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The Control of Operations of Federal Savings and Loan Associations

THE CONTROL OF OPERATIONS OF FEDERAL SAVINGS AND LOAN ASSOCIATIONS

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GENERAL BACKGROUND

FEDERAL savings and loan associations, the federal counter-part of the local and state-supervised building and loan associations, were created under the provisions of the Home Owners' Loan Act of 1933.[1] The local building and loan associations were buffeted severely by the winds of the depression, and this system of mutual liability thrift associations, to encourage savings and to help members in buying homes, was jeopardized. Congress decided to establish a parallel system of Federally incorporated associations, with the very important additional mainstay of insurance of accounts, which security to members or depositors was not provided in the State building and loan systems. The amount of insurance originally was $5,000, and is now $10,000, generally for each account. All accounts in Federal associations are required to be insured by the Federal Savings and Loan Insurance Corporation, and instrumentality of the United States,[2] operated by Federal Home Loan Bank Board.

This same Federal Home Loan Bank Board is an independent agency in the executive branch of the Government of the United States,[3] and is charged with the duties and responsibilities for the "organization, incorporation, examination, operation and regulation" of Federal savings and loan associations.[4] The Board is composed of three members, appointed by the President and confirmed by the Senate. It now governs a vast and important section of our financial activities, since it controls more than 27 billion dollars of assets which are held by almost 1,800 Federal savings and loan associations with about 12 million shareholders.[5] In addition, local building and loan associations may now qualify for insurance of accounts while remaining State associations. To the extent of the insurance of accounts, these state associations are under the control and supervision of the Federal Home Loan

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[1] 48 STAT. 132 (1933), 12 U.S.C. § 1464 (1946). See generally, Heisler, *"Federal-State Associations: Their Status"*, National Sav. and Loan Journal, May 1958, p. 10.

[2] 48 STAT. 1256, 1257 (1934), 12 U.S.C. § 1725, § 1726a (1946).

[3] 69 STAT. 640 (1955), 12 U.S.C.A. § 1437b (1957).

[4] 48 STAT. 132 (1933), 12 U.S.C. § 1464a (1946).

[5] See Pleadings, Sept. 1958, Greater Del. Valley Fed. Sav. and Loan Ass'n. v. Federal Home Loan Bank Bd., No. 12664 (3d Cir. 1958).

Bank Board. It is said that the insured accounts in both Federal and State associations now number more than 21 million and involve more than 50 billion dollars.[6]

Generally, qualified State associations may now convert to Federal associations, and vice-versa, on a reciprocal basis. A great many State associations have converted into Federal associations. A few Federal associations, principally in California and for unusual reasons, have converted into State associations. There is some competition between the two systems, and one of the important considerations for building and loan association managers, in resolving the question of Federal or State charter, is the kind of supervision and control exercised by the appropriate regulatory agency. The President of the United States Savings and Loan League[7] said recently:

> "How fortunate we are in the savings and loan business that there is little Federal-State controversy. . . . The dual system of charters [affords] an incentive for progress. Competition between chartering authorities is one of the means of progress. Federal associations are granted some new power by Congress, and State associations are thus able to persuade State authorities to give them the same or even broader powers. . . . The dual system of charters also provides a type of escape valve against dictatorial, arbitrary or unwise supervision. One of the reasons associations in some States have converted to Federal charters was because the State supervisors were not at all helpful and at times almost completely reflected commercial banker antagonism toward our business. On the other hand, I know there have been a few Federal associations that converted to State institutions because the State law was better and the State supervisor had a better understanding of our business. The dual system of charters provides some measure of protection against bad supervisory practices and an antagonistic attitude toward the business. . . ."[8]

THE POWER TO REGULATE

Congress has given the Federal Home Loan Bank Board authority to make policy and rules and regulations for the operation, supervision and regulation of the Federal associations, "giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States."[9] Every Federal savings and loan association is a mutual, quasi-public, corporate instrumentality of the United States operated, not for the profit of its officers, but "to provide local mutual thrift institutions in

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[6] See Proceedings, Pennsylvania Sav. and Loan League, June 15, 1958; Heisler, *"Federal-State Associations", supra* note 1; Fortune Magazine, May 1958, p. 151.

[7] This is the larger of two voluntary "leagues" of both Federal and State associations, the other being The National League of Insured Savings Associations.

[8] Address of Mr. Joseph Holzka, Pa. Sav. and Loan League, June 15, 1958.

