

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 17, 1937

To Mr. Eccles

Subject: Digest of Daiger memorandum re

On Mr. Clayton

proposed Home Loan Bank legislation

By way of introduction Mr. Daiger points out that Mr. Delano's argument in favor of the legislation is that it will satisfy a powerful lobby which wants a good deal more than the proposed legislation would give.

The proponents of the legislation also claim a parallel with the Farm Credit Administration's powers to issue bonds which are eligible for purchase by the Federal Reserve banks in the open market. Mr. Daiger's answers to these arguments are as follows:

(1) The building and loan lobby is not as formidable as it is made out to be.

(2) The analogy with the Farm Credit Administration is not well taken since the purpose of that set-up is to make available to farmers for long-time loans on their lands the long-term investment funds of savings banks, life insurance companies, commercial banks, trust companies and other investors who buy long-term obligations. There never was any conception that the Farm Credit Administration was to supply only those funds representing the savings or stock investments of the member borrowers. Building and loan associations and mutual savings banks on the other hand have traditionally and characteristically loaned only the funds supplied by the savings of the members. To pyramid lending power on these savings would violate the traditional function of the building and loan set-up and would be much the same as though mutual savings banks, life insurance companies, commercial banks and trust companies borrowed against their assets for the purpose of enlarging their mortgage portfolios.

The above are the principal points made by Mr. Daiger although his memorandum is replete with background and detailed argument in support of the above points.

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April 22, 1937

Board of Governors

Mr. Dreibelbis, Assistant
General Counsel.

Amendments to section 14(b) of
Federal Reserve Act and 4(n) of Home
Owners Loan Act proposed by Federal Home
Loan Bank Board.

At Mr. Clayton's request I have reviewed Mr. Daiger's memorandum of April 17th addressed to Chairman Eccles upon the subject "Open Market Operations proposed by the Federal Home Loan Bank Board". This review, however, has been confined solely to an analysis of the existing applicable statutes and the legal effect of suggested amendments to section 14(b) of the Federal Reserve Act and section 4(n) of the Home Owners Loan Act, which amendments, I understand have been proposed by the Federal Home Loan Bank Board. For the convenience of the Board the various Acts involved are separately analyzed under descriptive headings, as follows:

FEDERAL FARM MORTGAGE ACT

The Federal Farm Mortgage Corporation Act creating the Federal Farm Mortgage Corporation was approved January 31, 1934.

This Act authorized the Corporation to issue \$2,000,000,000 of bonds fully guaranteed by the United States both as to interest and principal, which bonds, among other things, may be exchanged for consolidated Farm Loan bonds of equal face value issued under the Federal Farm Loan Act.

The Act amended section 13 of the Federal Reserve Act by making the bonds of the Corporation eligible for pledge as security to a member bank's fifteen day collateral note. At the same time, section 14(b) of the Federal Reserve Act was amended to make bonds of the Corporation having maturities from date of purchase of not exceeding six months eligible for purchase and sale in the open market.

HOME OWNERS LOAN ACT

The Home Owners Loan Act creating the Home Owners Loan Corporation was approved June 13, 1933.

The Act originally authorized the issuance of \$2,000,000,000 of bonds guaranteed as to interest only by the Government. By process of amendment the Act finally authorized the issuance of \$4,750,000,000 of bonds guaranteed both as to interest and principal by the United States. Approximately \$1,500,000,000 of this sum remains unissued.



Section 4(n) of the Act authorizes the Corporation to (1) purchase Federal Home Loan Bank bonds, debentures, or notes, or consolidated Federal Home Loan Bank bonds or debentures; (2) to purchase full paid income shares of Federal Savings and Loan Associations after funds made available to the Secretary of the Treasury for the purchase of such shares have been exhausted, such purchases to be on the same terms and conditions as apply to the purchase of such shares by the Secretary of the Treasury. \$300,000,000 of the authorized bond issue is set aside for the purpose of this subsection.

It is now proposed to amend the subsection by allocating the \$300,000,000 to the purchase of shares of Federal Savings and Loan Associations and providing that the total amount of unused bond authorization of the Corporation (\$1,500,000,000) shall be available for the other purposes of the subsection; to wit, the purchase of Federal Home Loan Bank bonds, debentures, or notes, or consolidated Federal Home Loan Bank bonds or debentures.

