1987

Maryland's Savings and Loan Crisis of 1985: The Resulting Legislative Reform

Steven I. Batoff
Batoff Associates, P.A.

Follow this and additional works at: http://scholarworks.law.ubalt.edu/ublr
Part of the Banking and Finance Law Commons

Recommended Citation
Available at: http://scholarworks.law.ubalt.edu/ublr/vol16/iss3/2

This Article is brought to you for free and open access by ScholarWorks@University of Baltimore School of Law. It has been accepted for inclusion in University of Baltimore Law Review by an authorized administrator of ScholarWorks@University of Baltimore School of Law. For more information, please contact snolan@ubalt.edu.
MARYLAND'S SAVINGS AND LOAN CRISIS OF 1985:
THE RESULTING LEGISLATIVE REFORM

Steven I. Batoff†

Maryland's publicized savings and loan crisis was caused, in part, by insufficient state regulation of the savings and loan industry. Legislation subsequently was enacted by the Maryland General Assembly to prevent recurrence of the crisis. This article, written by one of the primary drafters of the curative legislation, reviews the history of savings and loan associations in Maryland, the causes of the crisis that arose in 1985, and the legislation enacted to prevent a reprise.

TABLE OF CONTENTS

I. SUMMARY OF THE MARYLAND SAVINGS AND LOAN CRISIS ........................................... 403
II. REGULATORY HISTORY OF MARYLAND'S SAVINGS AND LOAN ASSOCIATIONS ............... 406
III. REGULATORY REFORM OF 1986 ..................... 414
IV. CONCLUSION........................................... 451

I. SUMMARY OF THE MARYLAND SAVINGS AND LOAN CRISIS

In May, 1985, widespread publicity about financial difficulties at several Maryland savings and loan associations led to a general run on thrifts insured by the Maryland Savings-Share Insurance Corporation (MSSIC). At the time, MSSIC was a private insurance program that insured 102 state-chartered savings and loan associations. In May, 1985, it was revealed that numerous financial irregularities existed at Old Court Savings and Loan, the second-largest privately insured savings association in the state. The alleged financial irregularities of Old Court included several million dollars of overdrafts in accounts owned by directors, officers, and stockholders; unsecured note loans to directors, officers, and entities controlled by them totalling over $5 million dollars; management, consulting, and similar fees to directors, officers, and enti-

† B.A., 1973, University of Connecticut; J.D., 1977, Hofstra University; Principal, Offit & Batoff, P. A., Baltimore, Maryland; Assistant to Special Counsel to State of Maryland, Savings and Loan Crisis, 1985-86.
ties controlled by them; and numerous loans without the necessary documentation. In a press release issued on May 8, 1985, the president of MSSIC announced that because of Old Court's rapid growth and increasingly difficult management problems, it was believed that someone with greater expertise was needed to run its operations. Old Court president Jeffrey Levitt was removed as the association's chief manager and John D. Faulkner, a member of the Board of Directors of MSSIC, was named to replace him.

Charles Hogg, president of MSSIC, insisted that the management change was initiated by Old Court and not by MSSIC. MSSIC, however, had recently increased its monitoring of member associations in light of the March, 1985 savings and loan crisis in Ohio. MSSIC officials admitted that they had been concerned about Old Court's condition before the Ohio closings and that their concern increased because of the Ohio crisis. MSSIC insisted, however, that the association's problems were manageable.

On May 9, 1985, the day following the press release stating that Jeffrey Levitt was to be replaced, Old Court depositors lined up at two of the branch offices to withdraw their money. The following day, hundreds of depositors withdrew funds from Old Court and Old Court had to borrow funds from the Federal Reserve Bank to meet depositors' demands. Negotiations were undertaken to sell Old Court or to merge it with another lending institution, but no agreement was reached. On May 13, 1985, the state received court approval to appoint a conservator to take over the operations of Old Court, including the imposition of $1,000-a-month withdrawal limits.

Reacting to the numerous withdrawals from Maryland privately insured savings and loans, Governor Harry R. Hughes extended the $1,000-a-month limit on withdrawals to all 102 such institutions. This limit was to remain in effect until each institution's deposits were covered by federal insurance or until a new state insurance program was proposed by the governor. Governor Hughes also responded by declaring a state of public crisis and emergency and by calling a special session of the General Assembly to enact long-range solutions. In the emergency ses-

1. The Baltimore Sun, May 13, 1985, at 1A, col. 5.
2. The Baltimore Sun, May 9, 1985, at 1A, col. 1.
3. Id.
4. Id.
5. Id. In Ohio, approximately 70 privately insured Ohio savings and loans were closed by the Governor following the collapse of a large Cincinnati savings and loan. The losses of the collapsed Ohio thrift institution threatened to deplete that state's private insurance fund. Id.
6. Id.
7. The Baltimore Sun, May 9, 1985, at 1A, col. 5.
8. The News American, May 12, 1985, at 1A, col. 5.
10. The Baltimore Sun, May 14, 1985, at 1A, col. 5.
11. Id.
sion, it was determined that the state should conduct an independent investigation of the Maryland saving and loan crisis.

The Office of Special Counsel was created to conduct this independent investigation and Governor Hughes appointed Wilbur D. Preston, Jr. as Special Counsel. On January 9, 1986, before a joint session of the General Assembly, Mr. Preston presented the report of the Office of Special Counsel which, in addition to revealing the extent of abuse and criminal activity by officers and directors of associations, demonstrated extensive shortcomings in the State’s regulation of the savings and loan industry. The report included all the findings and recommendations of the Office of Special Counsel as well as a draft of proposed legislation extensively changing Titles 8 and 9 of the Financial Institutions Article of the Annotated Code of Maryland (the Financial Institutions Article).

According to the Office of Special Counsel, the three major causes of the Maryland savings and loan crisis were: (1) absence of regulation of savings and loan associations; (2) industry individuals who took advantage of the absence of regulation for their own benefit; and (3) a flawed statutory system that permitted the industry to make and enforce its own rules.

The Office of Special Counsel reported that MSSIC and the Division of Savings and Loan Associations (Division) completely failed to regulate the industry. Both MSSIC and the Division claimed that they were powerless to do so. The Office of Special Counsel disagreed and concluded that, “[a]lthough additional statutes and regulations would have been helpful, both had ample power to regulate the savings and loan industry. Both, however, chose not to exercise their substantial authority.”

The Office of Special Counsel reported that a final, less significant, cause of the crisis was the “failure of State government on all levels to discover the gross regulatory failure and the criminal conduct of certain industry members.” The report noted that the Maryland legislature had enacted legislation that was drafted and proposed by boards and commissions that were dominated by industry members. The legislative history demonstrates how these commissions were controlled by the very industry that the legislation was intended to regulate. The Office of Special Counsel, therefore, recommended that the legislation drafted by that office be considered as a framework for regulating Maryland-chartered savings and loan associations.

14. Id. at 10. In its report, the Office of Special Counsel discussed the various powers available to the Division Director. Id. at 11.
15. Id. at 16-17.
II. REGULATORY HISTORY OF MARYLAND'S SAVINGS AND LOAN ASSOCIATIONS

A. Introduction

Maryland's savings and loan associations trace their roots to 1837 when the General Assembly first authorized the chartering of mutual savings societies created to assist members in purchasing homes.16 The first Maryland associations were patterned on the plan of "benefit building societies" originally recognized by the British Parliament.

In 1852, these partnerships were permitted to incorporate in Maryland.17 All of the members of an association subscribed to shares and agreed to pay for them in installments until their "par value" was reached. When this was accomplished the corporation was dissolved. If a member wished to purchase a home, he could obtain an "advance" on the money he ultimately would receive upon the liquidation of the corporation. A mortgage was given to insure the payment of future installments, and the member usually had to pay interest on the sum advanced to him. When the predetermined par value was reached and the corporation terminated, all mortgages, whether paid in full or not, were released.

A problem with these early "building and loan associations" was their self-liquidating nature. Various attempts were made to provide alternatives to the terminating plan.18 The "permanent association" developed as a solution to the drawbacks of the terminating plan. This type of association attracted individuals who otherwise would not be able to join an association after it was formed, and thereby brought about a constant flow of new money to the association. Furthermore, this plan provided an inducement to savers in that a shareholder was entitled to withdraw money from the association prior to the time a subscription was fulfilled and could receive dividends that had been credited to his account.

Until the late 1950s, most building and loan associations traced their origins to the small local associations designed to promote homeownership. Historically, ethnic and other neighborhood groups provided impetus for the development of these associations. They were conservatively

---


17. Md. Laws 1852, ch. 148. These groups were self-liquidating and did not engage in building or trade loans.

18. For example, in 1872 the General Assembly permitted "non-participating" associations to overcome the difficulties of a terminating plan in order to achieve perpetual existence. The purpose of the 1872 Act was to expand the Act of 1852. The Act of 1872 repealed Section 92 of Chapter 471 of the Act of 1868 relating to corporations formed for the purpose of loaning money, and re-enacted similar provisions with modifications. Nevertheless, the non-participating associations were a failure. Another variation of the terminating plan was the permanent association, where each individual member of the association had a separate termination date.
managed and efficiently run. Most of these "neighborhood associations" were located in the City of Baltimore.

Although many associations retained their traditional place within the financial arena, others changed in response to changes in the economy. Stimulated by the increased prosperity and the home building boom that followed the Second World War, these associations grew into imposing institutions with substantial assets and numerous customers.

As early as 1890, proposals were made to regulate building and loan associations. The demands for supervision sprang from the associations' competitors. In the 1920s, for example, the Maryland Bankers Association led a campaign for closer scrutiny of savings and loan associations. Often the legislators who were being petitioned to pass regulatory laws were active in the affairs of state-chartered associations.

Until 1929 there was little, if any, regulation by the Maryland state legislature of building and loan associations. In 1929, as a reaction to the stock market crash, the General Assembly began to regulate the nature and character of investments made by building and loan associations. Attempts to regulate the industry in areas other than investments, however, were unsuccessful. In the early 1940s, various bills were presented to the General Assembly, but none were enacted into law. On the other hand, the building and loan association lobby experienced no difficulty in effecting passage of bills that it favored, such as the expansion of permissible investments that could be made by the association.

Promoters were attracted by the combination of unregulated operations and speculative real estate investment opportunities. As a result, new associations were formed and older ones were taken over and expanded. Frequently, these associations were controlled by out-of-state interests. Before state regulation was enacted, it was simple for an individual to obtain a new charter and start an association, or to take over an existing association and expand its business.

The absence of regulation of the industry was partially responsible for the savings and loan crisis in Maryland in 1960. In the late 1950s

---

20. Approximately 46,000 depositors with funds in 28 troubled Maryland associations lost money during this period. According to press reports, the average refund to a depositor was between 30% to 40% of his account with the association. The number of associations decreased from more than 700 to 345. According to Richard W. Case, chairman of 1960 Savings and Loan Study Commission, the losing depositors themselves should not be considered entirely blameless. Case noted that the age old quest of something for nothing — or the receipt of the "top dollar" — surely found its presence in these cases. Some of the associations that were placed in receivership during the early 1960's are still in the process of being liquidated today.

Dishonest practices in Maryland's financial institutions have not been limited to savings and loan associations or to the modern era. One of the most famous Supreme Court decisions, McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819), grew out of unsecured insider dealing by some of Maryland's leading citizens who controlled the Baltimore branch of the Bank of the United States. Today, however, the case is best known for the phrase "the power to tax is the power to destroy."
and early 1960s, depositors poured large sums of money into associations in order to receive valuable "gifts" and promotion items. Depositors shifted their money from one association to another, apparently in order to receive better "promotions." Some of the state-chartered associations claimed that their deposits were insured in order to compete favorably with banks and federal associations. This claim led to the first investigation of a building and loan association, and the insurance on deposits in many cases proved to be illusory.  

B. Robinson Commission

The first legislative response to the savings and loan crisis was the creation of the Robinson Commission in 1959. The Commission was a subcommittee of the Budget and Finance Committee of the Legislative Council and its principal purpose was to determine the extent of the change in the operations of savings and loan associations. In December, 1959, when the subcommittee issued its "interim report," one bill submitted for consideration would have prohibited a savings and loan association from advertising that it was insured if it did not carry federal insurance or insurance with a commercial company approved by the state insurance department. The subcommittee believed that such legislation was needed in light of advertisements by savings and loan associations using insurance carriers that were not subject to state regulation and displaying an emblem strongly resembling the Federal Savings & Loan Insurance Corporation (FSLIC) emblem. The subcommittee also recommended that it continue its study of the savings and loan industry in Maryland. The proposed legislation was never enacted by the General Assembly.

McCulloch v. Maryland also described the framework from which "destroyers of widows, (sic) and orphans" preyed upon the people of Maryland. Bogen, The Scandal of Smith and Buchanan: The Skeletons in the McCulloch vs. Maryland Closet, 4 MD. L. F. 125, 129 (1985), quoting letter from Anna Boyd to John McHenry, August 6, 1819 (McHenry papers, manuscript, Maryland Historical Society).

Similar activities, again by the leading citizens of the day, led to the closing of the Bank of Maryland in 1834, and the resulting "Baltimore Bank Riot of 1835." See D. Grimstead, Democratic Rioting: A Case Study of the Baltimore Bank Mob of 1835, 125 (W. O'Neill ed. 1973). Depositors who could not get access to their funds rioted; five were killed and over twenty wounded. Finally, in 1838, over four years after the bank closed, all debts were paid in full plus a dividend. Most of the poor who had savings at the bank, however, already had been forced to sell their credits to investors at far less than face value.

21. In 1958, Senator Glenn Beall questioned the claim of a Silver Spring association that insurance was to be provided by a Panama corporation whose assets were stored in the association's own vault. This precipitated an investigation. Postal inspectors inquired into activities of Federated Swiss Insurance Underwriters, a company based in Tangier, Morocco, and the American Savings and Loan Indemnity Company of Panama, companies that were advertised as insuring building and loan deposits.

22. LEGISLATIVE COUNCIL OF MARYLAND, REPORT TO THE GENERAL ASSEMBLY OF 1960, 76 (1958-60). The Commission was named after its chairman, Jerome Robinson.
In the 1960 session of the General Assembly, Joseph D. Tydings, Jr. introduced a bill that provided for a state licensing and regulatory authority for savings and loan associations. After a public hearing, however, Governor J. Millard Tawes vetoed the bill, indicating that it was too weak to be effective. The Governor also announced his intention to appoint a commission to study the regulatory problem. With the demise of the Tydings Bill, the state of the law relating to the savings and loan industry remained where it began over 100 years before.

C. The Case Act

After the 1960 session, the General Assembly appointed the Savings and Loan Study Commission, known as the Case Commission, to draft legislation. The Commission used the Savings and Loan League “Model Act,” as well as the law of other states, especially Massachusetts, for guidance in drafting. The Commission held a public hearing on its proposed legislation on December 21, 1960, and the Case Commission bill ultimately was passed with Governor Tawes’ support. The Case Act became the first comprehensive regulatory law for savings and loan associations in the State of Maryland.