[9] 48 STAT. 132 (1933), 12 U.S.C. § 1464a (1946); Fahey v. Mallonee, 332 U.S. 245 (1947); Home Loan Bank Bd. v. Mallonee, 196 F. 2d 336 (9th Cir. 1952).

which people may invest their funds", and "to provide for the financing of homes." [10] It is evident that a large measure of control and regulation in such a system would be required for the protection of the public.

This power to control and regulate Federal savings and loan associations has been granted to the Federal Home Loan Bank Board by two subsections of the Home Owners' Loan Act of 1933, as amended.[11] By the provisions of the first subsection, the Board is authorized to state by formal resolution:

> ". . . any alleged violation of law or regulation and give written notice to the association concerned of the facts alleged to be such violation. . . . Such association shall have thirty days within which to correct the alleged violation of law or regulation and to perform any legal duty. If the association concerned does not comply with the law or regulation within such period, then the Board shall give such association twenty days' written notice of the charges against it and of a time and place at which the Board will conduct a hearing as to such alleged violation of duty. . . . After such hearing and adjudication by the Board, appeals shall lie as is provided by the Administrative Procedure Act, and the review by the Court shall be upon the weight of the evidence. Upon the giving of notice of alleged violation of law or regulation as herein provided, either the Board or the association affected may, within thirty days after the service of said notice, apply to the United States district court for the district where the association is located for a declaratory judgment and an injunction or other relief with respect to such controversy, and said court shall have jurisdiction to adjudicate the same as in other cases and to enforce its orders. The Board may apply to the . . . court . . . for the enforcement of any order of the Board and such court shall have power to enforce any such order which has become final. . . ."[12]

These provisions were adopted by Congress in 1954 by amendment to the Act "to provide a means by administrative and court proceedings whereby the Board may enforce compliance with law and regulations . . . in cases where the Board felt that the appointment of a conservator or receiver was not necessary or desirable." [13]

It is obvious that under this subsection, while power is given to the Board to enforce compliance with law and regulation, there are broad safeguards of notice, hearing, and court control and review. Until all these safeguards are exhausted, the Board may not interfere with the operation of a Federal

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[10] 48 STAT. 132 (1933), 12 U.S.C. § 1464a (1946); Hopkins Fed. Sav. and Loan Ass'n. v. Cleary, 296 U.S. 315, 343 (1935); Fed. Sav. and Loan Ins. Corp. v. Kearney Trust Co., 151 F. 2d. 720 (8th Cir. 1945).

[11] Section 5 (d) (1) and 5 (d) (2) of the Act, 48 STAT. 132 (1933), 12 U.S.C. § 1464 (d) (1) and (2) (1946).

[12] 48 STAT. 132 (1933), 12 U.S.C. § 1464 (d) (1) (1946).

[13] See note 12 U.S.C.A. § 1464 p. 37 (1957).

association, unless the case falls within the "emergency" provisions of the Act, which will be discussed next. The provisions of this first subsection might be termed the "cease and desist" provisions.

The other relevant subsection,[14] which contains the "emergency" provisions, as amended in 1954, now provides for the procedure for the appointment of a conservator or receiver for any association charged by the Board with violation of law or regulation, and also provides that in an emergency the Board may *immediately and without notice* appoint a Supervisory Representative in Charge. This subsection provides:

> "(2) The grounds for the appointment of a conservator or receiver for a Federal savings and loan association shall be one or more of the following: (i) insolvency . . .; (ii) violation of law or of a regulation; (iii) the concealment of its books, records, or assets . . .; and (iv) unsafe or unsound operation. The Board shall have exclusive jurisdiction to appoint a Supervisory Representative in Charge, conservator, or receiver. If, in the opinion of the Board, a ground for the appointment of a conservator or receiver as herein provided exists and the Board determines that an emergency exists requiring immediate action, the Board is authorized to appoint *ex parte* and without notice a Supervisory Representative in Charge to take charge of said association and its affairs who shall have and exercise all the powers herein provided for conservators and receivers. Unless sooner removed by the Board, such Supervisory Representative in Charge shall hold office until a conservator or receiver, appointed by the Board after notice as herein provided, takes charge of the association and its affairs, or for six months, or until thirty days after the termination of the administrative hearing and final proceedings herein provided, or until sixty days after the final termination of any litigation affecting such temporary appointment, whichever is longest."