In an amendment of the Act (April 27, 1934) providing for the guarantee by the United States, both as to principal and interest, of bonds issued by the Corporation, sections 13 and 14 of the Federal Reserve Act were amended in the same manner as already amended with respect to bonds of the Federal Farm Mortgage Corporation. Section 13 of the Federal Reserve Act was amended by making the bonds of the Corporation eligible for pledge as security to a member bank's 15 day collateral note. Section 14(b) of the Federal Reserve Act was amended to make bonds of the Corporation having maturities from date of purchase of not exceeding 6 months eligible for purchase and sale in the open market.

FEDERAL HOME LOAN BANK ACT

The Federal Home Loan Bank Act, authorizing the establishment of Federal Home Loan Banks, was approved July 22, 1932.

Any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, or savings bank, is eligible to become a member or a nonmember borrower of a Federal Home Loan Bank and a Federal Home Loan Bank under certain conditions and against certain security may make advances to its members, as well as, to nonmember borrowers.

Each Federal Home Loan Bank is authorized to issue debentures, bonds, or other obligations upon such terms and conditions as the Board may approve. The Act also provides for the issuance of consolidated



Federal Home Loan Bank debentures representing the joint and several obligations of all Federal Home Loan Banks. These debentures cannot be issued if any of the assets of any Federal Home Loan Bank are pledged to secure any debts and are limited in amount to five times the total paid-in capital of all of the Federal Home Loan Banks. If no debentures are outstanding, consolidated Federal Home Loan Bank bonds constituting the joint and several obligations of all of the Federal Home Loan Banks may be issued upon such terms and conditions as the Board may prescribe.

The Act provides that all obligations of Federal Home Loan Banks shall plainly state that such obligations are not obligations of the United States and are not guaranteed by the United States.

It is now proposed to amend section 14(b) of the Federal Reserve Act to make bonds, debentures or other obligations issued under the provisions of the Federal Home Loan Bank Act, as amended, eligible for purchase and sale in the open market.

ANALOGY BETWEEN FARM CREDIT ADMINISTRATION AND
FEDERAL HOME LOAN BANK SYSTEM WITH RESPECT
TO AVAILABILITY OF FEDERAL RESERVE FUNDS
UNDER EXISTING LAW.

Bonds of the Federal Farm Mortgage Corporation pursuant to the provisions of section 14(b) of the Federal Reserve Act may be bought and sold by Federal Reserve banks.

Correspondingly, bonds of the Home Owners Loan Corporation pursuant to the provisions of section 14(b) of the Federal Reserve Act may be bought and sold by Federal Reserve banks.

Bonds of the Federal Farm Mortgage Corporation may be exchanged for consolidated Farm Loan bonds issued under the Federal Farm Loan Act.

Correspondingly, bonds of the Home Owners Loan Corporation may be used by the Home Owners Loan Corporation to acquire Federal Home Loan Bank bonds, debentures or notes of consolidated Federal Home Loan Bank bonds or debentures, at present within the limit of the \$300,000,000 allocated for that and other purposes and, if the proposed amendment to section 4(n) of the Home Owners Loan Act is enacted, within the limit of the unused bond authorization of that Corporation (\$1,500,000,000).



Bonds of both the Federal Farm Mortgage Corporation and the Home Owners Loan Corporation are fully guaranteed as to principal and interest and pursuant to the proviso added to section 14(b) of the Federal Reserve Act by amendment at the time of the enactment of the Banking Act of 1935 these bonds may now be bought and sold without regard to maturities.

Section 943 of Title 12 U. S. C. A. provides as follows:

"Any Federal Reserve bank may buy and sell farm loan bonds issued under this chapter to the same extent and subject to the same limitations placed upon the purchase and sale by said banks of State, county, district and municipal bonds under section 14(b) of the Federal Reserve Act of December 23, 1913 (maturities from date of purchase of not exceeding six months)."