The Case Act provided that it was the policy of the State of Maryland to promote and foster the business of savings and loan associations and to assure their financial stability. The savings and loan business was to be supervised as a business affecting the economic security and general

---

23. The Tydings bill was passed in the House of Delegates and the Senate.
24. Any three people with thirty dollars among them could start an association. No person or agency was vested with authority to check into the identity of the incorporators, who were to become the trustees of the public’s savings. No initial capital was required to commence business. There was no provision for reserves. No state officer could examine an association’s books. There was no regulation of advertising. No state agency could police the meager restraints on investments that associations might legally make.
25. The Commission was named after its chairman, Richard W. Case.
26. The Model Savings Association Act was published by The United States Savings & Loan League. THE UNITED STATES SAVINGS & LOAN LEAGUE, LEGAL BULLETIN (Jan. 1961).
27. Senators North and Northrop introduced the bill on February 1, 1961, as Senate Bill 254. It was amended by the House before its passage.
28. Although the Case Act was approved by the General Assembly, it was challenged by referendum. Under the State Constitution, laws petitioned to the ballot do not take effect until ratified. While required signatures were being filed for the referendum, a special session of the General Assembly was held, at which the bill was passed again as an “Emergency Act,” and codified at MD. CODE ANN. art. 23 §§ 161A-161KK (1961). As an emergency measure, the bill could not be subject to a second referendum attempt. The Case Act ultimately was ratified by the voters at the general election held on November 7, 1962. The General Assembly had provided that the Emergency Act, as passed in the special session, should not be construed as repealing what was enacted during the regular session, and that the legislation enacted during the special session would terminate at such time that the Case Act was ratified. The first regulations promulgated under these sections of the Code were effective October 10, 1963.
welfare of the citizens of Maryland.29

The Act established the Department of Building, Savings and Loan Associations.30 The head of the department, the Director, had general powers of administration.31 The Director was authorized to issue orders to compel any association to comply with its charter, constitution, and bylaws, as well as with the laws of the State of Maryland and the regulations adopted by the Board of Commissioners.32

The statute also established a Board of Building, Savings and Loan Association Commissioners (Board of Commissioners) to be selected from the industry.33 The powers and duties of the Board were to advise and make recommendations to the Department Director on any questions within the scope of the authority of the Director. In addition, the Board was to submit to the Governor proposed amendments to savings and loan legislation. The Board was also to establish the methods and standards to be used in examining associations, in valuing association assets, and in controlling the advertising and promotional activities of associations. Finally, the Board was to promulgate rules and regulations to carry out provisions of the law applicable to savings and loan associations.34

29. In this regard, the Act suggests that there is a public interest in fostering healthy competition among associations, as long as it does not become suicidal. See, e.g., County Fed. Sav. and Loan Ass'n v. Equitable Sav. and Loan Ass'n, 261 Md. 246, 274 A.2d 363 (1971).

30. Later called the Division of Savings and Loan Associations.

31. The Director was required to have five years experience as an attorney, officer, or director of a savings and loan association, or to have been an employee of the Department for at least five years. In addition, the Director had to be a resident of Maryland for five years prior to being appointed Director.

32. Only stock associations that were in existence on or before January 1, 1962, were permitted under the Case Act. If the Director found that an association was violating the laws of Maryland or any order, he could direct the discontinuance of such violation and require the association to conform to all of the requirements of the law. If the association failed or refused to carry out any final order, the Board of Commissioners could petition to the appropriate court for the appointment of a conservator. Under the statute, a court was authorized to appoint a conservator if it found that the association was in an impaired or insolvent condition, or was in substantial violation of any applicable law or regulation, was concealing any of its assets, books or records, or was conducting an unsafe or unsound operation. The conservator, upon recommendation of the Board of Commissioners, also could remove any director, officer, or employee.

If the irregularities complained of in a final order were not corrected, or if the irregularities complained of in the petition for the appointment of a conservator were not corrected, or if there were "an emergency," the Board of Commissioners could apply to an appropriate court for the appointment of a receiver. The court was authorized to appoint a receiver based on the same findings as in the case of appointing a conservator.

33. The Board consisted of five members, each appointed by the Governor with the advice and consent of the Senate. Each member of the Board was to have been an officer, director, or an attorney for a building and loan association for at least five years prior to the year of appointment. The Board later became known as the Board of Savings and Loan Association Commissioners.

34. See 47 Op. Att'y Gen. 52 (1962), which discussed the scope of authority to enact
The Case Act established new requirements for entry into the state-chartered savings and loan industry, including an initial capitalization requirement, a general reserve fund requirement, and an expense fund requirement. The Board of Commissioners was granted the authority to investigate the character, responsibility, and general fitness of the incorporators to determine whether the association would be managed honestly and efficiently.

The Act required that the association prepare an annual financial statement to be filed with the Director. Certain transactions, which constituted conflicts of interest, were prohibited. Insider loans were prohibited, except for loans upon the security of the individual's home or free share account in the association. There was also a general exception for loans approved by a two-thirds vote of the board of directors of the association and appraised by a disinterested appraiser appointed by the Director, as long as the loan was approved by the Director.

The statute also contained a variety of other provisions. Associations were authorized to make certain investments as permitted under the Maryland law and to invest in real estate related to the transaction of their business. Finally, the statute also set forth specific rules with regard to reserves. The provision for the apportionment of profits in the new law required that there first be a proper allocation made to the reserve fund before any other apportionment of profits. Although the regulations under the savings and loan regulatory acts. The general rule is that statutory provisions control with respect to what rules and regulations may be promulgated as well as with respect to what fields are subject to regulations. The opinion noted that the power given under the savings and loan acts, the Case Act as well as the Emergency Act, was "comparatively broad." The general rule-making power granted in both acts extended to such rules and regulations as were reasonable and necessary to carry out the provisions of the law and to define the terms as they related to or affected associations. 47 Op. Att'y Gen. at 57.

35. Loans to an officer, director, or employee of an association, or to any corporation or business in which he or a member of his family owned an interest of ten percent or more were prohibited.


37. Each association had the power to invest in such real estate reasonably anticipated to be necessary or convenient for the transaction of its business, real estate purchased at auction sale, public or private, judicial or otherwise, upon which the association had a lien or claim, real estate accepted by the association in satisfaction of any obligation, real estate acquired by the association in exchange for real estate owned by the association, real estate acquired by the association in connection with salvaging the value of property owned by the association, and chattels and equipment necessary to conduct its business. Section 150 of article 23 was repealed by the Acts of 1968 ch. 65. For a similar provision see §§ 9-419, -422, -423, -426 of MD. FIN. INST. CODE ANN. (1986). The associations, however, were prohibited from accepting real estate or leasehold property as security for a loan if it was outside the State of Maryland or outside a fifty mile radius of the principal Maryland office of the association.

38. If the reserves of an association were less than six percent of the aggregate withdrawal value of the association's free share accounts, ten percent of the profits or such lesser portion as would increase the reserve to the required total amount had to be allocated to the reserves.
Case Act provided for regulation of savings and loan associations themselves, it did not provide for or regulate the insuring of accounts, the other major problem encountered in the 1960 crisis.

D. 1980 Revision to Title 9 of the Financial Institutions Article

In 1961, the Case Commission recommended that the operational provisions in the savings and loan statute regarding the internal operations of associations be left untouched, because even the smallest change could create an onslaught of litigation. There was insufficient time to complete a comprehensive review of these operational provisions because the problems were so complex. In 1967, the Department of Savings and Loan Associations requested that a legislative committee rewrite the savings and loan statute. A draft was prepared by the committee, but at the request of Governor Spiro T. Agnew, the bill was not introduced in the General Assembly.

It was not until 1979 that the General Assembly and the industry believed that there was a need for reorganization of the savings and loan statute to remove obsolete, archaic, and contradictory provisions. The Committee on Economic Matters of the House of Delegates appointed a commission\(^39\) to study the statute and to prepare a substantive revision to be introduced in the 1980 session of the General Assembly. The Commission based the new law on the existing Maryland statute, the Model Act produced by the United States League of Savings and Loan Associations, and federal statutes, as well as on the statutes of other states.\(^40\) This recodification of Title 9 of the Financial Institutions Article was approved by the General Assembly and became effective on July 1, 1980.\(^41\)

The provisions of the new statute drawn from federal law were included to allow state-chartered savings and loan associations to compete with federally-chartered associations. The Commission believed that the original statute needed to be modernized to keep the state-chartered savings and loan industry viable. Numerous changes were taking place within the federal system that required changes in state-chartered associations in order that competitive equality be maintained. Therefore, the basic thrust of the bill was to permit greater flexibility in the state-chartered associations.

The annual statement provision, which had specified that the annual statement be on a form required by the Division Director, was deleted from the statute. The Division Director had advised the Commission

\(^39\) The Savings and Loan Association Law Commission, rather than a legislative committee, was appointed to study the law. The staff of the Commission to Revise the Annotated Code also recommended to Governor Harry R. Hughes that a commission, rather than the legislature, rewrite the savings and loan association law.

\(^40\) The final report was introduced to the House as House Bill 1008 on February 1, 1980.

\(^41\) 1980 Md. Laws ch. 856.
that this annual statement was not significant in the Director's view because, by regulation, quarterly audited statements were received.\footnote{The Commission also recommended that annual statements be available at all offices, not only the principal office of the savings and loan association.}

The Commission also refined the conflict of interest provision to clarify what is meant by a "member of the family" and deleted employees from the conflict rule. It also added the phrase "directly or indirectly" for the purpose of tightening the provision by applying the conflict of interest prohibition to loans made through other entities for the benefit of officers and directors.\footnote{Compare the Committee Comment to section 9-307(e), which indicates that this phrase was added for clarity. Chapter 282 of the 1986 Maryland laws repealed the former section 9-307 and enacted a new section in lieu thereof.}

The "controlling persons" conflict of interest provision also was revised to provide that the restrictions did not apply to compensation for services rendered, thus creating an opportunity for controlling persons to receive various fees from their associations. The Commission also changed the vote required to approve a loan to a controlling person from a two-thirds vote of disinterested directors to a simple majority.\footnote{This should be compared to the required two-thirds vote of the board of directors in the case of a loan to an officer or director.}

The Commission also revised the investment provision of the statute to provide savings and loan associations a broader exercise of business judgment in making investments designed to increase lending capital. The new statute contained a "laundry list" of authorized investments subject to regulation of the Board of Commissioners. The Commission believed that, because of the inflationary economy, the market rather than statutes should dictate investments. It noted that flexibility to invest was tempered by the requirement that associations maintain eighty percent of their funds in residential mortgages in order to qualify for treatment as a savings and loan association under the Internal Revenue Code.\footnote{This may not be a correct statement of the Internal Revenue Code at that time. Under the Internal Revenue Code of 1954 section 7701(a)(19), a savings and loan association must, in order to qualify as such, have at least 60% of its total assets consist of "qualifying assets." "Qualifying assets" include certain certificates of deposit, loans for residential real property, loans relating to real property in an urban development area, loans for health, education and welfare institutions, and student loans. Pursuant to section 593(b) of the Internal Revenue Code, a mutual institution generally is permitted to compute its bad debt reserves by use of the "reduced percentage of taxable income method." The amount determined under this method is 40% of the association's taxable income less the amount added to the reserve for losses for nonqualifying loans. The percentage of income method is subject to a percentage of "qualifying assets" test. To take the full percentage deduction of 40%, an association is required to have at least 82% of its funds in "qualifying assets." If less than 60% of an association's assets are in "qualifying assets," the percentage of taxable income method may not be used.}

In short, the Commission, which was dominated by the savings and loan industry, revised the Code to accomplish significant deregulation. Prior investment restrictions were abandoned and the Board of Commis-
sioners, which was also dominated by the industry, was given blanket authority to expand authorized investments even further. Conflict of interest prohibitions were diluted. Reserve and profit allocation provisions were liberalized. The Commission responded to a rapidly changing economy that threatened the savings and loan industry by recommending a Code revision that greatly increased the likelihood of abuse in savings and loan management.

The 1980 revisions to Title 9 of the Financial Institutions Article deregulated the savings and loan industry considerably. Aside from the substantive changes just discussed, the introductory comments to the new Title 9 reveal that the drafters afforded great discretion to the regulatory authorities, all industry-oriented, to implement the provisions because the regulatory authorities were "better suited" to handle the rapidly changing industry. Moreover, committee comments reveal that the new statute was intended to be remedial in nature and was not designed to prevent prospective problems.

III. REGULATORY REFORM OF 1986

The law in effect at the time of the 1985 crisis consisted of Titles 8 and 9 of the Financial Institutions Article, the primary statute regulating Maryland's savings and loan associations, as well as the regulations promulgated by the Board of Commissioners to effectuate the goals of Title 9. Title 8 of the Financial Institutions Article set forth the provisions concerning the Board of Commissioners and the Division of Savings and Loan Associations. Title 9 contained the provisions for regulating savings and loan associations. Because of the 1980 revision to Title 9, regulation of the savings and loan industry was woefully inadequate to prevent the industry crisis that caused such alarm in 1985.

In 1986, as part of the Report of the Office of Special Counsel, a comprehensive legislative proposal was introduced. The object of the bill, as originally drafted by the Office of Special Counsel, was to strengthen Maryland's statutory body of law regulating state-chartered

48. The bill was introduced as Senate Bill (SB) 266 — House Bill (HB) 466. Because many of the amendments adopted by the House of Delegates were accepted by the Senate, the House version of the Bill became the vehicle for the enactment of the regulatory reform measure.

In the Senate, a new standing committee, the Standing Committee on the Savings and Loan Industry, was created to review and deliberate on HB 466. The Chairman and Vice-Chairman were the Senate Majority Leader and Senate Minority Leader, respectively, and its members included the leadership of the Senate Finance, Economic and Environmental Affairs, Budget and Taxation, and Judicial Proceedings Committees. In the House, the Committee on Economic Matters administered HB 466, but was assisted by a Special Oversight Committee, established by the House leadership and chaired by the Speaker, to examine issues related to the savings and loan industry and the state administrative structure for regulating the banking and insurance industries.
savings and loan associations and to address some of the causes of the crisis by making appropriate changes in the law. The following discussion summarizes the key provisions of Titles 8 and 9 and the Commission regulations at the time of the 1985 crisis and highlights the important changes made to the law by the new legislation. The section also compares, primarily by way of footnote discussion, the law in effect in 1985 with similar laws in North Carolina, Pennsylvania, Massachusetts, and Ohio and with the Maryland banking law in effect at that time.

A. Title 8 — Board of Commissioners and Division of Savings and Loan Associations

1. Legislative Policy

In 1985, the state’s legislative policy was to supervise savings and loan associations as businesses affecting the economic security and general welfare of the people in the State of Maryland, and to promote and insure the business and financial stability of savings and loan associations. In order to further the legislative policies of Title 8 and to promote the purpose of savings and loan associations, the provisions were to be construed liberally.

In 1986, a new state legislative policy was adopted by the General Assembly. The new policy of Titles 8 and 9 is to protect the interest of the depositors and the general public in savings and loan associations. The new policy also provides for the safety and soundness of the business of savings and loan associations. The primary focus, therefore, has

49. Federally chartered savings and loans are governed by federal law and therefore are not subject to Maryland law. During the course of deliberation on HB 466, the General Assembly expanded the scope of the Bill to address its concerns relating to the savings and loan associations with assets of less than $15,000,000, as well as the disclosure of information on the withdrawal of funds from state-chartered associations by state public officials during the sixty day period prior to the onset of the crisis in May, 1985. Discussion of those provisions of the legislation is beyond the scope of this article.

50. This section will provide, primarily by way of footnotes, a comparison of the regulation of Maryland savings and loan associations with the regulation of Maryland banks and other states savings and loan associations where there is a private or state insured system. Except as otherwise noted, citations to Maryland law are as they existed prior to the First Special session of the 1985 General Assembly. Citations to laws of other states are as they existed at that time and for the most part are as they exist at the time of the publication of this article.