The appointment of a conservator or receiver may not be made "except pursuant to a formal resolution of the Board stating the grounds therefor" and until after an administrative hearing. "Such hearing shall be held in accordance with the provisions of the Administrative Procedure Act and shall be subject to review as therein provided and the review by the court shall be upon the weight of the evidence." It should be noted, however, that there are no provisions in the Act for either prevention or review of the appointment by the Board of a Supervisory Representative in Charge. This "temporary receiver" is entirely distinct from a conservator or receiver as provided in the Act.

The appointment of a temporary receiver for a savings institution is a drastic step, obviously fraught with danger both to the association and to the Federal savings and loan system. While there are no provisions in the Act

[14] 48 STAT. 132 (1933), 12 U.S.C. § 1464 (d) (2) (1946).

requiring public notice of the appointment of the Supervisory Representative in Charge, the appointment must, with the rapidity always attendant upon news reflecting upon the position or conduct of a financial institution, become known immediately. With the spread of this news, it is evident that the flow of money into the association may cease, the flow out may increase even to the extent of a "run"—making new mortgage commitments and investments difficult or impossible. There may be an adverse effect upon the stability of personnel. The Board must weigh carefully the ultimate objects sought to be achieved against the many resulting harmful effects.

It is also evident that emergency powers must exist somewhere. In the delicate field of banking, conditions may and do arise and change so quickly that time is of the essence. As the Federal savings and loan system is now constituted, the proper repository for such powers is the Federal Home Loan Bank Board. However, legitimate questions arise: (1) whether the emergency provisions in the Act are clear, and (2) whether the exercise of emergency powers by the Board is fair and as contemplated by Congress.

The Emergency Powers

The Act provides that the drastic method of control of a federal association charged with violation of law or regulation may be exercised by the Board if *in the opinion of the Board* a ground exists for the appointment of a conservator or receiver, and if the Board *determines* that an emergency exists. This, of course, is not the same as requiring that one of the grounds *exist* and that an emergency *exist.* If the latter were the case, there would be clear standing for judicial interference or review.

Among the grounds for the appointment of a conservator or receiver are "violation of law or of a regulation" and "unsafe or unsound operation." If the Board believes that one of these grounds exists, and if the Board determines that an emergency exists, a Supervisory Representative in Charge may be appointed, *ex parte* and without notice, to supersede the directors and officers (and to a large extent the powers of the shareholders) of the association.

There is no provision specifying how the Board shall determine whether one of the grounds for the appointment of a conservator or receiver exists, and no provision specifying how the Board shall determine that an emergency exists. Of course, any requirement specifying on what basis or how these determinations are to be made, of necessity, would derogate from the extent and efficacy of the grant of the emergency power. However, these considera-

tions become important in the light of recent conduct of the Board in interpreting the "cease and desist" and the "emergency" powers granted to it by the Act.

Ordinarily, one would suppose that the legislation is sufficiently clear that in the ordinary case, *where in fact no emergency exists,* the Board should control an association, which it charges with some violation, by means of the "cease and desist" provisions of Section 5 (d) (1). On the other hand, it would seem sufficiently clear that where in fact an emergency exists, the Board should have the right to move quickly and drastically under Section 5 (d) (2). However, a study of some recent cases leads to the conclusion that the Board may believe it has the right to exercise its "emergency" powers even when in fact no emergency exists, and that the Board is carrying this belief into effect.

The particular point I am raising is not whether the position which seems to have been taken by the Board is sound or unsound, as a principle of control in this delicate financial field, but whether that position is sound in the light of the words of the Act, and whether this is what Congress intended.

Since the alternate procedure of "cease and desist" or "emergency" was incorporated in the Home Owners Loan Act, by the 1954 Amendment, the Board has apparently chosen to proceed under the "cease and desist" powers on only one occasion.[15] It is natural that even in a non-emergency situation, the Board should seek to avoid the somewhat cumbersome procedure specified in Section 5 (d) (1). Before the 1954 Amendment, the only enforcement machinery possessed by the Board was to appoint a conservator or receiver, without a hearing, subject to the right of the association, within fourteen days, to request a hearing to show cause why the conservator or receiver should not be removed.

Does the Board have the right to use the "emergency" provisions in a non-emergency situation, or is it relegated to the "cease and desist" procedure? The statutory requirement that the Board must determine that an emergency exists before a Supervisory Representative in Charge may be appointed would seem to be devoid of real meaning if the Board is free to make such an appointment whenever it desires to do so, whether or not an emergency exists, without fear of judicial restraint against arbitrary and capricious action.

