects of the association are to promote thrift. . . . [T]his association shall have power to do all things reasonably incident to the accomplishment of its express objects and the performance of its express powers." 12 C.F.R. § 544.1(a)(3) (1974).
Thus, despite the interest rate ceilings and the insured savings accounts there remain practical incentives for mutual members to exercise their membership rights. Because such incentives do continue to exist, reform cannot be rejected as a mere academic exercise with no practical benefits.

C. Effects Upon Stability and Public Confidence

It is argued that if membership voting rights are reformed and strengthened, association managements will be forced to contend with frequent challenges by opposition candidates. Management personnel continually will be replaced by such candidates, thereby depriving the association of a stable leadership with experience and seasoned judgment. Clearly, a constant turnover in the makeup of association managements might undermine public confidence in savings institutions, causing widespread withdrawals of savings. These arguments are unpersuasive, however, for there is no reason to believe a well-informed, self interested member will dislodge honest, responsible management groups.

With reforms in disclosure and proxy solicitation procedures, incumbent and opposition candidates for board directorships will have equal opportunity to garner support from voting members. Only a grossly complacent or unresponsive management would arouse the broadly based opposition among members necessary for management removal in a mutual association.

The great value of increasing membership rights lies in the internal policing effect such an increase would have on association managements. Constant membership surveillance of management activities and the threat of ouster by members, even if unlikely, would certainly cause management to think twice before engaging in questionable practices such as lax cost discipline and management profit taking. This deterrent effect alone is worth the price of membership reform. The ultimate result of such reform would be the strengthening of the FSLIC program by reducing the risk of association failure, and the reduction of the burden upon the

---

182. Herman, supra note 4, at 790.
183. Even with rehabilitated membership rights, the nature of mutual ownership makes it difficult for opposition candidates in mutual associations to amass large blocks of votes. In a federal association, the ability of an opposition candidate to gather the necessary votes is restricted by a federal regulation which places a maximum limit on the number of votes which each association member may have. 12 C.F.R. § 544.1(a)(4) (1974).
184. FSLIC, like any insurance company must rely upon broadly based solvency and non-failure of its insureds, so that adequate funds are available when failures do occur. From 1965 to 1968 FSLIC was forced to make payments of over $238 million upon default of 5 failing associations. This forced FSLIC to liquidate a sizeable portion of its investment portfolio at a loss of $11.8 million in income in 1969. 1971 Hearings, supra note 30, at 88-89.
SANTA CLARA LAWYER

FHLBB and other regulatory agencies of supervising the associations. Contrary to the arguments raised by opponents to reform, the net effect of reform would actually be to strengthen the public confidence in the savings and loan industry.

IV. CONCLUSION

Rehabilitation of corporate democracy within mutual savings and loan associations is needed to strengthen the quality of the savings and loan industry. There is substantial evidence that savings and loan management activities are riddled with lax cost discipline, conflicts of interest, self-dealing, and nepotism. The fundamental problem is that mutual managements are virtually free from supervision, both externally and internally. The FHLBB has been unable or unwilling to eliminate these improper activities through its own external supervisory methods. In addition, legislative inaction and regressive court interpretations have greatly undermined corporate democracy within mutual associations. As a result, internal supervision of management practices by association members has been virtually nonexistent. Free from both external and internal supervision, mutual managements have become autonomous and self-perpetuating.

To remedy this lack of supervision it is imperative that the membership rights of association members be reformed and strengthened. Reform measures should focus on broader membership control rights, strengthened enforcement procedures in support of these rights, and extensive disclosure requirements to insure that mutual members are fully aware of the rights available to them.

Rehabilitation of corporate democracy within mutual savings and loan associations is not a complete solution. The FHLBB should still bear the major burden for regulation of the industry. Democratic reform and rehabilitation, however, would be of substantial benefit to both the associations and their members.

FSLIC expenses are paid primarily through its own income received from insurance premiums. MARVELL, supra note 7, at 39. Because premium rates are set by statute, 12 U.S.C. § 1727(b)(1) (1974), the only way FSLIC can protect its solvency is by minimizing the insured associations' risk of failure.

185. Herman, supra note 4, at 941-45.