52. Id. § 8-103. Chapter 282 of the 1986 Md. Acts repealed the former section 8-103 and transferred the former section 8-104 to be the present section 8-103.
54. At the time of the savings and loan crisis, the legislative policy as set forth in section 8-102 was to have savings and loan associations supervised as businesses affecting the economic security and general welfare of the people of the State of Maryland, and to promote and insure the business and financial stability of savings and loan associations. Md. Fin. Inst. Code Ann. § 8-102 (1986). This provision formerly appeared as Section 161A(a), (c) and (d) of Article 23 (Case Act).
55. Id. § 8-102(a)(2).
shifted from protecting the industry to protecting the public. Rule-making power has been granted to the Division Director under this policy so that he may regulate and supervise savings and loan associations in a manner which is responsive to changes in the economic conditions affecting such associations. Titles 8 and 9 now set forth standards that are to be observed by the Division Director in adopting regulations, examining and supervising associations, and exercising his discretionary power.

2. Board of Commissioners

Title 8 established the Board of Savings and Loan Association Commissioners (Board of Commissioners) as part of the Department of Licensing and Regulation. At the time of the savings and loan crisis, the Board of Commissioners consisted of nine members appointed by the Governor with the advice of the Secretary of Licensing and Regulation, and with the advice and consent of the Senate. Three of the members were to be, for at least five years prior to appointment, industry members who had been officers or directors of, or attorneys for, MSSIC-insured associations. Two of the nine were to be industry members who were officers or directors of, or attorneys for, Maryland savings and loan associations insured by FSLIC for five years prior to appointment. The remaining four members were to be public members who had not served as officers or directors of, or attorneys for, a savings and loan association during the year preceding appointment, nor while the member is serving on the Board. Thus, by statute, the Board was controlled by the industry.

The Board of Commissioners had the authority to adopt rules and regulations to carry out the provisions of the Financial Institutions Arti-

56. Id. § 8-102(a)(4).
57. MD. FIN. INST. CODE ANN. § 8-201 (1980). See id. § 2-201, which establishes a Banking Board in the Department of Licensing and Regulation. See also 7 PA. CONS. STAT. ANN. § 6020-223 (Purdon Supp. 1985), which created a Savings Association Board that consisted of nine members, one of whom was the Secretary of Banking and the remaining eight members were appointed by the Governor. This Board was terminated in April, 1984. In Ohio the Building and Loan Advisory Board was repealed effective July 26, 1963. OHIO REV. CODE ANN. § 1155.01 (Page 1968).

In North Carolina there is a Savings and Loan Commission that consists of seven members appointed by the Governor. At least two members must be persons who are managing officers of state-chartered associations. Four members are to represent the public and cannot be employees or directors of any financial institution. The Commission is to review, approve, disapprove, or modify any action taken by the Administrator of the Savings and Loan Division. N.C. GEN. STAT. § 54B-53 (1982).
58. MD. FIN. INST. CODE ANN. § 8-202 (1980) (amended 1986). This section was derived substantially from subsections 161E(b) and (d) of Article 23 (Case Act).
59. MD. FIN. INST. CODE ANN. § 8-207 (1980 & Supp. 1985). A member of the Board could not participate in any hearing before the Board or rule on any order that affects any savings and loan association in which the member had an interest or any connection as a stockholder, member of the association, director, mortgagor, borrower, attorney or otherwise. Id.
cle to the extent that it related to savings and loan associations.\textsuperscript{60} The Board, therefore, had regulatory power and was not purely advisory.\textsuperscript{61} It could advise and make recommendations to the Division Director and could recommend changes in the laws governing savings and loan associations.\textsuperscript{62} In addition, the Board had the authority to determine procedures and standards for examinations, evaluation of assets, advertising, and promotional activities.\textsuperscript{63} In comparison, the Maryland Banking Board's functions were purely advisory.\textsuperscript{64}

The Office of Special Counsel concluded that because the Board of Commissioners was controlled by representatives of the savings and loan industry, it was unlikely that the Board would be able to operate as an effective regulator. Similar problems of self-regulation did not exist in North Carolina, Pennsylvania, or Ohio, or with the Maryland Banking Board.\textsuperscript{65}

Under the 1986 legislation, the Board of Commissioners still consists of nine members appointed by the Governor, with the advice of the Secretary of Licensing and Regulation and the advice and consent of the

\begin{itemize}
\item \textsuperscript{61} The function of the Banking Board is advisory. The Banking Board consists of eight members. One is the state comptroller and the remaining seven are appointed by the Governor. Of the seven appointed members, one is to represent the Maryland State Bankers Association, one is to be an economist, one is to be a certified public accountant, and two are to be public members. The economist and the certified public accountant may not be employed by a bank. The Board's duties include giving the Bank Commissioner advice on (1) approval or disapproval of applications, (2) how to protect the interest of the general public and depositors and stockholders of banking institutions, and (3) any other matters relating to the business of banking. Members of the Banking Board are not entitled to receive compensation but are entitled to reimbursement for expenses. \textit{Md. Fin. Inst. Code Ann.} §§ 2-202 and 2-203 (Supp. 1985). In addition to the Banking Board, there was a Bank Regulations Board in the Department of Licensing and Regulations. The Bank Regulations Board was repealed by Acts 1981, ch. 753, § 1, effective July 1, 1981.
\item \textsuperscript{63} \textit{Id.} § 8-207(c)(3) (amended 1986).
\item \textsuperscript{64} \textit{Id.} § 2-203(a) (1986).
\item \textsuperscript{65} In North Carolina, there was a Savings & Loan Commission comparable to the Board of Commissioners, which consisted of seven members appointed by the Governor. Four of the seven members were to represent the public, and could not be employees or directors of any financial institution. \textit{See supra} note 57. In Pennsylvania, the Savings Association Board consisted of nine members, one of whom was the Secretary of Banking, and the remaining eight members were appointed by the Governor. The Savings Association Board was terminated in April 1984. In Ohio, law creating the Building & Loan Advisory Board was repealed, effective July 26, 1963.
\end{itemize}

The Maryland Banking Board consisted of eight members. One was the State Comptroller, and the remaining seven were appointed by the Governor. \textit{Md. Fin. Inst. Code Ann.} §§ 2-201 to -204 (1986). Of the seven appointed members, one was to represent the Baltimore Clearinghouse, one was to represent the Associated Mutual Savings Banks of Baltimore, one was to represent the Maryland State Bankers Association, one was to be an economist, one was to be a certified public accountant, and two were to be public members. The economist and the certified public accountant could not be employed by a bank. \textit{Id.} § 2-202. See \textit{supra} note 61.
Senate. Three members are officers or directors of, or attorneys for, Maryland savings and loan associations. The remaining six members are public members who have not served as officers or directors of, or attorneys for, a savings and loan association or related entity during the three years immediately before appointment. Additionally, there is no longer a distinction between MSSIC, now the Maryland Deposit Insurance Fund (MDIF), and FSLIC insured associations with regard to representation on the Board. By altering the composition of the Board of Commissioners from four to six public members, the new legislation insures that the Board will be more representative of the public.

It was the opinion of the Office of Special Counsel that if there were to be a Board of Commissioners, its functions should be solely advisory. Notwithstanding that the composition of the Board is weighted in favor of public members, the board could still be dominated by the savings and loan industry if it were not purely advisory. Additionally, it was necessary to make the role of the Board of Commissioners an advisory one in order to strengthen the office of the Division Director.

Under the new law, the Board's responsibilities are similar to those of the Maryland Banking Board. The duties include advising the Division Director on approval or disapproval of applications, advising how to protect the interests of the general public, depositors, and stockholders, and advising on proposed laws, regulations, or other matters relating to the business of savings and loan associations. If the Division Director does not follow the advice of the Board, he is required to send to the Board and to the Secretary of Licensing and Regulation a written statement of the reason for his action.

3. Division of Savings and Loan Associations

Title 8 established a Division of Savings and Loan Associations in the Department of Licensing and Regulation. The head of the Division was the Division Director, who was appointed by the Secretary of Licensing and Regulation with the approval of the Governor. The Secretary appointed the Director from a list of three nominees submitted by

67. Id.
68. Id. § 8-203 (1986).
69. Id. § 8-203(b).
70. Id. § 8-203(c).
71. Id. § 8-301. See id. § 2-101, which establishes the Maryland State Bank Commissioner in the Department of Licensing and Regulation.
72. Id. § 8-302 (1980) (amended 1986). The Secretary appointed the Division Director from a list of three nominees submitted by the Board of Commissioners. See id. § 2-102, where the Bank Commissioner is appointed by the Secretary of Licensing and Regulation with the approval of the Governor who, unlike in the case of the Division Director, must receive the advice and consent of the Senate in the appointment of the Commissioner. Under the current section 8-302, however, the appointment of the Division Director must receive the advice and consent of the Senate. Id. § 8-302 (1986).
the Board of Commissioners. The Director was required to have been, for at least five years, an officer or director of, or attorney for, a savings and loan association, or be an employee of any state or federal regulatory or supervisory agency for financial institutions. The Division Director served at the pleasure of the Secretary and was provided a salary as set forth in the state budget. He was responsible for the general supervision of savings and loan associations in Maryland.

The prior law also contained provisions for limiting the outside activities of the Division Director and the conflicts of interests of certain employees in the Division. For example, the Division Director was required to devote his full time to the duties of his office. In addition, the Division Director, the deputy director, and examiners could not be officers, directors, employees, or agents of, or attorneys for, any savings and loan association. They could, however, hold savings accounts at any association. There was no restriction against owning stock in any institution that was subject to examination or supervision by the Division.

It was the opinion of the Office of Special Counsel that the Division Director should be on a level comparable to the Banking Commissioner because the requirements in the law for qualification as Director limited

73. Id. § 8-302(a)(2) (amended 1986).
74. Id. § 8-302(b) (amended 1986).
75. Id. § 8-303.
76. Id. § 8-302. Cf. N.C. GEN. STAT. § 54B-55 (1982), where, in North Carolina, the Administrator of the Savings and Loan Division is given specific guidance as to his power and the discharge of his duties with regard to the promulgation of regulations. The Administrator, for example, as a by-product of his statutorily derived powers, has promulgated a regulation requiring a stock association to obtain the approval of the Administrator prior to the declaration or payment of any form of dividend. N.C. ADMIN. CODE § .0005 (1984). In Pennsylvania, the supervision and regulation of savings and loan associations falls within the Department of Banking. 7 PA. CONS. STAT. ANN. § 6020-2(7) (Purdon Supp. 1985). In Massachusetts, the Bank Commissioner regulates co-operative banks, virtually the equivalent to Maryland's savings and loan associations, and has the same power and duties that he has with respect to banks. MASS. GEN. LAWS ANN. ch. 170, § 41 (West 1984). The Superintendent of Savings and Loan Associations in Ohio has the power to see that the laws relating to savings and loan associations are executed and enforced. OHIO REV. CODE ANN. § 1155.01 (Page Supp. 1984). See also MD. FIN. INST. CODE ANN. § 2-105 (1980), where the Bank Commissioner exercises powers and performs the duties of his office subject to the authority of the Secretary of Licensing and Regulation.
78. Id. § 8-306 (1980). See id. § 2-111 (1980), where the Bank Commissioner and the employees of the Bank Commissioner's office may not own stock in any institution that is subject to examination or supervision by the Bank Commissioner. There was no similar statutory provision that applied to the Division Director or his staff.
79. See id. § 2-111 (1986), which provides that the Bank Commissioner and the employees of the Bank Commissioner's office could not own stock in any institution that was subject to examination or supervision by the Bank Commissioner.
80. See id. § 8-307(c) (1980).
the field of individuals for the position. Under the new law, the appointment of the Division Director now requires the advice and consent of the Maryland Senate, as well as the approval of the Governor.81 The Division Director will be required to have experience in state or national regulation or management of financial organizations, or be a bank or savings and loan director or officer.82 These adequate, but less strenuous, requirements broaden the field of applicants for the position of Division Director. For example, an individual with experience in the regulation or management of insurance companies could satisfy the new experience requirement.

At the time of the savings and loan crisis, there was no specific guidance in the law as to the Division Director’s powers and duties with regard to the promulgation of regulations. The Division Director was responsible for the general supervision of the savings and loan associations of Maryland.83 The Office of Special Counsel set forth specific areas with respect to which the Division Director should adopt regulations.84 This “listing” of regulations, however, does not limit the ability conferred on the Division Director to adopt regulations necessary to accomplish the policies set forth in statute.85 Seven days before adopting any regulations, the Division Director must forward the proposed regulations to the Board of Commissioners.86 The Board is to submit any comments and advice to the Division Director within thirty days of receipt of the proposed regulations.87

The Division Director is now required to report violations of Title 8 or Title 9 to the Secretary of Licensing and Regulation, the Governor, and the Attorney General, who is to take appropriate steps to institute an investigation.88 The Division Director now also may provide advisory opinions on conflicts of interest.89

Under Title 8, the Division Director had the authority to appoint a deputy director, with the approval of the Secretary of Licensing and Regulation, who would assist him in managing the Division.90 It was the

81. Id. § 8-302(a) (1986).
82. Id. § 8-302(c).
83. Id. § 8-303 (1980). This provision should be compared to the provisions of other states such as North Carolina, where the Administrator of the North Carolina Savings and Loan Division was given specific statutory guidance as to his power and the discharge of his duties with regard to the promulgation of regulations. See supra note 76.
85. Id. § 8-303(b).
86. Id. § 8-303(a)(2).
87. Id. § 8-303(a)(3).
88. Id. § 8-303(d).
89. Id. § 8-303(e).
90. Id. § 8-304 (1980) (amended 1986). The State merit system did not apply to the deputy director. If the deputy director was appointed from a classification that was subject to the merit system, then upon termination of his appointment as deputy director, he was entitled to all of the rights previously held under the system before his appointment. The deputy director was not required to have any experience in
opinion of the Office of Special Counsel that the position of deputy director should be comparable to the position of the Maryland deputy bank commissioner. Thus, for example, the deputy director, like the deputy bank commissioner, is now required to devote full time to his duties. 91 Additionally, the merit system does not apply to the deputy director, even if he is appointed from among the classified employees of the division. An additional regulatory precaution created by the new law is that the qualifications for the deputy director are the same as those for the Division Director. 92

The new conflict of interest provisions now apply to the Division Director, deputy director, and the staff of the Division. 93 The Director, as well as the deputy director, are required to devote full time to the duties of their office. 94 Additionally, the Division Director, deputy director, and staff may not be auditors nor be retained in any manner by an association, nor have any interest whatsoever in an association, including a savings account. 95

At the time of the savings and loan crisis, the Division Director did not have the power to subpoena witnesses nor to administer oaths or affirmations. It was the opinion of the Office of Special Counsel that the Division Director needed the authority to issue subpoenas and administer oaths. 96 A new provision was adopted by the General Assembly permitting the Division Director to subpoena witnesses and administer oaths or affirmations, to require the production of books and records, and to issue subpoenas duces tecum. 97

the savings and loan industry. This was true even though the deputy director had the powers and duties of the Division Director if the office of Director was vacant, or if the Director was unable to perform the duties of his office. Although there was a requirement that a Division Director devote his full time to the duties of the office, this requirement never applied to the deputy director. Id. § 8-306 (1980) (amended 1986).