The history of Section 5 of the Home Owners Loan Act of 1933 demonstrates this conclusion. As originally adopted, Section 5 provided merely

[15] Legal Bulletin, U.S. Sav. and Loan League, July 1958, p. 162.

that the Board could adopt regulations for the appointment of conservators or receivers. This provision, which prescribed no standards whatever for Board action thereunder, was the only enforcement machinery given to the Board by the original Act.

The constitutionality of the original Act, in giving the Board unlimited authority to appoint a conservator or receiver, unrestrained by statutory standards, was upheld in *Fahey v. Mallonee.*[16] In Mr. Justice Jackson's opinion in that case, he stated that "it may be that explicit standards in the Home Owners' Loan Act would have been a desirable assurance of responsible administration."[17] He characterized the practice of appointing a conservator before a hearing had been held as "a drastic procedure" and "a heavy responsibility to be exercised with disinterestedness and restraint."[18]

Against this background, the Housing Act of 1954[19] revised Section 5 (d). The Senate Committee report on this Act contains the following explanation of the purpose of the revision:

> "Under the broad statutory powers, the provisions for the appointment of conservators and receivers of Federal savings and loan associations have always been incorporated in the regulations of the Home Loan Bank Board for the Federal savings and loan system. Title VI of the bill would enact statutory provisions on this matter which would give the Board the authority needed to protect the welfare of Federal associations and their members, and at the same time provide orderly procedures for the exercise of the supervisory powers of the Board.
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> The Board presently has no means, except through the appointment of a conservator or receiver, to enforce the laws and regulations under which Federal savings and loan associations operate. The bill would provide a method for the enforcement of law and regulations without the necessity of the appointment of a conservator or receiver, and would also establish standards and procedures for the appointment of conservators and receivers."[20]

During the hearings before the House Committee, Congressman Gordon L. McDonough, the proponent of the amendment, in referring to the revision of Section 5 (d), made the following statement:

> ". . . this will give the Federal savings and loan associations a great deal more liberality than they have had under the existing law, and I think that, although the original law was restrictive in the beginning, it perhaps had to be

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[16] 332 U.S. 245 (1947).
[17] *Id.* at 250.
[18] *Id.* at 253-4.
[19] Sec. 503 (2), 68 STAT. 622, 634 (1954).
[20] Sen. Rep. No. 1472, 83d Cong. 2d Sess. 43 (1954). A similar statement appears in the House Report, H. R. Rep. No. 1429, 83d Cong. 2d Sess. 27 (1954).

> because the Federal savings and loan associations of that time were somewhat of an experiment. Now, we have millions of depositors, we have billions of dollars on deposit, it is probably the most commonly used middle class and low-income class group of deposit, next to postal savings, and the arbitrary, autocratic authority that the Board had in the beginning should, in my opinion, be modified because it has to do with the assets of so many people throughout the United States."[21]

That there was some concern that appointment of a Supervisory Representative in Charge be narrowly restricted is demonstrated by the following statement by Congressman McDonough during the same hearings:

> ". . . The supervisor in charge, so-called, in this bill, is the exclusive jurisdiction of the board only where immediate possession is necessary and where there is *evidence* that immediate possession is necessary. That does not apply to the conservator or receiver. The supervisor in charge is appointed *only* when an extreme emergency exists." [22] (Emphasis added.)

As will be seen, the Board apparently takes the position that no one can question in any case whether in fact an emergency exists, that the Board may exercise its "emergency" powers in any case, that it need not use its "cease and desist" powers unless it so desires, and that these matters are beyond review or question by any court. Judicial decisions, almost uniformly, have been in favor of the absolute powers of the Board. The savings and loan industry is concerned, and the United States Savings and Loan League has urged that Section 5 (d) be amended to contain a protective provision along the following lines: [23]

> "No supervisory representative in charge, conservator or receiver shall be appointed, or private property seized, with respect to an association which is solvent in that its assets are equal to or more than its obligations to its creditors, including the members and others, if the alleged wrongdoing can be stopped or otherwise corrected as is provided in this section or otherwise as provided by law."

CHANGE OF POLICY TOWARD SELF-DEALING

Those who are familiar with these Federal associations from their inception state that, at least in the early years, the Board encouraged the formation of these associations by real estate and mortgage brokers and lawyers, whose private businesses obviously would be related.[24] Until recently, the

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[21] Hearing before House Committee on Banking and Currency on H.R. 7839, 83d Cong. 2d Sess. 206 (1954).

[22] *Id.* at 204-205.

