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The Credit Union Act of Ohio

Rathuel L. McCollum*

A CREDIT UNION is composed of persons who have formed or joined a corporate organization to promote thrift and to provide credit for themselves. The membership consists of those having a common relation such as membership in the same church, lodge, or community, or as employees of a common employer.

The Act governing credit unions incorporated under Ohio law¹ is vague on numerous pertinent matters. Many of the statutory provisions are unreasonable, and some of them are meaningless for all practical purposes. It is the purpose of this article to discuss in detail various portions of the Act, in the light of actual experience in credit union work.

All incorporators of an Ohio chartered credit union must be citizens of the United States.² No other type of corporation in the state is required to meet this test. The General Corporation Act³ requires only that a majority of the incorporators be citizens. No source has been found by this writer that can explain the purpose of the requirement that all credit union incorporators be citizens of the United States.

Upon his joining a credit union, the law requires that "Each member shall subscribe to at least one share of stock."⁴ The word *stock* also appears elsewhere in the Act.⁵ Yet, the incontrovertible fact is that a credit union is not intended to operate on the principle of a stock corporation in relation to the members. Issuance of certificates for shares is optional, and when they are issued they are not negotiable.⁶ A member receives a passbook upon joining, and all entries for monies credited to or charged against his account are entered therein.⁷ Further, no shareholder has more than one vote regardless of the number of shares

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¹ Ohio Revised Code, Chap. 1733.

² *Ibid.*, Sec. 1733.01.

³ *Ibid.*, Sec. 1701.04.

⁴ *Ibid.*, Sec. 1733.10.

⁵ *Ibid.*, Secs. 1733.07, 1733.09.

⁶ *Ibid.*, Sec. 1733.09.

⁷ *Ibid.*, Sec. 1733.03; and Code of Regulations, Art. IX, Sec. 1; Division of Securities Rule 10; Manual of Procedure, Sec. 5.17.

owned. Thus, it is obvious that some of the major privileges of a holder of *shares of stock* are not available to credit union shareholders.

The question often has been raised: "Can a credit union enforce, by a legal action, a member's subscription to the share that he promised to 'buy' at the time of joining?" There is no known Ohio case on the point. Besides, just imagine hiring an attorney-at-law to hale a member into court, demanding that he comply with the condition of his "contract" and pay the \$5.00 for the share! Legal opinion is that the board of directors can only set a time limit for payment of the "subscription," and if the member fails to pay by the stated time he can be expelled.⁸

What, then, is the nature of the *share* account? It is simply a savings account that represents the member's equity in the corporation, rather than such a liability as is represented by the ordinary savings account. A member becomes a shareholder automatically as soon as he has saved \$5.00 in his account. The members are the owners, the savers and the borrowers. The Federal Credit Union Act and the acts of twenty-two states identify shares as savings. One of these is even more precise. The Credit Union Act of Nebraska⁹ states that: "No certificate shall be issued to denote the ownership of a share in a credit union organized under this act, but a share is hereby defined as the term applied to each five dollars of savings standing to the account of a member." In other words, a credit union is a mutual savings and loan corporation with a restricted membership. The division of savings into shares is merely a convenient method of apportioning earnings. Therefore talk of *shares of stock* in credit union parlance is strictly academic and meaningless.

Authority to amend the articles of incorporation of a credit union, or the Code of Regulations¹⁰ (*i.e.*, by-laws) is subject to the provision that "Any such amendment must have the written approval of two thirds of the shareholders *entitled to vote thereon* or the affirmative vote of two thirds of the shareholders present at a regular or special meeting at which at least ten per cent of all the shareholders are present . . ." (*Italics added*). The natural question then is: "When is a shareholder not entitled to vote on an issue?"

There are no pre-emptive rights¹¹ in a credit union, and no-

⁸ Ohio Rev. Code, Sec. 1733.07; Code of Regulations, Art. VII, Sec. 8.

⁹ Rev. Stat. Nebr. (1943), Sec. 21-1748.

¹⁰ Ohio Rev. Code, Secs. 1733.03, 1733.06.

¹¹ *Ibid.*, Sec. 1733.09.

where in the Act is there any authority to deny a shareholder the right to vote. Professor Oleck¹² has pointed out that statutory voting provisions in these types of organizations are seldom very specific. This is notably true in the case of a great number of credit union acts. However, once again we do get a ray of light from the Nebraska law.¹³ It provides that: ". . . A member to be in good standing, for the purpose of obtaining a loan, and to vote at a membership meeting must own at least one fully paid share. . . ." (*Italics added*). In view of this explanation, it seems to the writer that what the legislators intended was that amendments to the articles of incorporation or to the Code of Regulations may be made with the written approval of two-thirds of the members entitled to vote thereon, i.e., two-thirds of the shareholders. This would seem to be the logical alternative to the affirmative vote of two-thirds of the shareholders present at a regular or special meeting.