Paragraph 3 of section 13(a) of the Federal Reserve Act provides as follows:

"Any Federal reserve bank may also buy and sell debentures and other such obligations issued by a Federal Intermediate Credit Bank or by a National Agricultural Credit Corporation, but only to the same extent as and subject to the same limitations as those upon which it may buy and sell bonds issued under Title I of the Federal Farm Loan Act."

Drawing an analogy the Federal Home Loan Bank Board asserts that inasmuch as Farm Loan bonds and Intermediate Credit Bank obligations may be bought and sold, obligations of the Federal Home Loan Banks should likewise be made eligible for purchase and sale by Federal Reserve banks under section 14(b) of the Federal Reserve Act. The suggested amendment to accomplish this purpose would make "bonds, debentures or other obligations issued under the provisions of the Federal Home Loan Act, as amended," eligible for purchase without reference to maturity.

It may be pointed out, however, that since the proposed amendment would permit the purchase of Federal Home Loan Bank obligations without reference to the maturity thereof, whereas, the purchase of Farm Loan bonds and Intermediate Credit Bank obligations is limited to obligations with maturities not exceeding six months from the date of purchase, the eligibility of Federal Home Loan Bank obligations for purchase by Federal Reserve banks would be broader than that of Farm Loan bonds and Intermediate Credit Bank obligations.

Respectfully submitted,



J. P. Dreibelbis,
Assistant General Counsel.

April 21, 1957

Mr. Eccles

Attached memorandum

J. M. Daiger

Apropos of my memorandum to you of April 17 on the legislative proposals made by the Federal Home Loan Bank Board, you may wish to have the attached summary showing loans and investments made by the Federal Government to assist building and loan associations.

A handwritten signature in dark ink, appearing to read "J. M. Daiger", is written over a horizontal line. The signature is slanted and includes a large, stylized initial "J".

LOANS AND INVESTMENTS BY FEDERAL GOVERNMENT

IN BUILDING AND LOAN ACTIVITIES

Bonds of Home Owners' Loan Corporation as of June 12, 1936, given in exchange for mortgages in distress held by building and loan associations.	\$ 875,500,000
Paid subscription from Federal funds as of January 1937 for stock of the Federal Home Loan Banks - 99.7% of whose member institutions are building and loan associations.	119,972,500
Loaned by the Reconstruction Finance Corporation as of November 30, 1936, to building and loan associations (including receivers of building and loan associations).	116,559,180
Paid subscription by the United States Treasury and Home Owners' Loan Corporation as of January 15, 1937, for shares of the Federal Savings and Loan Associations.	177,084,200
Paid subscription by the Home Owners' Loan Corporation as of January 15, 1937, for shares of State building and loan associations.	22,094,900
Paid subscription by Home Owners' Loan Corporation as of November 30, 1936, for shares of the Federal Savings and Loan Insurance Corporation - only building and loan associations are eligible for this insurance protection.	<u>100,000,000</u>
Total	\$1,411,010,780
Amount repaid as of November 30, 1936, by building and loan associations to Reconstruction Finance Corporation.	<u>115,845,175</u>
Net amount of funds loaned or invested by the Federal Government in building and loan associations and in instrumentalities of the United States serving principally building and loan associations.	\$1,297,165,605

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM**Office Correspondence**Date April 19, 1937To Mr. EcclesSubject: Open-Market Operations ProposedFrom J. M. Daigerby Federal Home Loan Bank Board

These proposals seem to me to have very far-reaching implications that I think you will wish to consider and perhaps present to the Board of Governors as well as the Secretary of the Treasury and the Acting Director of the Budget. I have gone into the matter fully in order that you may see the relationship of these proposals to the credit-expansion program of the building and loan group.



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 17, 1937

To Mr. Eccles

Subject: Open-Market Operations Proposed

From J. M. Daiger

by Federal Home Loan Bank Board

Mr. Preston Delano, Governor of the Federal Home Loan Bank System, wishes to obtain an expression of your views regarding two provisions of a bill which the Federal Home Loan Bank Board has submitted to the Acting Director of the Budget "for consideration and for presentation to the President and for advice as to the position of the President in reference to the same."