[23] Legal Bulletin, U. S. Sav. and Loan League, July 1958, p. 163; Study of Banking Laws, Financial Institutions Act of 1957, Part 2, Senate Committee on Banking and Currency, 1957, p. 608.

[24] Russell, Sav. and Loan Ass'n. (1956), p. 145.

Board tolerated the management of Federal savings and loan associations by persons conducting concurrently their own real estate, mortgage, insurance, and conveyancing businesses, at least to the extent that the Board took no definitive action to divorce over-lapping activities, or to prevent possible or existing self-dealing.

Real estate, mortgage and insurance brokers, and conveyancers have earned income from borrowers from Federal associations while acting as directors, officers or employees of the association. This may or may not involve divided loyalty, or violation of a position of trust, dependent on the circumstances. The point I shall discuss is not the rightness of these practices, but whether the Board has the right to, or should, change its policy with reference to these practices, without adopting pertinent regulations, and whether it should implement its change of policy under the cover of exercise by the Board of its "emergency", rather than its "cease and desist" powers.

It is evident from addresses and articles by members and officials of the Board that there has been a radical change in policy. The Board now seems to have decided to enforce against directors and officers to the Federal associations the highest standards of unilateral loyalty and trusteeship, and to use all its enforcement machinery to this end.

In a recent article by John M. Wyman, Director of the Board's Division of Supervision, the following appears: [25]

> "Probably nothing within the control of directors and officers is basically more essential to real and abiding financial health and to the achievement and preservation of merited esteem in the savings and loan business than the faithful, full discharge by its directors and officers of their responsibilities as trustees for other people's money.
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> Among the very real, down-to-earth fundamentals of the savings and loan business in this definition—phrased in my own words—of the fiduciary obligations of every director and every officer of every savings and loan association:
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> FIRST: It is his duty to see to it that the operation of the association is conducted in accordance with applicable statutes and regulations, and in a safe and sound manner.
>
> SECOND: It is his duty to avoid placing himself in a position, and to avoid being placed in a position, where there is even an opportunity for considerations of personal benefit or advantage to militate against independence of judgment or to color or influence action in the performance of his first duty.

[25] *"Duties and Responsibilities of Directors and Officers"*, National Sav. and Loan Journal, August 1958, p. 8. For a strong reply to the "trusteeship" position, see Russell and Prather, *"The Association Director: Director or Trustee?"*, U. S. Sav. and Loan League Legal Bulletin, Sept. 1958.

> In this connection, it seems to be both fair and constructive to recognize, and to say, that neither necessity nor prudence furnishes any occasion or warrant for the institutions which comprise the savings and loan business to be regarded or conducted by anybody as 'adjuncts' to some other business or activity.
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> Whether or not there may have been times or circumstances which in some measure made tenable practices or relationships of a dependent nature is now a question of historical interest only. Today's 50 billion dollar savings and loan business is fully able to be independent, without invitation or resort to personal 'sideline' benefits or activities."

Mr. Wyman contends that there is no need of defining what is and what is not permitted, since the common law of trusteeship is clear. His article, it seems to me, if it reflects the present policy of the members of the Bank Board, does show that there has been a change of policy toward the whole matter of self-dealing. The Board does have broad power to adopt regulations covering this field. Of course, no regulation can cover every case, but a regulation, having the force of law, can be drafted and adopted to make clear what is the Board's new policy.[26] It can be argued that this is the only fair course.

In another article, which also appeared recently, it is said: [27]

> "The Federal Home Loan Bank Board, concerned about how much 'corporate opportunity'—and possibly fraudulent opportunity—is being indulged in by the Savings and Loans, in 1956 asked Congress for authority to regulate the 'affiliate' activities of Savings and Loan directors. The industry raised such a howl that the Senate failed to include the provision in the 1957 United States Financial Institutions Bill."

The Subcommittee of the Senate Committee on Banking and Currency held hearings upon the proposed Financial Institutions Act of 1957. The proposed Act was not adopted by Congress. In the proceedings before the Subcommittee, the Federal Home Loan Bank Board asked that provisions be inserted in the Bill "to give the Board express power to make rules and regulations with respect to the relationships of and business transactions between 'insured associations' and individuals, corporations, and organizations that are affiliated with such institutions." [28] The Board also asked that power be given to it by specific legislation to remove or suspend "any director or officer of a Federal home-loan bank member or an institution insured by the Federal Savings and Loan Insurance Corporation, where such officer or director violated

[26] See for instance, as to national banks, 12 U.S.C.A. § 78 (1957).