91. Id. § 2-110(a) (1986).
93. Id. § 8-307(b) (1986).
94. Id. § 8-307(a).
95. Id. § 8-307(b). The Director, deputy director, and staff, and members of their immediate families may not accept gifts or remuneration of any type from an association or related entity, or from certain individuals connected with an association or related entity. Id. § 8-307(c). Furthermore, the Director, deputy director, and staff, and members of their immediate families may not be indebted to any association or related entity that is subject to jurisdiction of the Division Director. Id. § 8-307(d). The General Assembly also added a provision restricting the Division Director and deputy director for a two-year period from termination of employment with the Division from representing, formally or informally, an association in any proceeding in which the Division is party and the former Division Director or deputy director substantially participated. Id. § 8-307(f).

96. In other states, such as North Carolina, the Administrator had the right to issue subpoenas and administer oaths, and the right of access to books and records of the associations. N.C. Gen. Stat. § 54B-60 (1982).
Under the old law, there was no requirement that the Division Director report to the Governor. Although this was not a cause of the savings and loan crisis, the report of the Office of Special Counsel recommended that the Division Director report the operations of his office to the Governor. By statute, the Bank Commissioner reports to the Governor on June 30 of each year on the operations of his office and recommends amendments to banking law and similar reporting was considered advisable in the savings and loan industry.98

Under the new law, on June 30 of each year, or at the discretion of the Division Director, the Division Director must provide a written report to the Governor, the President of the Senate, the Speaker of the House of Delegates, and the Secretary of Licensing and Regulation on the operation of his office and the condition of the savings and loan industry, including any violation of Titles 8 and 9.99 Additionally, the Division Director is to recommend amendments to the laws that he administers.100 The report is to be confidential and not subject to disclosure, in accordance with provisions of the State Government Article of the Annotated Code of Maryland.101 The Division Director is also required to report to the General Assembly on June 30 of each year describing the operations of his office and the general condition of the industry.102 The report may also include a summary of final enforcement actions taken by the Division Director but may not include pending investigations of violations of law reported to the Governor.103

4. Orders and Hearings

At the time of the savings and loan crisis, the Division Director could order a savings and loan association to comply with its charter or by-laws, any applicable law, or any rule or regulation of the Board of Commissioners.104 An order, however, was not effective until the savings and loan association had been given an opportunity for a hearing before the Division Director.105 After the association was given the opportunity for a hearing, the Division Director could issue the order, and it then became a final order if the savings and loan association did not file an appeal with the Board of Commissioners.106 If an appeal was filed, a

98. Id. § 2-107. In Ohio, the Superintendent of Savings and Loan Associations is required to report annually to the Governor on the operations of his office. OHIO REV. CODE ANN. § 1155.14 (Page 1968).
100. Id. § 8-309(a)(1)(iii).
101. Id. § 8-309(a)(2).
102. Id. § 8-309(b).
103. Id.
104. Id. §§ 8-401, -402 (1980 & Supp. 1985) (amended 1986). Sections 8-401 and 8-402 were derived substantially from former sections 161(G)(c) and 161(H)(a), (b), and (c) of Article 23 (Case Act).
106. Id.
hearing was held before the Board of Commissioners. After the hearing, the Board could either sustain, reject, or modify the order, or issue a final order. The association then had the right to appeal the order to the circuit court for the county where the association had its principal place of business.

Prior to July 1, 1985, although the Division Director could issue an order to compel a savings and loan association to comply with rules or regulations, there was no specific provision in Title 8 permitting the Division Director to issue cease and desist orders. Pursuant to legislation enacted during the 1985 regular session of the Maryland General Assembly, the Division Director was granted authority to order any savings and loan association to cease and desist from an unsafe or unsound practice, a practice that was injurious to the public interest, or a violation of law or of a rule or regulation of the Board of Commissioners. If the Division Director determined that the violation or practice required immediate action, he could issue a cease and desist order as a final order effective on service, and then give the association an opportunity for a hearing before the Board of Commissioners to rescind the order. The new cease and desist and removal powers granted to the Division Director were similar to those granted to the Bank Commissioner.

Also as a result of the 1985 legislation, authority was given to the

---

107. Id. § 8-404 (repealed 1986).
108. Id. § 8-405 (repealed 1986).
109. Id. § 8-403. Section 8-403 was derived substantially from sections 161(H)(c), 161(E)(e)(1), and 161(F) of Article 23 (the "Case Act").
110. See MD. FIN. INST. CODE ANN. § 8-402.1, -402.2 (1980 & Supp. 1985) (repealed 1986). Cf. N.C. GEN. STAT. § 54B-59 (1982), where the Administrator may issue a cease and desist order if a person or association is engaging in an unsafe or unsound practice or violation of any law, rule, or regulation. A hearing must be held before the order is issued unless it can be shown that immediate corrective action is needed, and then the Administrator may issue an immediate temporary order. See generally OHIO REV. CODE ANN. § 1155.02 (Page Supp. 1984), where the Superintendent may issue a cease or desist order if an association or person is engaging in an unsafe or unsound practice, or has violated any provision of the savings and loan law. The Superintendent may issue a summary cease and desist order without a prior hearing. If an order has been violated the Superintendent may request the attorney general to take appropriate action. In Pennsylvania, the Banking Department can order an association to discontinue any violation of law or unsafe or unsound practice. 7 PA. CONS. STAT. ANN. § 6020-224 (Purdon Supp. 1985).
111. Id. § 8-402.1 (1980 & Supp. 1985) (repealed 1986). This law was effective July 1, 1985. Similar legislation was introduced in the 1984 session of the General Assembly but was not enacted and was referred by the House Economic Matters Committee and the Senate Economic Affairs Committee for an interim study to the Joint Subcommittee on the Savings and Loan Industry. The report of the Joint Subcommittee was submitted to the General Assembly on August 15, 1984. MD. FIN. INST. CODE ANN. § 8-402.2 (1980 & Supp. 1985).
113. See MD. FIN. INST. CODE ANN. § 5-808 (1980 & Supp. 1985), where the Bank Commissioner, since 1981, has had cease and desist powers. See also MD. FIN. INST. CODE ANN. § 5-801 (1980), where the Bank Commissioner also has had authority, since 1957, to remove a director or officer who is engaging in an unsafe or unsound banking practice.
Division Director to send a written warning to any director or officer that the Division Director found had engaged in an unsafe or unsound business practice.\textsuperscript{114} If the Division Director found that the director or officer had continued to engage in the unsafe or unsound practice, then the Division Director, with the advice of the Board of Commissioners, was to report this action to the Secretary of Licensing and Regulation and to the Attorney General.\textsuperscript{115} After giving the officer or director the opportunity to be heard by the Board of Commissioners, if the Board found that the unsafe or unsound practice continued after the warning, it could remove the officer or director, with the approval of the Secretary of Licensing and Regulation.\textsuperscript{116}

One flaw of the 1985 legislation was that the Division Director had no authority to issue orders to an association’s holding company or subsidiary. In addition, there was no provision to remove an officer or director immediately and then give the officer or director an opportunity to be heard at a later date.\textsuperscript{117} Furthermore, there was no provision to remove an officer, director, or employee who has participated in any insider loan not authorized under section 9-307 of the Financial Institutions Article.

The Office of Special Counsel recommended that, for organizational purposes, all of the provisions on orders should be contained in one section, with all the provisions for hearings contained in a separate section.

Therefore, under revised section 8-401, the Division Director's power to issue orders, including cease and desist orders and removal of officer and director orders, is now contained in one section.\textsuperscript{118} Pursuant to this section, the Division Director can order an association to remove any officer, director, or employee who has violated the law, or partici-

\textsuperscript{114} Id. § 8-402.2(a) (1980 & Supp. 1985) (repealed 1986).
\textsuperscript{115} Id. § 8-402.2(b) (1980 & Supp. 1985) (repealed 1986). Similar legislation was introduced in the 1984 session of the General Assembly in Senate Bill 576. An unfavorable report was issued and the matter was referred for an interim study to the Joint Subcommittee on the Savings and Loan Industry.
\textsuperscript{116} The new cease and desist and removal powers granted to the Division director are similar to those that had been granted to the Bank Commissioner. See id. § 5-808 (1986).
\textsuperscript{117} In North Carolina, the Administrator of the Savings and Loan Division can remove an officer, director, or employee of an association who has violated the law, or participated in any unsafe or unsound business practice or unauthorized insider loan. If the Administrator believes that the situation requires immediate corrective action, the order to remove may be issued prior to a hearing. N.C. GEN. STAT. § 54B-69 (1982). See generally OHIO REV. CODE ANN. § 1151.18 (Page Supp. 1984), where the Superintendent can remove a director or officer for violating certain savings and loan laws or any unsafe or unsound business practice but only after a hearing. Pending a hearing, however, the director or officer cannot act for the association. In Pennsylvania, the Banking Department can remove, after a hearing, a director, officer, employee, or attorney if there is a continuing violation of the law or unsafe or unsound practice. 7 PA. CONS. STAT. ANN. § 6020-224 (Purdon Supp. 1985).
\textsuperscript{118} MD. FIN. INST. CODE ANN. § 8-401 (1986) sets forth the rules for orders of the Division Director. MD. FIN. INST. CODE ANN. § 8-402 (1986) provides for the Division Director's hearing and final orders. MD. FIN. INST. CODE ANN. § 8-403 (1986) provides the appeals from orders of the Division Director.
pated in any unsafe or unsound business practice or any unauthorized insider loan. In addition, an order may be issued under this section as an emergency order, not requiring a prior hearing, if the Division Director determines that the protection of depositors, members, or stockholders of the association, or the protection of the public, requires immediate corrective action. The emergency order would be effective upon receipt, and it would specify the charges, and set a hearing date within thirty days.

Under section 8-402, unless the order is an emergency order, the association or related entity named in the order has an opportunity for a hearing before the Division Director or the Division Director's designee. This section also sets forth provisions for the conduct of the hearings, including the right of the Division Director or the deputy division director to issue subpoenas compelling the attendance of witnesses or the production of documents. If the person fails to comply with the subpoena, the Division Director may apply for an order holding the person in contempt. The Division Director, the deputy division director, or the Division Director's designee also may administer an oath to the witness. In addition, the Division Director is to maintain a record of testimony and exhibits, and may adopt rules governing the hearings. An association still may appeal a final order to the Circuit Court of Maryland for Baltimore City pursuant to the State Government Article of the Annotated Code of Maryland.

B. Title 9 — Savings and Loan Associations

1. General Prohibitions and Incorporation

Title 9 of the Financial Institutions Article set forth the operational laws for savings and loan associations, including general rules on incorporation. Five or more individuals could act as incorporators to form a state-chartered savings and loan association in Maryland. A written application had to be submitted to the Board of Commissioners along with executed copies of the articles of incorporation and a copy of the proposed bylaws, as well as any other exhibits that the Board required. After receipt of a filing fee and the aforementioned items, the Board of

119. Id. § 8-401(a)(3).
120. Id. § 8-401(e).
121. Id. § 8-401(c).
122. Id. § 8-402(e).
123. Id. § 8-402(c)(2).
124. Id. § 8-402(c)(3).
125. Id. § 8-402(c)(4).
126. Id. § 8-403 (1986). There was no substantive change to this section by the 1986 amendments.
127. Id. § 9-202 (1980). The individuals, however, must be residents of this state and citizens of the United States. Id. The same is true for forming a bank or trust company in Maryland. Id. § 3-201 (1986).
Commissioners published a notice of the filing of the application and held a public hearing.

At the time of the savings and loan crisis, only a corporation that complied with Title 9 could conduct the business of a savings and loan association or make any representations implying that it was a savings and loan association. Although the statute set forth a penalty for violation of this provision, it was the opinion of the Office of Special Counsel that this penalty was insufficient to deter a violation. Under the new law, if a person is convicted of knowingly or willfully violating section 9-102, he will be subject to imprisonment, a fine, or both.

The Financial Institutions Article did not set forth what was required in an association’s articles of incorporation or bylaws. It was the opinion of the Office of Special Counsel that, because a savings and loan is a depository institution, its articles of incorporation should set forth certain items in addition to those required under the Corporations and Associations Article. Furthermore, by requiring an association to set forth certain provisions in its bylaws, the bylaws would become guidelines that the association would have to follow. Failure to follow these bylaws would be a basis for action by the Division Director against the association.

The articles of incorporation must now set forth the purpose for which the association is organized, as well as a statement that it is organized in compliance with Maryland law. The proposed bylaws of an association must now specify the qualifications of the directors of the association and provide for their removal or suspension. The by-laws

128. Section 9-203 of the Financial Institutions Article prohibited the use of certain words in the name of a savings and loan association that would be misleading. For example, the words “national,” “federal,” “United States,” “guaranteed,” or “insured,” if used in conjunction with the name of a savings and loan association, could imply a certain guarantee that did not exist. Id. § 9-203 (1980 & Supp. 1985) (amended 1986). The new legislation has added words that could be misleading when used in conjunction with the name of a savings and loan association. Under the new provision, the words “commercial,” “government,” “Maryland,” “national,” “trust,” “trustee,” and “United States” were added. Id. § 9-203 (1986 & Supp. 1987). It is interesting to note that Merritt Savings and Loan Association had changed its name to Merrit Commercial Savings and Loan Association. It is questionable whether Merrit Commercial Savings and Loan Association could have used the word “commercial” under FSLIC regulations.

129. The penalty was a $1,000 fine for each offense. MD. FIN. INST. CODE ANN. § 9-102 (1980 & Supp. 1985) (amended 1986).

130. The period of imprisonment cannot be more than ten years for each offense. The fine cannot be more than $100,000.00 for each offense. Id. § 9-102 (1986).

131. Most states have provisions in their financial institutions’ laws with regard to the articles of incorporation and proposed bylaws of an association. See, e.g., MASS. GEN. LAWS ANN. ch. 170 §§ 5, 6 (West 1984); N.C. GEN. STAT. § 54B-10 (1982 & Supp. 1987); 7 PA. CONS. STAT. ANN. §§ 6020-23, 6020-31 (Purdon Supp. 1987).

132. MD. FIN. INST. CODE ANN. § 9-204(a)(3) (1986). In addition, the name, occupation, citizenship, place of residence, and post office address of each incorporator and each member of the initial board of directors is required to be set forth in the articles of incorporation. Id. §§ 9-204(a)(5),(6).
must also set forth the powers and duties of the board of directors of the association.\textsuperscript{133}

At the time of the savings and loan crisis, section 9-207 of the Financial Institutions Article provided that the Board of Commissioners was to investigate the character, responsibility, and general fitness of the incorporators, directors, and managing officers of the proposed association. The business affairs of a savings and loan association were to be managed by directors who had to be United States citizens and either members of the association or holders of a savings account of the association.\textsuperscript{134} Unless the charter or bylaws provided otherwise, each member of the mutual association had one vote and each member of the capital stock association had one vote for each share of capital stock that the individual owned.\textsuperscript{135} Directors of each association were elected by the members.\textsuperscript{136}

It was not until July 1, 1984, that the Board of Commissioners was required to investigate the directors or managing officers.\textsuperscript{137} There was no requirement that the Board investigate the character, responsibility, and general fitness of the controlling persons of the proposed association.\textsuperscript{138} Furthermore, the Board of Commissioners, unlike the Bank Commissioner, was not required to investigate whether the proposed association would promote public convenience and was expedient and desirable.\textsuperscript{139} The Division Director will now be required to determine the

\textsuperscript{133} Id. §§ 9-204(b)(2), (3). The manner of apportioning, crediting, and paying dividends also must be provided in an association's bylaws. Id. § 9-204(b)(7). See also id. § 9-204(c), directing the Division Director to adopt by, January 1, 1987, model articles of incorporation and bylaws.