As both the provisions to which Mr. Delano refers involve matters of open-market operation, and as both seem to me to carry implications that are questionable from the point of view of credit and fiscal policy, I am giving to you herewith the substance of the two provisions, a summary of the arguments made in support of them, and my own comments and suggestions in regard to them.

The provisions take the form of an amendment to paragraph (b) of section 14 of the Federal Reserve Act and an amendment to subsection (n) of section 4 of the Home Owners' Loan Act. The present and proposed forms of these measures are appended to this memorandum. (Appendix A)

Proposed Amendment to Federal Reserve Act

Paragraph (b) of section 14 of the Federal Reserve Act would

be amended to include bonds, debentures, and other obligations of the Federal Home Loan banks among the securities which the Federal Reserve banks are authorized to buy and sell. The authorization would be permissive only and would apply only to open-market transactions, but there would be no limitation as to maturities.

Proposed Amendment to Home Owners' Loan Act

Subsection (n) of section 4 of the Home Owners' Loan Act would be amended to the following effect:

1. The \$500,000,000 previously made available to the Home Owners' Loan Corporation for (a) the purchase of Federal Home Loan Bank bonds, debentures, or notes, (b) the purchase of shares, certificates of deposit, or investment certificates of member or insured savings-and-loan institutions, and (c) the making of deposits in such institutions, would henceforth be available exclusively for the purchase of shares, certificates of deposit, or investment certificates.

2. The unused bond authorization of the Home Owners' Loan Corporation (approximately \$1,500,000,000) would be made available to the Corporation for the purchase of Federal Home Loan Bank obligations. The sale of HOLC bonds for this purpose would be subject to the approval of the Secretary of the Treasury, but the funds subsequently realized by the HOLC

from the sale or payment of Federal Home Loan Bank obligations would be available for reinvestment in similar support of the Federal Home Loan Bank System.

Relevant Provisions of the Reilly Bill

In connection with the foregoing proposals of the Federal Home Loan Bank Board, relevant provisions of the Reilly Bill (H.R. 5420) should also be noted. This bill was introduced by Congressman Reilly of Wisconsin at the request of the United States Building and Loan League. Mr. Merton Bodfish, executive vice-president of the League, informed me that he drafted the bill after consultation with officials of the HOLC and indicated that they regarded its provisions favorably. The provisions of the Reilly Bill relating to Federal Reserve matters are, briefly, as follows:

1. Section 13 of the Federal Reserve Act would be amended to authorize the Federal Reserve banks (a) to buy debentures or bonds issued by the Federal Home Loan banks; (b) to make loans to Federal Home Loan banks "upon the security of notes or notes secured by mortgage or other real-estate lien;" and (c) to authorize the Federal Reserve banks to "rediscount such notes and notes secured by mortgage or other lien on real estate with the endorsement of such Federal home loan banks." The Board of Governors would be

authorized to prescribe rules and regulations "not inconsistent herewith."

2. Section 14 of the Federal Reserve Act would be amended to authorize the Federal Reserve banks to buy and sell bonds, debentures, or other obligations of the Federal Home Loan banks. No limitation is made as to maturities and, unlike the draft prepared by the Federal Home Loan Bank Board, transactions are not limited to the open market.

The full text of the foregoing provisions, which appear as sections 11 and 12 of the Reilly Bill, are appended to this memorandum (Appendix B). Apropos of them, Mr. Bodfish has written to me as follows: "I doubt if there will be any particular objection to any of the sections except 11 and 12, and I really believe it would be both fair and wise to give the same privileges to the twelve Federal Home Loan Banks as are now enjoyed by the Federal Intermediate Credit Banks."

General Argument for Home Loan Bank Board Proposals

Mr. Delano is of the opinion that a concerted effort will be made during the present session of Congress to obtain further legislation to strengthen the Federal Home Loan Bank System. This effort, he says, will have behind it "a pretty damned powerful lobby." On the one hand, there is the proposal of the United States Building and Loan League to give to the Federal Home Loan banks, and thus indirectly to

their 3,800 member institutions, borrowing and rediscount privileges at the Federal Reserve banks that the law denies to Federal Reserve member banks. As you know, some of the high officials of the Federal Home Loan Bank System have themselves been disposed to urge that the Federal Home Loan banks be given power of note issue comparable to that of the Federal Reserve banks, or else that the Federal Home Loan banks be admitted to membership in the Federal Reserve System in order that their member institutions might thereby have indirect access to the Federal Reserve banks. These officials have contended, as have the building-and-loan people, that "some way" must be found to assure the Federal Home Loan banks of currency when they need it to meet the demands on their member institutions.