[27] Fortune Magazine, May 1958, p. 213.

[28] Hearings before Subcommittee of Senate Committee of Banking and Currency, Study of Banking Laws, Part 2, Financial Institutions Act of 1957, Statement of Honorable Albert J. Robertson, Chairman, F.H.L.B.B., p. 960.

any law or regulation relating to the institution, engaged in unsafe or unsound practices in conducting its business, or violated his duty to the institution as a director or officer." [29]

An Advisory Committee, representing the savings and loan industry, disapproved both these recommendations and they were not carried over into the committee print. The objections were that the powers sought by the Board were too general and indefinite, that the provisions would be unduly stringent and severe, and would result in "too great a concentration of power in the Board without adequate safeguards." [30] The Chairman of the Subcommittee indicated that the entire bill could not be jeopardized by the insistence of the Board upon "technical amendments" opposed by savings and loan associations.[31]

THREE RECENT CASES

On March 20, 1956, the Board, being of the opinion that a ground existed for the appointment of a conservator or receiver, and that an emergency existed, appointed a Supervisory Representative in Charge of Beacon Federal Savings and Loan Association.[32] On July 11, 1956, the Board ordered an administrative hearing to determine whether a conservator should be appointed for Beacon. On July 16, 1956, almost four months after the appointment of the Supervisory Representative in Charge, Beacon filed suit against the Bank Board for declaratory and injunctive relief.[33]

The complaint filed by Beacon did aver that the appointment of a Supervisory Representative in Charge was improper because there was no emergency. However, the main contention of Beacon seems to have been that the Board should have been required to proceed under Section 5 (d) (1), for correction of alleged improper practices, before resorting to the drastic procedure under Section 5 (d) (2). Beacon contended that by failing to allow it a fair opportunity to correct any violations of law or regulation, the Board had been guilty of an abuse of discretion. The District Court held that it was without jurisdiction since the Board had the discretionary right to use either

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[29] *Id.* at 961.

[30] *Id.* at 961 and 967. Statement of Chairman Robertson, Feb. 15, 1957.

[31] *Id.* at 963, Statement of Senator A. Willis Robertson, Subcommittee Chairman. See also, Russell, *"Two Theories of Supervision"*, U. S. Sav. and Loan League Legal Bulletin, Jan. 1957.

[32] 48 STAT. 132 (1933), 12 U.S.C. § 1464 (d) (2) (1946). I am informed that the first notice of any criticism was at a special meeting of the Board of Directors called at the request of the Bank Board. At 10 A.M. a demand was made that all the Directors resign. This was refused, and at 4 P.M. a Supervisory Representative in Charge took possession.

[33] Beacon Federal Sav. and Loan Ass'n. v. Federal Home Loan Bank Bd., 143 F. Supp. 534 (E.D. Wis. 1956).

5 (d) (1) or 5 (d) (2), "in a proper case", and that Beacon had failed to exhaust its administrative remedies, since it could obtain review of the appointment of a conservator, should one be appointed.[34]

The Board then proceeded with the administrative hearing, and a conservator was appointed for Beacon. Beacon sought review of that order, reiterating its contention that the Board had abused its discretion in proceeding under Section 5 (d) (2) and urging that there was no emergency because Beacon was solvent. On the procedural points, the District Court again held that the Board's choice of 5 (d) (2) over 5 (d) (1) was not reviewable as such, and that any question of emergency or right to appoint a Supervisory Representative in Charge had merged in the issue then before the Court, the propriety of the appointment of a conservator.[35]

On the latter point, the Court reviewed the evidence and refused to interfere with the appointment of the conservator.

The second case is that of *Miami Beach Federal Sav. and Loan Ass'n v. Callender.*[36] In that case, the Board was of the opinion that the Association was violating the law and regulations and engaging in unsafe and unsound practices. Representatives of the Board appeared at a meeting of the Directors of the Association (called upon demand of the Board) and informed the Directors that unless some of the Directors (who had been indicted) [37] resigned, and unless the number of Directors was increased, the Board would proceed under Section 5 (d) (2). Some of the Directors resigned, and the Association's by-laws were changed to increase the directorate. Other Directors satisfactory to the Board were elected on February 11, 1958.

Suit was brought in the Federal District Court, in the nature of a stockholders derivative action, for a declaratory judgment and a temporary and permanent injunction. The Board was charged with unlawful coercion, and the Plaintiffs asked that the shareholders be given the opportunity to elect a new Board of Directors and that the Federal Home Loan Bank Board be enjoined from its arbitrary and capricious interference.