\textsuperscript{134} Id. § 9-302 (1980).

\textsuperscript{135} Id. § 9-303.

\textsuperscript{136} Id. § 9-302 (1980). See id. § 3-401 (1980), where the business and affairs of a bank are managed under the direction of the board of directors. Each director of a bank is required to take an oath to perform diligently and honestly the duties of his office and not to violate knowingly or permit knowingly a violation of any law that relates to the bank. Id. § 3-404 (1980). No oath is required of a director of a savings and loan association.

A majority of the directors of a bank is a quorum. Each director is required to attend at least one-half of the scheduled board meetings that are held during his term. If the director fails to attend the required number of board meetings he is disqualified from being a director for the succeeding term unless the Bank Commissioner waives a disqualification based upon good cause for failure to attend the meetings. MD. FIN. INST. CODE ANN. §§ 3-408 and 3-410 (1980).

\textsuperscript{137} Id. § 9-207(1) (1980 & Supp. 1985) (amended 1986). The Board was also to determine whether the establishment of the savings and loan association and its location would promote the public interest. Id. § 9-207(2). See Senate Bill 103, which was introduced on January 11, 1984, by Senator Connell on behalf of the Department of Licensing and Regulation. The bill added directors and managing officers to section 9-207.

\textsuperscript{138} This should be compared to other states, such as North Carolina, where there has been a requirement to investigate the character, responsibility, and general fitness of the initial stockholders in a stock association. See, e.g., N.C. GEN. STAT. § 54B-12(a)(6) (1982); 7 PA. CONS. STAT. ANN. § 6020-26 (Purdon Supp. 1985).

\textsuperscript{139} The Bank Commissioner, when determining the approval of the bank, investigates
character, responsibility, and general fitness of the controlling persons of a proposed association. In addition, the Division Director must determine that the proposed association, if a stock association, has subscriptions for capital stock in an amount equal to no less than $1,000,000.

At the time of the savings and loan crisis, there was no regulation of the change in control of an association. Therefore, neither the Division Director nor the Board of Commissioners had the power to approve or disapprove the transfer of ownership of an association. Any individual could acquire control in a state-chartered savings and loan association. MSSIC, however, required reports of change in control of mutual and stock associations that were insured by it, and MSSIC also could disapprove of a proposed change in control.

Under the new law, a person may not acquire control of an association without prior written approval of the Division Director. Any person who intends to acquire control of an association, or interest in an entity that controls an association, must file an application for approval with the Division Director and deliver to the Director other information as required. The Division Director must conduct an investigation to determine whether the acquisition will be consistent with the purposes of

the character, responsibility, and general fitness of the incorporators and directors to determine if they command the confidence and warrant belief that the bank would be conducted honestly and efficiently. See id. § 3-203 (1980). In North Carolina, the Administrator investigates the initial board of directors of the association, and in the case of a stock association, the initial stockholders. See generally N.C. GEN. STAT. § 54B-12(a)(6) (1982).

Pennsylvania law requires the Department of Banking to investigate the director and the proposed officers of the proposed association. The Department is also to ascertain whether the proposed association will have sufficient personnel with adequate knowledge and experience to administer the business of the association. 7 PA. CONS. STAT. ANN. § 6020-26 (Purdon Supp. 1985).

140. MD. FIN. INST. CODE ANN. § 9-207(2) (1986).
141. Id. § 9-207(4) The Division Director is also now required to determine that the name complies with section 9-203, and that the name of the proposed association is not the same as that of an existing association. Id. § 9-207(1).
142. In the case of First Progressive Savings and Loan, the acquisition of the association was a factor in the Maryland savings and loan crisis. First Progressive Savings and Loan Association was a mutual association located in Baltimore City, Maryland. Control of First Progressive Savings and Loan Association passed to Jeffrey Levitt and Alan Pearlstein, who were two of the owners of the now defunct Old Court Savings and Loan Association, with no inquiry made by the Division as to how control was transferred. At the time of the savings and loan crisis, it was known that Mr. Levitt was the person responsible for the major portion of First Progressive's problems in his role as an officer of, and counsel for, the association.
143. Maryland Share-Savings Insurance Corporation Rules and Regulations § 3-401.
144. MD. FIN. INST. CODE ANN. § 9-216(b) (1986). Certain acquisitions do not require the Division Director's approval. For example, an acquisition of shares by one who already controls an association or entity does not require approval. In addition, a transfer by testate or intestate succession does not require prior approval as long as the acquiring party advises the Division Director in writing within thirty days of the acquisition and provides the information that the Division Director requires. See id. § 9-216(g) for other exceptions.
145. Id. § 9-216(c).
Titles 8 and 9, and to determine whether the proposed acquisition will be prejudicial to the interests of the depositors, creditors, beneficiaries, fiduciary accounts, or shareholders of the association involved.\textsuperscript{146} The Division Director then must approve or disapprove the proposed acquisition and give written notice of his decision to the applicant and to the association or entity involved.\textsuperscript{147} If the Director approves a proposed acquisition that may result in a change of control, he may impose certain conditions to be observed after the acquisition is complete.\textsuperscript{148}

2. Capitalization

Under the old law, a capital stock association, had to have subscriptions for capital stock of not less than $200,000, or such greater amount as determined by the Board of Commissioners to ensure that it would conduct a safe and sound operation.\textsuperscript{149} In addition, an association had to establish an initial subscription for savings accounts, an initial general reserve fund, a general reserve fund, and an expense fund. The Board of Commissioners had not promulgated regulations requiring a greater amount of subscription for capital stock. Capital stock associations could use paid-in-surplus if the expense fund was not sufficient to pay organizational and operating expenses.\textsuperscript{150} The new law has changed these capitalization requirements. For example, the minimum aggregate amount of acquired subscriptions for savings accounts was increased from $500,000 to $1,000,000.\textsuperscript{151} In addition, the required subscriptions for capital stock were increased from $200,000 to $1,000,000.\textsuperscript{152}

At the time of the savings and loan crisis, an association had to

\textsuperscript{146} Id. § 9-216(d).
\textsuperscript{147} Id. § 9-216(e).
\textsuperscript{148} Furthermore, a person may not make any untrue statement of material fact or omit a material fact in connection with any acquisition within the scope of this new section. Id. § 9-216(f). Any person who acquires shares of an association or interest in an entity that controls an association, in violation of this section, is subject to imprisonment for a period of not more than ten years, or a fine of not more than $100,000, or both. In addition, any person who violates this section is liable civilly to any association, entity, shareholder, or other person damaged by the violation. Id. § 9-216(i).
\textsuperscript{149} Id. § 9-221. Cf. N.C. GEN. STAT. § 54B-12(b)(1) (Supp. 1985) (Administrator can only approve a capital stock association with at least $1,500,000 of subscriptions for capital stock).
\textsuperscript{150} MD. FIN. INST. CODE ANN. § 9-222 (1980). See MD. FIN. INST. CODE ANN. § 3-209(a) (Supp. 1985), where the initial capital requirements for commercial banks (in a location where there are more than 50,000 inhabitants) is capital stock of at least $1,500,000 and a capital surplus of at least 20% of the bank's required capital stock. This amount has been increased to $3,000,000 by regulation. Before the Bank Commissioner gives approval for a bank, the bank must go through an examination to determine whether the authorized capital stock and surplus are paid in full and whether the bank has complied with all applicable banking provisions. See id. § 3-212(b) (Supp. 1985) There was no comparable provision applicable to Maryland savings and loan associations.
\textsuperscript{151} Id. § 9-218 (1986).
\textsuperscript{152} Id. § 9-221.
prepare an annual statement of financial condition that was to be submitted at the association's annual meeting.\footnote{153} A statement of the salaries, fees and expense accounts paid to officers and directors of the association also had to be sent to the Division Director.\footnote{154} Notwithstanding, there was no statutory requirement that an association report its financial condition to the Division Director.\footnote{155} The new law requires that a statement of financial condition be prepared quarterly rather than annually\footnote{156} and that it be submitted to the board of directors of the association at a meeting held within thirty days after the end of the quarter.\footnote{157} In addition, quarterly statements must be filed with the Division Director thirty days after the end of the quarter.\footnote{158}

3. Regulation of Insider Loans and Conflicts of Interest

Perhaps one of the most serious flaws in the law at the time of the savings and loan crisis was the weak conflict of interest provisions.\footnote{159} At that time, neither a savings and loan association nor its subsidiary could make loans directly or indirectly to any officer or director of an association, or to any corporation or business in which a ten percent or more interest was owned by the officer or director of the association, or member of the immediate family of the officer or director.\footnote{160} Nevertheless, a loan was not prohibited if it was secured by the borrower's principal residence, secured by the borrower's savings account up to the withdrawal value of the account, approved by two-thirds vote of the board of direc-

\footnote{154} Id. § 9-306(b).
\footnote{155} Prior to 1980, there was a requirement that the annual statement be filed with the Division Director and reported on a form required by the Division Director. The committee comment to this section indicates that this requirement was deleted in 1980 because the Division Director received audited financial reports quarterly by regulation. The regulations, however, did not require that quarterly statements of the association be filed with the Division Director. This requirement was deleted from the law on the advice of the then Division Director. Id. (Committee Comment).
\footnote{156} Although there was no filing requirement for the association, a service corporation apparently was required to file such reports with the Director. Md. Regs. Code tit. 9 § 05.01.34(E) (1985).
\footnote{158} Id. A quarterly statement including dividends, compensation, and loans, as well as salaries, fees and expense accounts, also must be filed with the Division Director for officers, directors and controlling persons of the association. Also, at least once each year the association must publish a summary of the statement of its financial condition and submit proof of publication of the summary to the Division Director. The summary must be in a form that is approved by the Division Director. Id. § 9-306(c).
\footnote{159} Id. § 9-307 (1980) (repealed 1986).
tors of the association, or approved by the Division Director and secured by collateral appraised by a disinterested appraiser approved by the Division Director.\^{161}

Directors and officers of a savings and loan association were fiduciaries and, therefore, could not directly or indirectly engage in any business transaction that would result in a conflict of interest with the association in a manner that would be detrimental to the association.\^{162} Regulations enumerated areas that would not be deemed to be conflicts of interest, including business transactions that were conducted in good faith and that were fair, honest, and reasonable to the association. Regulations also set forth certain restrictions governing the conduct of the directors and officers of the association. For example, a director could not receive remuneration as a director other than reasonable fees for services. Nevertheless, the director also could serve as an officer, employee, attorney, appraiser, or accountant or provide a service to the association and receive reasonable compensation for such services rendered in that capacity. A director, officer, or employee could not solicit or accept, directly or indirectly, for any person other than the association, compensation or any personal benefit in connection with the procurement of any loan made by the association or its subsidiaries. The penalty for violating the regulation was that the violation might be considered an unsafe and unsound practice necessitating the issuance of an order by the Division Director pursuant to Section 8-401 of the Code.\^{163}

\^161. \textit{Id.} § 9-307(b) (1980) (repealed 1986). \textit{Compare} N.C. GEN. STAT. § 54B-154(c) (Supp. 1985), which provides that a loan to any director, officer, member of the immediate family of such person, or company controlled by such person shall be limited to certain categories. Regulations promulgated under this section provide that a full disclosure of the transaction must be made to the members of the Board of Directors of the institution and that the loan must be approved by a majority of the directors with no director interested in the loan proceeds having a vote. N.C. GEN. STAT. § 54B-154(d). Furthermore, no officer, director, etc. can enjoy an improper advantage with respect to loan transactions beyond those advantages enjoyed by other loan applicants. The regulations also provide that each loan made under the insider loan limitation regulations must be in the ordinary course of business of the association and must not involve more than the normal risks of collectibility or impose unfavorable features to the association.

Under Pennsylvania law, a director or officer as well as an employee or attorney of an association cannot contract with the association upon terms less favorable to the association than is offered by any other corporation or person. Therefore, under the Pennsylvania law an 11% first mortgage on a director's primary residence would not be permissible even if the transaction is otherwise authorized under state law if the current interest rate for a similar loan to a disinterested party is 13%. 7 PA. CONS. STAT. ANN. § 6020-70 (Purdon Supp. 1985).

In Massachusetts, a cooperative bank is only required to report annually to the Banking Commissioner any loan or extension of credit made to officers and directors. MASS. GEN. STAT. ANN. ch. 170 § 19 (West 1984).

\^162. MD. REGS. CODE tit. 9 § 05.01.43 (1985). \textit{See also} 62 Op. Att'y. Gen. 804 (1977), where an officer and director of a state-chartered savings and loan association also had a fiduciary duty not to usurp a corporate opportunity in which the association has an interest or expectancy.

\^163. MD. REGS. CODE tit. 9 § 05.01.43 (1985).
Furthermore, “a controlling person” could engage in a transaction with a stock association if a full disclosure, including the nature of the person’s interest, was made to the board of directors, the transaction was approved by a vote of the disinterested directors, and the profits of the controlling person were not at the association’s expense and did not prejudice its interest. A stock association could make a loan to a controlling person only if the loan was approved by a majority of the disinterested directors, appraised by a disinterested appraiser, and approved by the Division Director.

Despite these measures, abuses of the prior statutory provisions relating to insider loans were widespread. At least one association adopted the view that a loan to an entity controlled by a “controlling person” of the association was not required to be disclosed under subsection 9-323(e) of the Financial Institutions Article. Because this was a spe-

164. Md. Fin. Inst. Code Ann. § 9-323(d) (1980) (amended 1986). “Controlling person” is defined as any individual or legal entity, acting directly or indirectly, individually or in concert with one or more other individuals or legal entities, or through one or more subsidiaries who owned, controlled, or held with power to vote, or held proxies to vote, more than 20% of the voting shares of the capital stock association, or controlled in any manner the election of the majority of the directors of the capital stock association. Id. § 9-323(a). This section did not apply to compensation paid to a controlling person for services.

See Md. Fin. Inst. Code Ann. § 5-512 (1980), which provides as a general rule, the following may not borrow directly or indirectly from a bank in Maryland: (1) director, officer, or employee of the bank; (2) partnership of which the director, officer, or employee is a member; (3) any corporation which the director, officer, or employee is an officer or owns a majority interest. This restriction, however, does not apply to the director of a bank, unless the director is also an officer or employee of the bank; a partnership in which the director is a member, unless an officer or employee of the bank is also a member of that partnership; or the corporation which the director holds any interest, unless an officer or employee of the bank is an officer or owns the majority interest in that corporation. Otherwise, a loan to a director, officer, or employee of a bank can be made only if the loan has been approved by the board of directors of the bank. See also id. § 3-601 (1980), where there are certain maximum loans that may be made to a specific individual. There is no statutory or regulatory requirement for receiving loan approval by the bank Commissioner or the Banking Board. Likewise there is no requirement of reporting the loan to the Commissioner or Banking Board. According to the Bank Commissioner’s office, all loans to officers, directors, or shareholders must, by unwritten regulation, be reported in the minutes of the Board of Directors’ meetings, which are reviewed by the Commissioner’s office when a bank is examined.


166. Under this theory, only loans made directly to the “controlling person” required Division approval. Similarly, it was contended pursuant to section 9-307 that a loan to an entity that an officer or director had an interest in did not need approval as long as the money was funneled to the entity through an intermediary, and not directly.

Former section 9-307 prohibited loans: directly or indirectly to (i) Any officer or director of the association; or (ii) Any corporation or business in which an interest of 10 percent or more is owned by an officer or director of the association . . . (emphasis supplied). Md. Fin. Inst. Code Ann. § 9-307 (1980 & Supp. 1985) (repealed 1986).