The provisions of the Reilly Bill that would open the reserve banks to the building and loan associations reflect, then, something more than the views of Mr. Bodfish and the objectives of the lobby that Mr. Delano speaks of. They reflect what was until comparatively recent months at least, even if it is so no longer, a substantial body of opinion within the organization of the Federal Home Loan Bank Board.

Mr. Delano apparently regards these various ideas as extreme and impracticable, but also apparently thinks that they will have a good deal of support in Congress. On the other hand, available as an

alternative, are the provisions of the bill prepared for the Federal Home Loan Bank Board by its general counsel, Mr. Horace Russell. Mr. Delano holds that the two open-market provisions, as I have called them, in Mr. Russell's draft, are far more moderate than the Federal Reserve provisions in Mr. Bodfish's draft; that they avoid the controversial aspects of the latter; and that their sponsorship by the Administration, with the assent of the Secretary of the Treasury and the Board of Governors of the Federal Reserve System, would effectually preclude the adoption of measures which the Treasury and the Reserve System would find objectionable, but which, in the absence of an Administration bill, Congress would be under great pressure to enact in the interest of the Federal Home Loan Bank System.

Arguments in Behalf of "Psychological Amendments"

Speaking quite frankly, Mr. Delano says his Board feels that the Federal Home Loan Bank System "needs dressing up with a few psychological amendments." The authority for the Federal Reserve banks to buy Federal Home Loan bank obligations in the open market is sought as a sort of "window dressing" to help the sale of those obligations. The authorization being purely permissive, it might never be availed of by the Open Market Committee of the Federal Reserve System; nevertheless its inclusion in the Federal Reserve Act would be "a good talking point" in respect of Federal Home Loan Bank bonds and debentures.

So with the proposed authority for the HOLC to sell up to \$1,500,000,000 more of bonds. The availability of such a revolving fund for use in supporting the market for Federal Home Loan Bank securities would of course be a very strong talking point. The authorization, however, would be permissive only, and the sale of HOLC bonds would in any case be subject to the approval of the Secretary of the Treasury.

Mr. Delano says that his Board wishes to make a special effort to round out the Federal Home Loan Bank System by making it representative of the life insurance companies and mutual savings banks as well as of the building and loan associations. In this effort, the Board believes, it needs some such strong inducement to membership as the potential reserve of \$1,500,000,000 would represent. The development of "a real home-mortgage system" is seen, therefore, as a very compelling reason why the unused bond authorization of the HOLC should be made available in the manner which the Board has proposed.

The further point is made that, if the present unused bond authorization of the HOLC were thus "frozen" for the purpose of supporting the Federal Home Loan Bank System, there would be an end to various efforts to have the \$1,500,000,000 made available for other purposes, chief among them being a resumption of direct lending to distressed home owners.

Arguments Relating to Farm Credit Administration

Mr. Delano and Mr. Russell in discussing the proposals of the Federal Home Loan Bank Board, and Mr. Bodfish in discussing the proposals of the United States Building and Loan League, have each drawn certain analogies between privileges already enjoyed by the Farm Credit Administration, or by agencies under its supervision, and the privileges now sought in behalf of the Federal Home Loan Bank System. Thus Mr. Delano points out that the Federal Reserve banks have authority to purchase obligations of the Federal Farm Mortgage Corporation, the Federal Land banks, and the Federal Intermediate Credit banks. Noting that this authorization is limited to obligations having maturities of not more than six months from date of purchase, he suggests that at least a similar authorization with respect to Federal Home Loan Bank securities would be unobjectionable, even if the Board of Governors should not look favorably on the proposal to authorize the purchase of these securities by the reserve banks "without regard to maturities."