The Bank Board filed a motion to dismiss. This, and the motion for a preliminary injunction, were argued on March 7, 1958. By that time, the Defendants, who included the newly elected directors, had not yet filed an

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[34] *Id.* at 536.

[35] Beacon Federal Sav. and Loan Ass'n. v. Federal Home Loan Bank Bd., 162 F. Supp. 350 (E.D. Wis. 1958). I have been informed that this decision has been appealed to the U. S. Court of Appeals.

[36] 256 F. 2d 410 (5th Cir. 1958).

[37] See U.S.A. v. Meyer, D.C.S.D. of Florida, Miami Division, No. 10,529 M-Criminal. The indictments were dismissed on July 3, 1958.

answer. No testimony was taken by the Court. On March 11, 1958, the District Judge entered an order, inter alia, that a special meeting of the shareholders be held to replace the newly elected directors. On March 12, 1958, the Bank Board filed an appeal and obtained a temporary stay.

The appeal was decided in favor of the Board on June 17, 1958. The Court said: [38]

> "When a governmental agency holds such great powers over its offspring, even to the point of appointing a conservator or receiver to replace the management, 12 U.S.C.A. Sec. 1464 (d) (2), it is difficult to hold that an informal request, even demand, to clean house would amount to an abuse of the statutory powers and discretion of the agency. Construing the vague allegations of the complaint most favorably to the plaintiffs, at the utmost there was a threat by the board representative to utilize the statutory and legal procedures and sanctions, if resignations of the directors under indictment were not tendered. Realistically, this appears to be the only pressure a representative of the Board could exert."

In a footnote, the Court pointed out that the Association and the directors could have refused to comply with the alleged demands, or invoked the formal administrative and judicial machinery to determine whether the Board's representatives were acting improperly.

The next case discusses the possible remedy open to the Association under similar circumstances; it involved an action brought by the Greater Delaware Valley Federal Savings and Loan Association to enjoin the appointment of a Supervisory Representative in Charge.[39] The Association averred that it was solvent, that there was no emergency, that the Board nonetheless had threatened to appoint a Supervisory Representative in Charge, and that this would cause irreparable harm.

In this case, on May 6, 1958, representatives of the Board, without prior notice, appeared at a meeting of the Association's directors and informally delivered an ultimatum (1) that all the directors resign immediately, or (2) that the Association immediately agree to merge with another Federal Association, or (3) that the Association immediately agree to the appointment of a conservator. The charges, orally stated, were based generally on an examination made as of June 26, 1956 (almost two years before) and were to

[38] 256 F. 2d 410, 414. Litigation and controversy in this case is continuing between those Directors who are satisfactory to the Bank Board and former Directors and others who contend they actually represent the shareholder. No Supervisory Representative or Conservator was appointed because the Bank Board is in practical control, through approved Directors of the Association.

[39] Greater Delaware Valley Federal Sav. and Loan Ass'n. v. Federal Home Loan Bank Bd., 163 F. Supp. 176 (E. D. Pa. 1958).

the broad effect that the two managing officers had obtained control of the Association and its operations and had shaped its financial policies with respect to its construction loans so as to receive substantial commissions or fees in connection with these loans. The Association replied that all its practices in connection with construction loans had been known to the Board for a period of twenty years, and that no law or regulation had been violated. The Association averred, while the Board denied, that the ultimatum was accompanied by the threat to appoint a Supervisory Representative in Charge unless the Association acceded to one of the tri-partite demands.

The District Court found that the threat to appoint a Supervisory Representative in Charge had been made and issued an injunction. The opinion states that while the Board did have the right to declare an emergency and to make such an appointment, it did not have the right to issue the coercive ultimatum and had abused its powers in threatening to make the appointment unless its terms were complied with. The District Court Judge[40] stated, in his opinion, that the Board did not have the power to dictate merger or resignation terms in the absence of a conservatorship.

In the course of the hearing in the District Court, counsel for the Association asked counsel for the Board to say in open court that the Board would not appoint a Supervisory Representative in Charge unless the Board first found that an emergency in fact existed. The record shows that the following then occurred:[41]

(Board Counsel)

> Our position is that the Board without notice, without hearing, *ex parte,* may appoint a supervisory representative in charge to take immediate charge of an association when the Board in its opinion believes that grounds exists for the appointment of a receiver, and when the Board determines that an emergency exists requiring immediate action.
>
> The statute does not say if an emergency exists they may, it says if the Board determines that emergency exists it may appoint a supervisory representative.