It was argued that because the phrase “directly or indirectly” only appeared before these subsections and not before the word “owned” in subsection (ii), loans to
cious argument, the Office of Special Counsel recommended that section 9-307 be totally revamped.

The primary purpose for the change in the conflict of interest provision was to prohibit associations from loaning money directly or indirectly to officers, directors, or controlling persons. Under the new provision, neither a savings and loan association nor a related entity can make a loan or extend credit, directly or indirectly, to a controlling person, director, officer or employee of the association or member of his immediate family. In addition, a loan may not be made, directly or indirectly, to any entity in which an interest of ten percent or more is owned by a controlling person, director, officer, or employee of the association or member of their immediate families.

There are only two exceptions to the loan prohibitions. First, a loan is not prohibited if it is secured by the borrower's principal residence, including a principal residence under construction, if the loan does not exceed eighty percent of the appraised value of the residence. Second, a loan is not prohibited if it is secured by the borrower's savings account and the loan does not exceed the withdrawal value of the account. In addition, subject to certain limitations, a consumer loan by a savings and loan association or related entity is not prohibited to an employee of an association or a member of the employee's immediate family.

The revised section also codifies the fiduciary responsibility of a director, officer, and controlling person of a savings and loan association. Additionally, the statute provides that a director, officer, or controlling person, as well as an employee of the association, may not place himself in a position that creates a conflict of interest. For example, no controlling person, director, officer, employee or agent of an association or member of his immediate family may directly or indirectly

---

entities indirectly owned by officers and directors did not require disclosure and approval. See Report of the Special Counsel on the Savings and Loan Crisis, at 236, 240 (January 8, 1986), where it is explained that Gerald S. Klein, who, through Middle States Financial Corporation owned Merritt Savings and Loan, Inc., removed himself as a director and officer of Merritt in an attempt to avoid the inside loan prohibition.

168. Id. § 9-307(c)(2).
169. Id. § 9-307(d).
170. Id. § 9-307(d)(1). Aggregate loans may exceed 80 percent of the appraised value, but only if the difference between that percentage and the total amount of the loans does not exceed 15 percent and the difference is insured by an agency of the federal government or a private mortgage insurance company. Id. § 9-307(d)(3)(ii).
171. Id. § 9-307(d).
172. Id. § 9-307(d)(2). The interest rate is to be at least 100 basis points above the rate of return on the savings account and the borrower may not withdraw funds from the account below the level of the amount of the outstanding balance of the loan. Id. § 9-307(d)(4)(v).
173. Id. § 9-307(a).
174. Id. § 9-307(b).
receive remuneration for procuring any loan from, investment by, or deposit in, the association.\footnote{175} Nor may a controlling person, director, officer, employee or agent of an association or member of that individual's immediate family purchase from, sell to, or lease from or to the association.\footnote{176} The new statute also prohibits a director, officer or controlling person from usurping a business opportunity, if such opportunity is within the corporate powers of the association or its service corporation, and is of present or potential advantage to the association.\footnote{177} An association or related entity may employ its officers, directors, and controlling persons in a capacity other than that of officer or director as long as the employment does not create a conflict of interest, is for reasonable compensation, and the employee is qualified for the position.\footnote{178} If a controlling person, director, officer, employee, or attorney knowingly violates or causes a violation of section 9-307, he is subject to imprisonment for not more than ten years or a fine of not more than $100,000, or both.\footnote{179} Moreover, the statute provides that an association may not make a loan for the purpose of frustrating or avoiding any prohibition in this section.\footnote{180} For example, in the past, associations had attempted to circumvent insider loan prohibitions by engaging in "cross lending."\footnote{181}

The Office of Special Counsel also recommended revision of the bonding provisions of section 9-308 of the Financial Institutions Article. Although the old law required that associations provide a bond to cover each director, officer, or agent of the association who had control over or access to cash and securities,\footnote{182} there were no penalties if a person failed to qualify for the bond required by this section. Under the new law, if a person fails to qualify for the bond, that person must be removed by the association.\footnote{183}

\footnote{175} \textit{Id.} § 9-307(e)(1). The statute does not prohibit an employee or agent of an association who is not a controlling person, director, officer, or member of their immediate family from receiving fees in the nature of loan origination commissions from the association. \textit{Id.} § 9-307(e)(2).

\footnote{176} \textit{Id.} § 9-307(f)(1). This provision does not apply if the Division Director makes a written determination that the transaction would be economically advantageous to, and in the best interest of, the association. \textit{Id.} § 9-307(f)(2). Any contractual obligation entered into before June 1, 1986, would not be affected by the new provision. \textit{Id.} § 9-307(f)(3). An association may not pay an overdraft to a controlling person, director, officer, employee of the association or member of his immediate family. \textit{Id.} § 9-307(g)(1). However, if an employee has overdraft protection, an association may honor an overdraft to the employee or member of the employee's immediate family. \textit{Id.} § 9-307(g)(2).

\footnote{177} \textit{Id.} § 9-307(h)(1). Any contractual obligation entered into before January 15, 1986 would not be affected by the new provision. \textit{Id.} § 9-307(h)(2).

\footnote{178} \textit{Id.} § 9-307(i).

\footnote{179} \textit{Id.} § 9-307(k).

\footnote{180} \textit{Id.} § 9-307(j).

\footnote{181} See \textit{Report on Office of Special Counsel on the Savings & Loan Crisis} at 370-71 (January 8, 1986) for an example of cross lending.


\footnote{183} \textit{Id.} § 9-308(2) (1986).
4. Organization

Under section 9-309 of the Financial Institutions Article, an association could not establish or relocate any branch office or relocate a principal office without the approval of the Division Director. The Office of Special Counsel recommended that language in this section be revised. Under the new provision, the Division Director cannot approve a new office or location for any association that is not in compliance with Titles 8 and 9 or any other Maryland law or regulation related to savings and loan associations.

There was no law at the time of the savings and loan crisis governing the appointment of officers of an association. The Office of Special Counsel recommended that Title 9 establish rules for the appointment of officers of an association. Section 9-311 now provides that an association is to have a president, secretary, treasurer, and such other officers as it may authorize.

Similarly, there was no statutory law on the reasonableness of compensation or fees. The savings and loan crisis of 1985 revealed that there was a need to impose the statutory duty on the board of directors to determine reasonable compensation and fees for the directors, officers, and agents of the association. Except as otherwise provided in the bylaws, the board of directors is now charged with the responsibility for determining compensation of officers of the association and its subsidiaries. In making such determination, the board is to consider qualifications, experience, compensation paid to other persons employed by the association or its subsidiaries, compensation paid to persons having similar duties and responsibilities in other associations, the size of the association or subsidiary, and the complexity of its operations, the financial condition of the association or subsidiary and the individual's contributions to the financial condition, amounts received for other services performed for the association or its subsidiary, and the value of the personal fringe benefits provided to the officer.

The board of directors is also now responsible for determining whether fees to accountants, appraisers, attorneys, or other professionals are reasonable and commensurate with the services being performed.

185. Charles H. Brown, Jr., former Division Director, believed that there were insufficient guidelines set forth in the statute as to when the Director could prohibit the establishment of a branch office. Therefore, it was his opinion that he could not prohibit such an establishment by an association. The Office of Special Counsel, however, disagreed with Mr. Brown's contentions.
187. Id. § 9-311(a). The board of directors is to elect the officers and fill all vacancies. Id. § 9-311(b). The officers are authorized to perform the duties provided in the association's bylaws or as otherwise provided by the board of directors. Id. § 9-311(c).
188. Id. § 9-312(a).
189. Id. § 9-312(c). This duty may be discharged by the establishment of standards for,
In establishing fees paid to the board itself, the board is to establish policies to protect the assets of the association and is to use the same factors in setting its fees as it does in setting officers' compensation.\textsuperscript{190}

Former section 9-324 required each capital stock association to send a list of its stockholders to the Division Director on an annual basis. This section, however, did not require the association to send to the Division Director a list of the stockholders of the association's holding company.\textsuperscript{191} Stock associations are now required to keep an up-to-date list of the names of their stockholders as well as those of their holding companies. In addition, whenever requested by the Division Director, an association must file a list of all of its stockholders and those of its holding companies.\textsuperscript{192}

5. Reserve Requirements

Another area of concern to the Officer of Special Counsel was the failure of the state to establish adequate net worth requirements. At the time of the savings and loan crisis there was no requirement that an association maintain a minimum net worth. Although a savings and loan association was required to maintain a reserve fund as determined by the Board of Commissioners, there was no \textit{statutory} requirement for the maintaining of reserves.\textsuperscript{193}

Maryland law did not give the Board of Commissioners specific guidance as to the percentage of reserves required to be maintained by an association.\textsuperscript{194} A legislative committee viewed the amounts to be allocated to reserves as a matter of business judgment to be decided by the savings and loan association subject to regulations by the Board of Commissioners. The Board of Commissioners had set forth a requirement that an association maintain reserves that exceed three percent of its sav-

\textsuperscript{190} Id. § 9-312(d); The minutes of the board must include the record of deliberations concerning compensation of officers and fees for other professionals and directors. See \textit{id.} § 9-312(e).

\textsuperscript{191} Id. § 9-323 (1980) (repealed 1986).

\textsuperscript{192} Id. § 9-323 (1986). The list must contain the resident address of each stockholder and the number of shares of each class of stock held by each stockholder. The Division Director must keep confidential the list of stockholders, except as otherwise provided in section 9-306(b)(2)(ii) of the Financial Institutions Article. \textit{Id.}


\textsuperscript{194} Former statutory amounts were deleted by the Committee on Economic Matters in the House of Delegates in 1980 upon advice of the Board of Commissioners, apparently to provide flexibility. The Committee viewed the amount of reserve allocations as a matter of business judgment to be decided by the savings and loan association, subject to regulation by the Board of Commissioners. \textit{Id.} (Committee Comment). See also \textit{OHIO REV. CODE ANN.} § 1151.33 (Page Supp. 1984), where the same is applicable to the Superintendent of Savings and Loan Associations in Ohio. \textit{But cf: N.C. GEN. STAT.} § 54B-154 (Supp. 1985) and discussion, \textit{infra} note 195.
ings' liability. Some state legislatures provide specific statutory reserve requirements or net worth requirements and do not leave such require-

195. Md. Regs. Code tit. 9 § 05.01.40-1B (1985). See N.C. Gen. Stat. § 54B-216 (1982), where the North Carolina Code provides that every state association is to establish and maintain a general reserve for the sole purpose of covering losses. The amount of the reserve is to be established pursuant to rules and regulations prescribed by the Commission. However, unlike Maryland law in effect at that time, the North Carolina statute provides specific guidance to the Commission. The reserve is to be maintained at a level set by the Commission based on assets. The Commission is to evaluate the risk attributable to various types of assets and is to establish percentages for each type of asset based on its level of risk rather than a uniform percentage applying to all levels of risks, as is the case under Maryland regulations. For example, under North Carolina regulations the level of reserves to be maintained against assets that are relatively "safe" investments, such as stock in the Federal Home Loan Bank of Atlanta or FSLIC secondary reserve, is zero. The level of the reserve account to be maintained against commercial loans, secured consumer loans, and investments in service corporations is five percent. The level of the general reserve account is increased to eight percent against assets that are invested in unsecured loans, real estate, and certain long-term commitments in excess of six months at the time of issuance.

North Carolina provides that the failure of an association to maintain the required level of reserves set by the Commission may be grounds for action by the Administrator of the Savings and Loan Division. Section 9-327 of the Maryland Annotated Code did not provide for any action by the Division Director in the case of failure of an association to abide by the reserve requirements as set forth by the Board of Commissioners. An "order" could be issued to the association pursuant to § 8-401 of the Code, demanding compliance with the reserve regulation.

Under Pennsylvania law, every association is required to maintain general reserves to be used solely for the purpose of absorbing losses. Whenever the reserves of an association are not equal to at least eight percent of the association's savings accounts, and whenever the net worth of an association is not equal to at least 10% of such savings accounts, the association is required under the statute to credit to its general reserves each year an amount equal to not less than five percent of its net profits for the year. Alternatively, in lieu of complying with these reserve requirements, an association may elect to have such reserves as required by FSLIC. See 7 Pa. Cons. Stat. Ann. § 6020-132 (Purdon Supp. 1985).

Under Massachusetts law, cooperative banks, when earnings are distributed, must transfer five percent of the net profits to a guarantee fund to be used to meet losses until the fund is at least equal to 10% of the assets of the cooperative bank. If at any date of distribution of earnings, the fund and any surplus account total at least 11% of the share liability of the cooperative bank, such transfer is not required. In addition, each co-operative bank is required to maintain at all times a minimum reserve for liquidation purposes to meet withdrawals from accounts and loans on accounts, of an amount equal to not less than 6-1/2% of its share liability, plus an amount equal to its liability upon "club accounts" and payments held for the payment of taxes on mortgaged real estate. Mass. Gen. Laws Ann. ch. 170 §§ 21, 22 (West 1984).

Maryland banks must at all times have reserves equal to at least 15% of their demand deposits and three percent of their time deposits. See Md. Fin. Inst. Code Ann. §§ 3-607(c)-(e) (Supp. 1985). The Bank Commissioner, with the advice of the banking Board, may change these requirements. Regulations promulgated by the Commission may increase the demand deposit reserves to 30% of those deposits and may increase the time deposit reserve to six percent of those deposits. The Commissioner's office refers to Federal Reserve Board regulations for guidance regarding the reserve requirements for Maryland banks. Md. Regs. Code tit. 9 §§ 03.06.05 and .06 (1985).
ments to administrative regulation. Additionally, the board of directors of any savings and loan association was to allocate profits of the association, at least annually, or such time as stipulated in its bylaws.

Under new section 9-324 there is now a specific net worth requirement. The minimum net worth requirement is at least five percent of liabilities as defined under generally accepted accounting principles, or accounting practices determined by the Director to be appropriate to achieve regulatory objectives. For those associations that did not meet the new net worth requirements on June 1, 1986, but were otherwise in compliance with the reserve requirements of prior law on May 30, 1986, the net worth requirements must be satisfied by July 1, 1989. Dividends of capital stock may not be declared or paid if the association, after the payment, would not be in compliance with minimum net worth requirements. If an association is not in compliance with the net worth requirements, the Director may take any action necessary under Title 9 of the Financial Institutions Article.

6. Regulation of Investments

Subsection 9-419(a) of the Financial Institutions Article set forth the investments authorized for state-chartered savings and loan associations. These investments were subject to regulation by the Board of Commissioners. With some exceptions, specific limitations were not set forth either with regard to the percentage of the association's assets, the net worth in a particular type of investment, or the amount of an association's net worth or assets that could be invested with or loaned to one

196. See supra note 195. The North Carolina Code provides that every state association is to establish and maintain a general reserve for the sole purpose of covering losses. N.C. GEN. STAT. § 54B-216 (1982). The statute provides specific guidance to the North Carolina Commission on Savings and Loan Association as to reserve requirements. Id. The Maryland Bank Commissioner refers to Federal Reserve Board Regulations for guidance regarding the reserve requirements for Maryland banks. MD. FIN. INST. CODE ANN. § 3-607 (1986).

197. MD. FIN. INST. CODE ANN. § 9-328(a) (1980).

198. Id. § 9-324 (1986). For the purpose of this section, net worth includes the following: Capital stock, paid-in capital or paid-in surplus; retained income, retained earnings, earned surplus, undivided profits; subordinated debt as defined by the Division Director; preferred stock as defined by the Division Director; and other items or amounts as defined or deemed appropriate by the Director to achieve regulatory objectives. Id.