Of the proposed amendment to make the present unused borrowing power of the HOLC available for investment in Federal Home Loan Bank obligations, Mr. Russell states in the covering memorandum to the Acting Director of the Budget: "At present, the Federal Farm Mortgage Corporation can supply funds to the farm credit corporations, such as the Federal Land Banks, by purchase of their bonds, and this amendment is

designed to enable the Federal Home Loan Bank Board to employ the remaining resources of the Home Owners' Loan Corporation in the support of the Federal Home Loan Bank System, if necessary."

In this same connection Mr. Delano observes that the Federal Farm Mortgage Corporation has a bond authorization of \$2,000,000,000 available to support the market for Federal Land Bank bonds, and that under this authorization the Corporation has purchased some \$700,000,000 of such bonds. He cites this as evidence that the proposal to make \$1,500,000,000 available to the Home Owners' Loan Corporation for a similar purpose has ample precedent and should meet with no valid objection.

Objections to the General Argument

The first thing to be said of all these arguments is that the reasoning behind them is very much oversimplified and that they proceed for the most part upon mistaken assumptions.

To begin with, the general argument for the two open-market proposals of the Federal Home Loan Bank Board is an argument for political expediency on the part of the Administration in combatting what is purported to be a formidable building-and-loan lobby. The assumption is that a pressure group exists to which important concessions must be made; in other words, that the Administration is under the practical necessity of choosing between a radical change in the composition of

the Federal Reserve System on the one hand and, on the other, the creation of a huge potential reserve fund, based upon Federal credit, for the Federal Home Loan Bank System.

Since you and I have had virtually a parallel experience over the past four years in dealing with the so-called building-and-loan lobby, I think you will agree that the lobby in question consists in the main of one very resourceful young man, who is not, however, as our experience has shown, altogether invincible. The crux of the matter in dealing with the lobby, therefore, is a matter of will and intention on the part of the Administration and not a political necessity of surrender or compromise.

The great difficulty, now as in the past, is to differentiate between pressure from without and pressure from within; to differentiate, that is, between what the building-and-loan lobby is after and what the governmental agencies directly concerned are after; to differentiate between private maneuvering for advantage or expansion and official maneuvering for advantage or expansion. As you have put it more than once: "The trouble is you never know where you stand with these fellows; you just have to watch them all the time." What can be said with certainty is that, regardless of the origin and authorship of a given proposal or set of proposals, the building-and-loan group and the HOLC group are alike habitually building-and-loan minded rather than financial minded.

They can usually be found aiming at pretty much the same objectives, urging pretty much the same arguments, and in any event seeking special favors for building and loan associations. This was the case in 1953, 1954, 1955, and 1956. It is again plainly the case in 1957.

The present proposals of the United States Building and Loan League and of the Federal Home Loan Bank Board have a common origin in the natural resentment of the building-and-loan people toward the enlarged real-estate-loan and eligibility provisions of the Banking Act of 1935. When that measure was pending in Congress, the building-and-loan people were lobbying against it. Their contention was that real-estate loans had no place at all in demand-deposit institutions, and that the proposals which you had put forward would simply make a bad situation worse. They argued that to authorize national banks to use a larger proportion of their assets for real-estate loans, and to make long-term amortized loans on real estate, was to encroach on the building-and-loan field and to improve the competitive position of national banks in relation to building and loan associations. They argued further, with forcible logic, that the enlarged eligibility provisions gave to real-estate paper held by Federal Reserve member banks an exceptional status which no other real-estate paper possessed, and that this preference given by the Government to the member banks placed the building and loan associations at an extreme competitive disadvantage.

The building-and-loan opposition was not pressed in the open, however, because the personal and political factors were in your favor right where Mr. Bodfish ordinarily found them in his favor. He was well advised, as I informed you at the time, not to embarrass friends of his who were committed to your support (or at any rate not in a position to oppose you) and not to embarrass himself by a defeat from which they could not then save him. Partly because of these considerations, and partly because he was unable to get the mutual savings banks and the life insurance companies to join the building and loan associations in an attack before the Congressional committees, Mr. Bodfish withdrew his request for a hearing of himself and other building-and-loan witnesses against your proposals. But the Banking Act of 1935 has been gall and wormwood in the Federal Home Loan Bank System ever since.