A credit union may borrow money in an aggregate amount not exceeding fifty per cent of its "paid-in and unimpaired capital and surplus."¹⁴ Credit unions in Ohio do not usually carry such accounts as capital and surplus on their books. The accounting method used is that found in the Manual of Procedure which is issued by the Division of Securities of the Ohio Department of Commerce, statutory supervisors of credit unions.¹⁵ The Supreme Court of Ohio, in *Society v. Peck*¹⁶ stated: "It should be observed that the word 'capital,' when used with reference to a corporation, may be used to describe at least three different things. For example, it may be used (1) to describe all of the property or assets of the corporation . . . (2) to describe a book-keeping figure representing a part or all of the net worth of the corporation . . . (3) to describe part or all of the property interest in the corporation which belongs to its shareholders or other owners." Then the court proceeded to use the terms "capital" and "net worth" interchangeably. This is in accord with accepted accounting practices. *Surplus* is defined in the General Corporation Act¹⁷ as the excess of assets over liabilities plus stated capital. The shares of a credit union comprise its

¹² Oleck, Howard L., *Non-Profit Corporations and Associations*, 252 (Prentice-Hall, Inc., Englewood Cliffs, N. J., 1956).

¹³ Rev. Stat. Nebr. (1943), Sec. 21-1715.

¹⁴ Ohio Rev. Code, Sec. 1733.07 (D).

¹⁵ *Ibid.*, Sec. 1733.14.

¹⁶ *Society for Savings v. Peck*, 161 Ohio St. 122, 118 N. E. 2d 651 (1954).

¹⁷ Ohio Rev. Code, Sec. 1701.32 (A).

stated capital, and the sum of undivided earnings, reserves, profits and entrance fees is equivalent to surplus. Then, stated capital plus surplus equals net worth, and the statute is satisfied.

One of the major sore spots in credit union activity concerns the right of directors, officers and committeemen to borrow money. The Act¹⁸ provides that "Upon the majority vote of the members present at an annual or special meeting, the officers, directors, and committeemen may be permitted to borrow from the credit union under the same general terms extended to other members, provided that the total amount of loans to officers, directors, and committeemen shall not exceed the amount of the combined equity of such group plus the share balance of the borrowers in such group, *and that the loan applications of the members of such group shall have received the additional unanimous approval of all officers, directors, and committeemen. . . .*" (*Italics added.*) Because of this ultra-restrictive provision some officials have found it necessary to resign their positions when they wanted to borrow in order to meet a financial emergency. The objection is not to the limitation on the amount that they can borrow, but to the requirement that they secure the unanimous approval of the other officials. In some credit unions this presents no problem because the members may see each other daily. In others the members may not see each other for days or even weeks. Furthermore, in case of a serious illness of an official the other officials may be unable to see him for an indefinite period. This therefore is an unreasonable burden, especially when one considers that, with the exception of the treasurer, elected officials of a credit union are voluntary workers and are barred by law from receiving any compensation for their services in office.¹⁹ It is stark irony that those who are primarily responsible for the success of a smoothly-run organization are the victims of the most stringent provisions of the law governing its operations.

Each year the credit union is required to set aside as a reserve fund against losses all entrance fees plus twenty per cent of net earnings until the fund equals ten per cent of the amount paid in on shares.²⁰ Thereafter such amount of the net earnings is to be transferred to the reserve fund, after charging off actual losses, as is necessary in order to maintain the fund at ten per cent of the share payments. First, the procedure of tying a re-

¹⁸ Ibid., Sec. 1733.12.

¹⁹ Ibid., Sec. 1733.11.

²⁰ Ibid., Sec. 1733.13.

serve for losses from loans to the total amount paid in on shares cannot be justified by any known accounting principle. The potential losses do not increase or decrease with share savings. They occur on the basis of the money loaned and uncollected, not the money saved. The Credit Union Acts of Illinois²¹ and New Mexico²² recognize the true meaning of the reserve for losses. They provide that the reserve is to be maintained at ten per cent of the *loans* of the credit union. Secondly, the amount set aside for losses is extremely excessive. Losses in credit unions average less than one-fifth of one per cent of the volume.²³ In a study of 129 large credit unions, John T. Croteau,²⁴ Notre Dame University economist, found that two-thirds of them had losses averaging from 0.14 to 0.23 per cent of volume during the years 1952 to 1956. These figures, the report adds, are similar to those of banks and considerably lower than those of small loan companies.

Summary

The lack of litigation in credit union affairs is a good indication that the members usually manage their operations well. However, the law should be clear and concise on all matters provided for in the Credit Union Act. Hence the writer makes the following recommendations:

- (1) That ambiguous terms be defined.
- (2) That express provisions be added where they have been shown to be needed.
- (3) That the provision requiring all of the incorporators to be citizens of the United States be modified.
- (4) That the requirement that the loan application of an elected official receive the unanimous approval of the other officials of his credit union be eliminated.
- (5) That the reserve for losses be based on a reasonable percentage of the total amount of outstanding loans.

In conclusion it is noteworthy that the success of any credit union is dependent to a great extent on the unselfish and tireless service rendered by those who manage its affairs and those who serve willingly in lesser positions.

²¹ Ill. Stat. Ch. 32, Sec. 496.21.

²² New Mex. Stat. Anno. (1953), Sec. 48-19-17.

²³ The Credit Union Yearbook (1957) p. 5. (Published by Credit Union National Association).

²⁴ The Credit Union Bridge (December, 1957). (Published by Credit Union National Association).