199. Id. § 9-324(b)(i). The Division Director may deem necessary additional amounts to ensure that the interest of the depositors, members, stockholders, and the public are protected. Id. § 9-324(b)(ii).

200. Id. § 9-324(b)(2).

201. Id. § 9-324(c).

202. Id. § 9-324(d).

203. See id. §§ 9-419(a)(6), (16), (18)(1980), where general obligations of any other state were limited to not more than five percent of the association's savings liability, secured and unsecured loans could not exceed 10% of the savings liability of an association, and an obligation, of the State of Israel could not exceed 20% of the association's net worth.
individual or entity.\textsuperscript{204}

Subsection 9-419(a) provided that a Board of Commissioners was to regulate the percentage of an association's total assets that could be invested in a specific type of investment. By regulation, not more than ten percent of the assets of any association could be concentrated in any one person, partnership, company, firm, or corporation.\textsuperscript{205} In addition, an association by regulation could not make any one loan that exceeded 100 percent of its net worth as of the date the loan was made.\textsuperscript{206} The composition of an association's mortgage loan portfolio was subject to several limitations.\textsuperscript{207} The savings and loan association was to give priority to first mortgages for owner-occupied residences in the State of Maryland.\textsuperscript{208} There was no specific statutory requirement, however, that a certain percentage of the association's portfolio be first mortgages for owner-occupied residences in Maryland.

The Office of Special Counsel recommended that the section on investments be revised because the statute did not set forth specific limitations on investments. In other states, such as Ohio and Pennsylvania, specific limitations regarding investments and loans were set forth in the statute.\textsuperscript{209} In addition, the provisions gave associations broad investment powers comparable to federally-chartered savings and loan associations


\textsuperscript{205} \textit{Md. Regs. Code} tit. 9 § 05.01.30 (1985).

\textsuperscript{206} \textit{Id.}

\textsuperscript{207} The following limitations were applied to an association's loan portfolio:

1. The aggregate outstanding balance of all loans owned by an association on residential property of a homeowner had to be in excess of fifty percent of the association's total assets.

2. The aggregate outstanding balance of all loans owned by an association on improved residential property that was owned by a non-homeowner could not exceed fifty percent of the total assets of the association.

3. The aggregate outstanding balance of all other loans owned by the association could not exceed forty percent of the association's total assets subject to the following additional limitations: (a) the aggregate outstanding balance of all loans secured by improved commercial property could not exceed twenty percent of the association's total assets; (b) the aggregate outstanding balance of all loans secured by unimproved property could not exceed fifteen percent of the association's total assets; (c) the aggregate outstanding balance of all land development loans could not exceed ten percent of the association's assets; (d) the aggregate outstanding balance of all construction loans could not exceed forty percent of the association's total assets. \textit{Md. Regs. Code} tit. 9 § 05.01.30 (1985).


\textsuperscript{209} \textit{See supra} note 204.
and banking institutions. These broad investment powers enabled associations to make virtually any investment and such powers were therefore a factor in the savings and loan crisis.

Under the new section 9-419, the Division Director, instead of the Board of Commissioners, is now authorized to promulgate regulations on the types of investments set forth in the statute. The primary changes in section 9-419 are the repeal of Paragraph (19) and subsection 9-419(c). Subsection 9-419(c) greatly expanded the investment powers of state-chartered associations and arguably deprived the Board of Commissioners of the power to regulate investments that were authorized for federal associations. The revised section allows the Division Director to provide by regulation that the specific investments permissible for a federally-chartered association are permitted for a state-chartered association. The purpose of this new subsection is to permit state-chartered associations to make the same investments as federally-chartered associations, but only to the extent specifically permitted by the Division Director.

Under the new law, Maryland associations must make investments in first and second mortgages for owner-occupied residences equal to not less than twenty-five percent of their assets. The Division Director, however, can approve another percentage if it does not affect the safety and soundness of the association. The major change to section 9-419 is contained in subsection (f), which sets forth the limitation on real estate investments in other states.

In 1985, subject to certain limitations, a savings and loan association also could invest in a service corporation. A service corporation was a corporation in which all stock was owned by a state-chartered savings and loan association or a federally-chartered savings and loan association. The outstanding investment in service corporations and subsidiaries of service corporations could not exceed two percent of the association's assets. The activities of a service corporation were limited to

---

211. Id.
212. Id. § 9-419(b) (1986). Section 9-419 also permits acquisition, development and construction loans, participation interests in mortgages, consumer loans and commercial loans, if the specific percentage limitations, as set forth in new section 9-420, are met.
213. Id. § 9-419(e).
214. Id. § 9-419(f). Under this subsection an association that is insured by MDIF may invest in real estate located in Maryland, Pennsylvania, Virginia, Delaware, West Virginia, and the District of Columbia. An association that is insured by FSLIC may invest up to twenty percent of its assets in real estate located in Alabama, Arkansas, Delaware, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, West Virginia, Pennsylvania, Virginia, and the District of Columbia. Id. § 9-419(f)(2) (1986 & Supp. 1987). A FSLIC insured institution may invest up to ten percent of its assets in other states. Id. § 9-419(f)(3).
to the following: (1) originating, purchasing, selling, and servicing loans, and participation in loans secured by first liens upon real estate; (2) originating, purchasing, selling, and servicing educational loans; (3) making any investment as specified in section 9-419 of the Code; (4) performing certain services primarily for the association itself, such as accounting and data processing services; (5) purchasing unimproved real estate lots for the purpose of development or subdivision; (6) the development and construction of improvements for sale or rental on real estate; and (7) conducting a real estate brokerage business.

There were three conditions for an investment in a service corpora-

(Supp. 1985), where a banking institution may not have an affiliate unless the Bank Commissioner, with the advice of the Banking Board, approves the affiliate. The affiliate may be approved only if it offers to the public a financial, fiduciary, or insurance service. The affiliate would be approved only if the Bank Commissioner determines that such approval is required to protect the welfare of the general economy of the state and of the banking institution and would not be detrimental to the public interest or to the banking institution. In addition, the approval by the Bank Commissioner imposes the same conditions the federal law requires, or permits, as to national banking associations. The Bank Commissioner has the same authority to examine the business of the affiliate as it does with a banking institution.

See generally N.C. GEN. STAT. § 54B-194 (1982), which provides that an association in North Carolina may establish service corporations. The maximum investment in a service corporation in North Carolina is 10% of the association's total assets. A service corporation in North Carolina is subject to audit and examination by the Administrator of the Savings and Loan Division. The cost of the examination is to be paid by the service corporation. The permitted activities of the service corporation are set forth in rules and regulations promulgated by the Administrator. Under the statute, a service corporation may engage in activities that are approved by the Federal Home Loan Bank Board for service corporations owned solely by federal associations, unless these activities are prohibited by the Administrator. Under regulations promulgated by the Administrator, a service corporation may engage only in activities that are approved by the Federal Home Loan Bank Board for service corporations owned solely by federal savings and loan associations and investments authorized for state-chartered savings and loan associations in North Carolina.

Under OHIO REV. ANN. CODE § 1151.344 (Supp. 1984), an Ohio savings and loan association may invest 15% of its assets in a service corporation. If no association holds more than 50% of the stock of a service corporation, then the corporation may provide services compatible with the purposes, powers, and duties of Ohio savings and loan associations. In addition, the service corporation may provide mechanical, clerical, and recordkeeping services subject to written approval of the Superintendent of Building and Loan Associations. If an association owns more than 50% of the service corporation stock, the service corporation may provide only such services as the Superintendent of Building and Loan Associations authorizes. The Superintendent may authorize services that he determines to be related to the business of building and loan associations. The Superintendent is to consider whether the performance by a service corporation can be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound practices.

In Ohio, the Superintendent may, at any time, examine the affairs of a service corporation. Whenever the service corporation fails to meet the requirements of the law, all loans to, or investment by, an association in a service corporation are deemed unauthorized investments.
tion. First, an association could not invest in a service corporation unless there was a written agreement with the Board of Commissioners that the service corporation would permit and pay the costs of an examination of the corporation by the Division Director or by a certified public accountant. Second, annual financial statements of the service corporation had to be prepared and "submitted" with the annual financial statements required under the Code. Finally, if a service corporation exceeded the limitations proposed by statute or regulation as to an investment, the corporation had to dispose of the investment.

Other than general obligations of any other state, secured or unsecured loans, and obligations of the State of Israel, specific limitations with regard to authorized investments were not set forth in section 9-419. It was the opinion of the Office of Special Counsel that there needed to be a statutory limitation on the amounts of loans to any one borrower and percentage limitations as to certain loans permitted under section 9-419. In addition, there was a need for a statutory restriction on acquisition development and construction loans. Therefore, a new section was recommended by the Office of Special Counsel to set forth specific investment limitations. Under the new section 9-420, an association may not directly or indirectly grant loans that exceed five percent of the association's assets to an individual business entity. Furthermore, consumer loans may not exceed twenty percent of the association's assets, and commercial loans may not exceed ten percent of the association's assets. Also, privately placed mortgage-backed securities cannot exceed ten percent of the association's assets. Finally, acquisition, development, and construction loans cannot exceed ten percent of the association's assets.

218. Id. § 05.01.34B(2).
220. Id. § 9-420(b)(1)(ii).
221. Id. § 9-420(c).
222. Id. § 9-420(d)(2).
223. Id. § 9-420(e). In addition, acquisition, development, and construction loans may not exceed the loan-to-value ratios provided by regulation. Id. The regulations adopted by the Division Director for the repayment of acquisition, development, or construction loans, may not be less restrictive than those applicable to federally-chartered savings and loan associations. Id. Unless otherwise provided by regulation, the loans are to be repayable within the term that is applicable to federally-chartered savings and loan associations. Id. The recognition of income and the amortization method used by the association for such loans must be in accordance with generally accepted accounting principles. Id. Loan documentation for such loans must contain a preliminary development plan and a projection of not less than the investment in the loan will be recorded. The provisions on acquisition, development and construction loans do not apply to loans made for the purchase of real estate that has or will have not more than one dwelling designed principally as a residence for not more than four families. Id.
7. Supervision of an Association's Records

In 1985, every savings and loan association was required to have an examination by the Division Director at least every two years.224 The examination could include a "service company" or subsidiary of a savings and loan association.225 The Division Director also could require savings and loan associations to be audited.226 By regulation, if an association had assets exceeding $5,000,000 it was required to have, at its own expense, an audit at least once a year by a certified public accountant.227 An association whose assets were $5,000,000 or less could have

224. Id. § 9-502(a) (1980) (amended 1986). Maryland banks are still required to be examined at least once every twelve months. Id. § 5-201(a) (1986 & Supp. 1987). For each examination of the bank, the institution must pay the Bank Commissioner $1000 plus eight cents for each $1000 of assets of the institution over $1,000,000. Id. § 5-203(b). The purpose of the examination, which is specifically set forth in the statute, is to determine the condition of the institution and whether it is complying with the law. Id. § 5-201(b). No similar purpose is set forth in the parallel statute applying to the examination of Maryland savings and loan associations.

In Massachusetts, at least once during each calendar year, and more frequently if required by the Bank Commissioner, each cooperative bank is to have an examination and audit made of its books and records. The examination and audit shall be performed by a certified public accountant not connected with the cooperative bank. MASS. GEN. LAWS ANN. ch. 170 § 14 (West Supp. 1987).

Under North Carolina law, the Administrator of the Savings and Loan Division may at any time examine and investigate anything relating to the business of a savings and loan association or a savings and loan holding company. N.C. GEN. STAT. §§ 54B-56(a) (1982). If the association willfully delays or obstructs the examination, it is guilty of a misdemeanor. Id. § 54B-56(c). The association pays the examination fees. Id. § 54B-57 (Supp. 1987). The Administrator may also conduct an extended audit or examination of the association or revaluation of any assets or liabilities of the association at anytime it is deemed prudent. Id. § 54B-58 (1982).

In Ohio, at least once every 18 months the Superintendent of Building and Loan Associations is to make an examination into the affairs of each building and loan association. OHIO REV. CODE ANN. § 1155.09 (Page Supp. 1984). The expense of the examination is paid by the state. Id. The Superintendent can establish different schedules of examination for different associations. Id. The Superintendent also may make "special" examinations of building and loan associations and the expense of such examination is to be paid by the association. Id. § 1155.10.

In Pennsylvania, the Department of Banking is to examine the association at least once a year and more frequently as it deems necessary to protect the members or creditors of the association. See generally 7 PA. CONS. STAT. ANN. § 6020-221(a) (Purdon Supp. 1987). The Department may examine any person who is performing services for the association. Id. The provisions of the law regarding banking apply to the examination process. Id. § 6020-221(c).

225. Id. The term "service company" is not defined in the Financial Institutions Article.

226. Id. § 9-502(b).

227. MD. REGS. CODE tit. 9 § 05.01.06 (1985). The annual audit of the association's books and records must be in accordance with generally accepted auditing standards and be performed by a certified public accountant who is in good standing. Upon written application, the Division Director may extend the time for compliance with the audit requirement. MD. FIN. INST. CODE ANN. § 9-502(b)(2) (1986).

The statute sets forth specific time limits when the audit must commence, be completed, and be furnished to the Division Director. Id. § 9-502(b)(4). The costs of the audit are to be paid by the association. Id. § 9-502(b)(5). The requirements under this alternative provision were set forth in the regulations. Cf. MD. FIN.
its annual audit made by its board of directors.\textsuperscript{228}

The Office of Special Counsel recommended that an association be examined at least once a year. For an association insured by FSLIC, the Division Director is to have an examination at a time that he considers appropriate but at least every eighteen months.\textsuperscript{229} The Division Director must communicate the results within two months of the completion of the examination and send the results to the president and to each member of its board of directors. The board must report promptly to the Division Director and the applicable insurer any corrective action taken. The statute specifically requires that the directors, officers, controlling persons, employees, and agents of the association cooperate with the Division Director in the examination of the association. In addition, the Office of Special Counsel recommended that an association be required to have an audit by an independent auditor on an annual basis.

All books and records of the association are to disclose fully and accurately all of the assets and liabilities of the association and any related entity.\textsuperscript{230} In addition to the examination of an association and its subsidiary or service company, the Division Director may investigate any related entity.\textsuperscript{231}

8. Conversions and Extraordinary Actions

Nominal changes were made by the General Assembly to the conversion and extraordinary actions subtitle of Title 9 of the Financial Institutions Article. A mutual association could convert to a capital stock association if its members approved, if its charter was amended, and if

\textsuperscript{228} \textit{Inst. Code Ann.} § 5-205 (1986), where a bank is \textit{required} to have an audit by a certified public accountant at least once every five years. In addition, at least twice a year, the Bank Commissioner is required to ask every bank to submit a financial report that shows in detail the assets and liabilities of the institution as of the close of a business day specified by the Bank Commissioner. \textit{Id.} § 5-206(a). Within 45 days after the institution receives the request for the financial report, it must publish a summary of the report and submit proof of publication of the summary to the Bank Commissioner. \textit{Id.} § 5-206(d). The form of the report is to conform as closely as possible to the forms used by federal banking authorities. \textit{Id.} § 5-206(b). This report must be submitted within 30 days after the institution receives the request for the financial report. \textit{Id.} § 5-206(c). In addition, the Bank Commissioner may request a bank to submit a “special financial report” in accordance with § 5-207 of the Code.