It has been only a question of time, therefore, when the United States Building and Loan League and the Federal Home Loan Bank Board would come forward with a plan to "compensate" the building and loan associations for the liquidity presumably given by the Banking Act of 1935 to real-estate paper held by member banks. You and I have been hearing Mr. Fahey, Mr. Delano, Mr. Russell, and Mr. Bodfish talk about this in one form or another for the past eighteen months. At first it appeared that the building-and-loan group and the HOLC group would make a concerted effort to obtain borrowing and discount privileges at the

Federal Reserve banks for the Federal Home Loan banks. The circumstances under which the Reilly Bill subsequently originated tended to confirm that earlier impression. More recently, however, the HOLC open-market or central-reserve plan has been proposed as an alternative.

The important point to be noted here is that the essence of the two sets of proposals is the same--namely, that an additional source of borrowing and discount must be provided for the Federal Home Loan banks, so that they in turn may be assured of funds to meet the demands on their institutions. The essential question to be determined, then, is not whether the building-and-loan lobby can be conciliated in a manner unobjectionable to the Treasury and the Federal Reserve System, but whether the home-mortgage institutional situation calls for the additional borrowing and discount facilities that the bill drafted by Mr. Bodfish would obtain through the Federal Reserve banks and that the bill drafted by Mr. Russell would obtain through the sale of Government-guaranteed bonds in the open market.

In short, I think that Mr. Delano is unduly alarmed over the building-and-loan lobby and quite unnecessarily concerned about the threat of the Reilly Bill to the Federal Reserve System. The Reilly bill was threatening only insofar as it may have embodied the aims of both the building-and-loan people and the HOLC people, whose combined political strength is obviously very great. Once the alternative plan

of the Federal Home Loan Bank Board were devised, however, the Federal Reserve provisions of the Reilly Bill were effectually disposed of. For Mr. Bodfish is sensible enough to have no pride of authorship. He would be the first to concede that the availability in the HOLC of a \$1,500,000,000 open-market or central-reserve fund is a far better proposition for the building and loan associations than anything he had proposed in the Reilly Bill.

Hence, if there is to be during the present session of Congress, as Mr. Delano suggests, a concerted effort to "strengthen the Home Loan Bank System," it will be because a governmental agency is pressing for a larger measure of new assistance to building and loan associations than their own trade body has asked for.

Objections to the "Window-Dressing" Arguments

From the point of view of Federal Reserve policy, there could scarcely be any objection to a proposal to make Federal Home Loan Bank obligations of short maturity available for open-market operations of the Federal Reserve banks. Such a proposal would be wholly in accord with a variety of provisions in existing law. But this is not the proposal submitted by the Federal Home Loan Bank Board to the Acting Director of the Budget.

The proposal as submitted is "without regard to maturities." The principal objection to it, therefore, is that it singles out one

class of non-governmental paper from all others and puts it into a special category now reserved to direct and guaranteed obligations of the Government. Manifestly, a departure of this kind could not, as a matter of legislative or financial policy, be confined to the bonds of the Federal Home Loan banks; for these bonds possess no peculiar elements that set them above all other corporate issues which, like these, carry no governmental guarantee.

The proposal is not objectionable from the broad point of view of central-banking operation. Theoretically, it might well be argued, the monetary authorities ought to be free to engage in whatever open-market operations would in their judgment give effect to the credit policies for which their operations were projected. It might even be argued that they ought to be free to ease the credit position of the Federal Home Loan banks if such an operation appeared to be in the public interest and compatible with the general credit conditions existing at the time. Such an argument, however, would be susceptible of indefinite extension to a great variety of special situations in the capital markets for which the Federal Reserve Act makes no provision.

The suggestion that the proposed amendment to the Federal Reserve Act would confer merely a permissive power, and hence need not be exercised by the Federal Reserve authorities if they were disposed to disregard it, is not one that could be countenanced with propriety

simply to help the sale of Federal Home Loan Bank securities. That would be making a show window of the Federal Reserve Act, besides being altogether at variance with the ethical standards contemplated in the Securities Exchange Act. Furthermore, no exaggerated imagination is required to see that, if the Board of Governors now formally or tacitly assents to the enactment of the amendment as proposed, the Open Market Committee would in all probability at some time in the future be under pressure to act in accordance with it, and would be subjected to questioning and criticism if it failed to do so.