(The Court)

> Yes, they create the emergency by determining that it exists."

This seems to be a statement by the Board's legal representatives that any situation is an emergency if the Bank Board chooses to think so. This seems

[40] Hon. Thomas C. Egan.

[41] Transcript of Proceedings, Greater Delaware Valley Federal Sav. and Loan Ass'n. v. Federal Home Loan Bank Bd., Civil Action No. 24,716 (E.D. Pa. 1958).

to be an indication that the Board will not use Section 5 (d) (1) but consider Section 5 (d) (2) as the proper and most effective machinery of enforcement of its policies.

The Bank Board filed an appeal in the Court of Appeals for the Third Circuit. This was argued on November 7, 1958. On November 10, 1958 the Association held a special meeting of its shareholders and overwhelmingly adopted the proper resolutions to convert to a state-chartered savings and loan association, with retention of its Federal insurance of accounts. On November 12, 1958, the Bank Board having decided to appoint a conservator, the administrative hearings on the appointment of a conservator commenced.

On December 30, 1958, the Court of Appeals filed its opinion [42] sustaining the position of the Bank Board, reversing the judgment of the District Court, and directing the dismissal of the complaint. In its opinion the Court of Appeals stated the question to be whether "it is within the province and authority of a court to determine whether 'any existing acts and practices' . . . of the local Association are such as to justify the Board in a contemplated and threatened exercise of its emergency power of *ex parte* seizure and temporary management of the business of the association." The question advanced by the Association was whether a court may interfere when the Board threatens to use emergency provisions in a non-emergency situation. It may be noted that the manner of stating the question in a case often leads to the decision. However that may be, the Court of Appeals answered the question as stated by it by holding that the Bank Board has absolute statutory discretion to use the emergency machinery, and that no court may interfere with its judgment as to the gravity of the situation and the urgent need for immediate corrective measures. The Court [43] said:

> "In the nature of the matter involved, it is entirely understandable that Congress should have viewed the danger of harm to the local enterprise through any error of judgment or even abuse of discretion by the responsible national Board in this preliminary procedure as far less than the danger to the enterprise, its investors and the public generally, if the Board should not be empowered immediately to supersede management whenever in its view an emergency should so require."

The Association, in the face of the proceedings in the Courts and the proceedings (not yet concluded) for the appointment of a conservator, pursued the path toward conversion to a state-chartered savings and loan association with retention of its Federal insurance of its accounts. On January 2, 1959, the

[42] ——— F. 2d —— (1958).

[43] Opinion by Hastie, Circuit Judge.

Pennsylvania Secretary of Banking formally approved the proposed conversion, and the new state charter was issued by the Pennsylvania Department of State on January 5, 1959.[44]

CONCLUSION

The record of the Bank Board in reported litigation shows, therefore, uniform success. It is difficult to criticize adversely any of these decisions because of the apparently plain meaning of the statutory provisions when interpreted without regard to the intentions of the legislative proponents and the understanding and expectations of the savings and loan industry.

That there will be repercussions in the industry seems beyond question. These savings and loan institutions are usually regarded with jealous pride by many able founders and managers who have devoted their lives to the growth and progress of their associations. The feeling is becoming widespread that Congressional inquiry into the present philosophy of supervision of the Bank Board is necessary. Litigation and controversy cannot be considered as beneficial to any banking system. The use of the iron hand, where plain regulation and direction is all that is required, would seem to be harmful in an area where balances are always delicate. The fact that one Association, in the face of the iron hand, has withdrawn from the Federal system is bound to raise revaluations of both Federal and State supervision with reconsideration of the benefits and disadvantages of each.

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[44] The Bank Board has taken the position that because of the reciprocal provisions of the Pennsylvania Building and Loan Code, this conversion required its approval. Such approval was not obtained. This raises other interesting questions. On January 21, 1959, Federal Home Loan Bank Board instituted suit, Civil Action 25844, in the United States District Court for the Eastern District of Pennsylvania, against Greater Delaware Valley Federal Savings and Loan Association, praying for a declaratory judgment that its conversion to a State-chartered Association was void because of failure to obtain the approval of the Bank Board and because this approval is required under the reciprocal provisions of the Home Owners' Loan Act, since Pennsylvania requires the approval of its Secretary of Banking for a conversion from State to Federal.