If a banking institution fails to make any required report, it is subject to a civil penalty of $50 for each day the report is overdue. \textit{Id.} § 5-208(a). Instead of making an examination, the Bank Commissioner, pursuant to § 5-204 of the Code, may accept a copy of a report of a recent examination by a federal banking authority.

\textsuperscript{229} \textit{Md. Fin. Inst. Code Ann.} § 9-502(a) (1986). The cost of these examinations is to be paid by the association.

\textsuperscript{230} \textit{Id.} § 9-502(e).

\textsuperscript{231} \textit{Id.} § 9-502(d).
the Division Director approved. In order to convert to a capital stock association, a mutual association had to deliver to the Division Director, along with a filing fee, an application for conversion, a certified copy of the resolution of the board of directors that authorized the conversion, the proposed amended charter and bylaw amendments, the proposed notice of the meeting to consider conversion, the time and manner in which the notice would be given to members, the proposed proxy statement, and the proposed plan of conversion.

The Division Director was to review the application for the conversion and determine whether the plan was fair to members of the converting association as well as ensuring that insurance of accounts would remain in effect after the conversion. An application for conversion would not be approved by the Division Director if the plan did not comply with regulations governing conversions or if it would result in a taxable reorganization under the Internal Revenue Code. Regulations had been promulgated by the Board of Commissioners that set forth the required provisions for the proposed conversion.

The Office of the Special Counsel recommended revision to the conversion provisions, particularly section 9-604. Section 9-604 sets forth the rules for review by the Division Director of an application for conversion from a mutual to a stock association. The section has been modified to require the Division Director to determine whether a plan of conversion is fair not only to the members of the converting association, but also to the general public. In addition, the Division Director is to determine whether the association will be in a sound financial condition and will be managed competently after the conversion. The Division Director must determine that the conversion will not impair the capital of the association nor adversely affect its operations and that no person will receive any inequitable gain or advantage by reason of the conversion.

Another change made in 1986 was to section 9-630 of the Financial Institutions Article, which sets forth the rules governing the approval or disapproval of a plan of consolidation, merger, or transfer of assets. Under prior law, a savings and loan association could consolidate with, merge into, or transfer its assets to any other savings and loan association or any savings bank as long as it complied with Title 3 of the Corporations and Associations Article and the Division Director approved the plan. A Maryland corporation having capital stock could consolidate with one or more Maryland corporations having capital stock to form a

232. Id. § 9-601 (1980) (This requirement remained unchanged by the 1986 amendments).
233. Id. § 9-602 (The filing fee was raised by the 1986 amendments).
234. Id. § 9-604 (amended 1986).
236. Id. § .05.01.21B(2).
new consolidated corporation. It also could merge into another Maryland corporation having capital stock or having one or more such corporations merge into it. Finally, it could merge into a business trust having transferable units of beneficial interest, or it could have one or more such business trusts merge into it. It is questionable whether a stock association could merge with or be merged into a mutual association. Under the Corporations and Associations Article, a non-stock corporation could consolidate or merge only with another non-stock corporation. However, it was not altogether certain as to whether this section of the Corporations and Associations Article applied because only the general corporation law applied to a financial institution.

A savings and loan association could effect a "statutory merger" into any other savings and loan association or any savings bank if the proposed statutory merger complied with Title 3 of the Corporations and Associations Article and was approved by the board of directors of both associations, the members of the transferor association, and the Division Director.

To consolidate, merge, transfer assets, effect a statutory merger, reorganize, partially liquidate, or dissolve a savings and loan association, the association had to deliver to the Division Director a proposed plan of the respective action. The Director was to examine the plan to determine whether a successor association satisfied certain requirements of Title 9, whether the plan was fair, and whether the implementation of the plan would promote the public interest. Within sixty days of the filing, the Division Director had to approve or disapprove the plan. There was, however, no provision for the Division Director to consider whether the plan would be consistent with sound savings and loan practices. Therefore, under the new law, the Division Director must now determine whether the successor association complies with the requirements of Subtitle 2 of Title 9 and whether the plan is consistent with adequate and sound savings and loan practices and is in the public interest. In making this determination, the Division Director is to consider the financial history and condition of the parties to the plan, their prospects, the man-

240. Id.
241. Id.
242. Id. § 5-207. See also N.C. Gen. Stat. § 54B-35 (Supp. 1987), where a mutual association may merge only with another mutual association and a stock association may merge only with another stock association. In order for a mutual association to merge with a stock association, it must first convert to a stock association. Id. § 54B-37 (1982).
244. Id. § 9-628 (This provision remained unchanged by the 1986 amendments).
245. Id. § 9-630.
246. Id. If the Division Director did not approve of the plan, there could be an appeal. Id.
247. Id. § 9-630.
agement of the association, the effect of the plan on competition, and the convenience and needs of the area primarily to be served by the resulting association.248

9. Conservatorship and Receivership

At the time of the savings and loan crisis, the Board of Commissioners could institute proceedings for the appointment of a conservator if the savings and loan association failed to comply with a final order, or if the Board of Commissioners considered the appointment of a conservator to be in the public interest.249 Only the Board of Commissioners could institute proceedings for the appointment of a conservator. The applicable insurer, either FSLIC or MSSIC250 (now MDIF), had the absolute right to be appointed the conservator of the savings and loan association insured by it.251 Otherwise, the court could appoint the Division Director, deputy director, or an examiner from the Division as the conservator.252 A conservator could be appointed if the court found that the savings and loan association was in an impaired or insolvent condition, was in substantial violation of any law or regulation, was concealing any of its assets or records, or was conducting an unsafe or unsound operation.253

The Division Director did not have authority to institute proceedings for the appointment of a conservator even if the holding company or subsidiary association failed to comply with the final order. Under the new law, the failure by a holding company or subsidiary to comply with the final order will now be a ground for the appointment of a conservator.254 In addition, if an association, holding company, or subsidiary refuses to submit its records or affairs for inspection to an examiner or agent of the Division, or is in violation of any final order, the court may appoint the Division Director, deputy division director, or an examiner from the Division as conservator.255 The Division Director before instituting suit must obtain prior written approval from the Secretary of Licensing and Regulation.

In the past, the conservator was to correct the irregularities in the operation of the association.256 The conservator had the powers, rights and privileges of the officers, directors, and members of the savings and loan association. Upon recommendation of the Board of Commissioners,

248. Id.
252. Id. § 9-701(c).
253. Id. § 9-702.
254. Id. § 9-701 (1986).
255. Id. Division Director has been substituted for the Board of Commissioners.
by order of the court, the conservator could remove any director, officer, or employee of the association.\textsuperscript{257} Under the new law, the conservator may exercise powers not only of the officers, directors, or members of the association, but also of stockholders.\textsuperscript{258} In addition, if authorized by the court, a conservator can approve a merger, conversion, transfer of assets, reorganization, or acquisition of the association in place of the shareholders or members if authorized by the court. In addition, the conservator can request a stay of other proceedings, including bankruptcy proceedings in other courts. Under revised section 9-703, a member, director, officer, or controlling person of an association that is under conservatorship may not act in connection with any of the association's assets or property unless otherwise approved in writing by the conservator in the case.

In addition to instituting conservatorship proceedings, the Board of Commissioners could institute proceedings to appoint a receiver if the savings and loan association failed to comply with a final order, if irregularities gave rise to conservatorship that were not corrected, or if an emergency existed.\textsuperscript{259} In each case, the Board of Commissioners had to consider the appointment of a receiver to be in the public interest.\textsuperscript{260} As in conservatorship, only the Board of Commissioners could institute pro-

257. \textit{Id.} In the case of a Maryland bank, if the Bank Commissioner finds that any bank is impaired, it may require the bank to correct the impairment, and if the bank fails to correct the impairment within three months, the Commissioner may take possession of the bank. If the reserves of the bank fall below the amount required, the Bank Commissioner can require the bank to correct the deficiency. If the bank fails to correct the deficiency within 30 days after it receives notice, the Commissioner may take possession of the bank. \textit{Id.} § 5-602 (1986). Within a reasonable time after the Bank Commissioner takes possession of the institution, he or she is to petition the court to take jurisdiction over the institution and appoint as receiver any examiner or the Federal Deposit Insurance Corporation (FDIC). \textit{Id.} § 5-605.

In North Carolina, the Administrator of the Savings and Loan Division, with prior approval of the Commission of Savings and Loan Associations, may take possession of an association if the association is being conducted in a fraudulent, illegal, or unsafe manner, or if the association is in an unsafe or unsound condition to transact business. N.C. GEN. STAT. § 54B-70(a)(3) (1982). In addition, if the officers, directors, or employees have assumed duties or have performed acts in excess of those permitted by law, the Administrator also may take possession of the association. \textit{Id.} § 54B-70(a)(4). If the association has experienced a substantial dissipation of assets or earnings because of any violation of law or because of an unsafe or unsound practice, the Administrator also may take possession of the association. \textit{Id.} § 54B-70(a)(5). If the Administrator has taken custody of an association and finds little or no likelihood of amelioration of the situation, he or she can then appoint a receiver for purposes of liquidating the association. \textit{Id.} § 54B-70(d).

In Ohio, if the Superintendent of Savings and Loan Associations finds that an association is operating in an unsafe or unsound condition, that it is conducting its business contrary to law, or that its affairs are not being conducted for the best interest of its depositors, shareholders, or creditors, he or she may take possession of the business and property of the association. \textit{Ohio Rev. Code Ann.} §§ 1157.01 - .09 (Page Supp. 1986).

260. \textit{Id.}
ceedings for the appointment of a receiver. Subject to priority of FSLIC or MSSIC (now MDIF) as the insurer, the court could appoint a receiver if it found that a savings and loan association was in an impaired or insolvent condition, was in substantial violation of any law or regulation, was concealing any of its assets or records, or was conducting an unsafe or unsound operation.\textsuperscript{261}

Under the new law, the Division Director, rather than the Board of Commissioners, can institute proceedings for the appointment of a receiver.\textsuperscript{262} A receiver may be appointed by a court based upon certain violations committed by an association or by its related entities. In addition to the past provisions for the appointment of a receiver, the court now also may appoint a receiver if an association or related entity refuses to submit its records or affairs for inspection to an examiner or agent or is in violation of any final order. The Division Director cannot institute proceedings without the prior written approval of the Secretary of Licensing and Regulations. The receiver will have all of the powers and authority of a conservator, as well as the power to liquidate.\textsuperscript{263} The receiver also has all the powers and authority as expressed in the order of any court of competent jurisdiction.


One of the principal weaknesses in the Financial Institutions Article with regard to savings and loan associations was the total omission of civil and criminal penalties for violations of Title 8 or Title 9. In addition, there were no provisions restricting persons who had been convicted of a crime from serving as officers or directors of an association. Under the new law, a person convicted of a crime involving dishonesty or breach of trust cannot serve as an officer or director of an association.\textsuperscript{264}

Civil penalties have been added to the Financial Institution Article. Any director, officer, controlling person, or employee of an association or related entity who violates Title 8 or Title 9 may be subject to a penalty of $10,000 for each violation.\textsuperscript{265} In addition to the civil penalties set forth in this section, the person who financially gains from violating Title

\begin{itemize}
  \item \textsuperscript{261} Id.
  \item \textsuperscript{262} Id. § 9-708 (1986).
  \item \textsuperscript{263} Id. § 9-708(c).
  \item \textsuperscript{264} Id. § 9-911. The person, however, can be exempt from this restriction if he receives written consent from the Division Director. Id.
  \item \textsuperscript{265} Id. § 9-912. The Division Director, in determining the financial penalty to be imposed, is to determine the seriousness of the violation, the good faith of the violator, the violator's history of previous violations, the deleterious effect of the violation on the public and the industry, and the assets of the violator. The Division Director is to serve a notice specifying the charge and the time and place for a hearing. The hearing is to be conducted in accordance with the provisions set forth in section 8-402. The Division Director may issue a final order pursuant to section 8-402 following the hearing. An appeal may be taken from the final order to the Circuit Court of Maryland for Baltimore City. Id. § 9-912(e).
\end{itemize}
8 or Title 9 is required to forfeit the gain.\textsuperscript{266}

Along with civil penalties, there will now be criminal penalties for violating certain sections of Titles 8 and 9. The willful omission, making or concurrence in the making or publishing of a written report, or entries in financial statements that contain material statements known to be false, will be punishable by a fine not to exceed $100,000, or imprisonment for not more than ten years, or both.\textsuperscript{267} Furthermore, the knowing declaration of a dividend in violation of section 9-324 of the Financial Institution Article is subject to a fine of not more than $100,000, or imprisonment of not more than ten years, or both.\textsuperscript{268} An officer, director, controlling person, agent, or employee who makes a loan for his own use with an attempt to conceal that loan from the Division will now be subject to a fine of not more than $100,000, or imprisonment for not more than ten years, or both.\textsuperscript{269} Furthermore, if such persons make a false statement to an agent or employee of the Division with the intent to deceive, they will be subject to a fine of not more than $100,000, or imprisonment for not more than ten years, or both.\textsuperscript{270}

The Division Director must furnish to the Attorney General, or the proper prosecuting attorney, information pertaining to a violation of the laws relating to savings and loan associations and related entities.\textsuperscript{271} In addition to the above, there is a catch-all criminal penalty where a director, officer, controlling person, or an employee of an association violates Title 9 or any regulation adopted under Title 9.\textsuperscript{272} In such a case, the fine cannot exceed $10,000, or imprisonment for not more than eighteen months, or both.

If a controlling person, officer, or director causes his funds, or those of a member of his immediate family, or other depositor, to be withdrawn from an institution knowing that it is about to go into conservatorship, receivership, reorganization, or liquidation, or is about to suspend its operation because of financial difficulties, that person shall be sentenced, upon conviction, to imprisonment for not more than ten years and shall be fined not more than $100,000.\textsuperscript{273} Finally, a savings and loan association, holding company or subsidiary may not indemnify any person who is fined under any criminal provision of Titles 8 or 9, or one who

\textsuperscript{266} \textit{Id.} § 9-912(f). This section is not meant to prevent any person who is damaged by an action of any party from bringing a separate cause of action.

\textsuperscript{267} \textit{Id.} § 9-913(b).

\textsuperscript{268} \textit{Id.} § 9-913(c).

\textsuperscript{269} \textit{Id.} § 9-913(d).

\textsuperscript{270} \textit{Id.} §§ 9-913(e), (f). Any person who aids or abets another person in violating the provisions set forth in section 9-913 of the Financial Institutions Article will be subject to a fine of not more than $10,000, or imprisonment for not more than one year, or both. \textit{Id.}

\textsuperscript{271} \textit{Id.} § 9-913(g).

\textsuperscript{272} \textit{Id.} § 9-913(a).

\textsuperscript{273} \textit{Id.} § 9-914. A person convicted under this section also shall be required to make full restitution. \textit{Id.}
is subject to a civil penalty of Titles 8 or 9.\textsuperscript{274}

IV. CONCLUSION

One of the causes of the savings and loan crisis of 1985 was the weak regulatory system in effect at the time. The absence of sufficient safeguards and penalties allowed unscrupulous directors and officers to mismanage and misappropriate funds, with catastrophic consequences for individual depositors and the state in general. The reformatory legislation enacted by the Maryland General Assembly in 1986 was carefully crafted to prevent recurrence of a similar crisis and should serve as a model savings and loan statute for other states, as well as for the federal regulatory system.

\textsuperscript{274} Id. § 9-916.