The suggestion that the authority to create a huge revolving fund for support of the Home Loan Bank System would likewise be permissive only, and hence would not necessarily be availed of, is what William James, who was the leading American psychologist of his day, would have called "monstrously simplified." It ignores the plain evidence of experience with the pressure groups that have in recent years obtained such a large measure of governmental assistance for the building and loan associations. There may be arguments which can be advanced to demonstrate that an additional \$1,500,000,000 of Federal credit should be made available in support of the Federal Home Loan Bank System, but the idea that the present proposal is moderate, or tentative, or more psychological than real, is far too simple to be considered seriously.

In these circumstances, it is hardly necessary to argue the

point that the main body of mutual savings banks and life insurance companies would not respond to mere psychological treatment. The great majority of these institutions have thus far resisted all efforts to bring them into the Home Loan Bank System, and the reasons for this are well known. The System was designed from the outset with building and loan associations primarily in view; it has from the outset been dominated by the building-and-loan group. This is no doubt attributable in large part to the original apathy of the mutual savings banks and life insurance companies—to their superior feeling of self-sufficiency—which left the building-and-loan group unopposed in shaping the pattern of the System and the terms of membership in it to their own advantage as against the other groups.

The fact nevertheless remains indisputable that these two large groups are for the most part now hostile to the System, first because they regard it as a vested interest of the building and loan associations, and second because they regard many of its activities as competitive rather than cooperative with their own interests. Moreover—and this is probably the principal reason for their abstention from membership—the mutual savings banks and life insurance companies are not primarily home-mortgage institutions, so that membership could only afford them in any event a relatively small advantage. It may therefore

reasonably be asked whether the plan proposed by the Federal Home Loan Bank Board is not too high a price for the Federal Government to offer as an inducement to these groups to do what not even the experience of the recent depression could induce them to do.

The availability of the proposed revolving fund would unquestionably make it possible for the Home Owners' Loan Corporation to support the market for Federal Home Loan Bank bonds in a period ^{of} general credit stringency. It would thus be able to supply funds to the member institutions of the Federal Home Loan Bank System. In such a period, however, the fiscal and monetary authorities of the Government would necessarily have as a principal concern the market for Treasury securities, and the injection into the market at that time of additional guaranteed obligations of the Government to relieve pressure on the obligations of the Home Loan banks would be a complicating rather than an ameliorating factor. The practical problem, then, would be one of emergency lending and not one of open-market operation.

At other times no such huge fund as that proposed would be required for the purpose of supporting the Home Loan bond market. The problem would be only a temporary one, such as the maintenance of the market against offerings that might interfere with the sale of a new issue. The current Federal Home Loan Bank Review shows the outstanding advances of the Home Loan banks as \$141,205,000 and the total borrowing

Mr. Daiger's office called re JMD's memo to MSE of April 17, 1937 entitled Open Market Operations Proposed by Federal Home Loan Bank Board. He wants you to detach pages 19 to 23 inclusive and bring them to Mr. Eccles' attention

APPENDIX A

Present Form of Paragraph (b), Section 14, Federal Reserve Act

Every Federal reserve bank shall have power:

(b) To buy and sell, at home or abroad, bonds and notes of the United States, bonds of the Federal Farm Mortgage Corporation having maturities from date of purchase of not exceeding six months, bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended, and having maturities from date of purchase of not exceeding six months, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System: Provided, That any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities but only in the open market;

Proposed Form of Paragraph (b), Section 14, Federal Reserve Act

Section 22. Paragraph (b) of Section 14 of the Federal Reserve Act, as amended, is further amended to read as follows:

"(b) To buy and sell, at home or abroad, bonds and notes of the United States, bonds of the Federal Farm Mortgage Corporation having maturities from date of purchase of not exceeding six months, bonds, debentures or other obligations issued under the provisions of the Federal Home Loan Bank Act, as amended, bonds issued under the provisions of subsection (c) of section 4 of Home Owners' Loan Act of 1933, as amended, having maturities from date of purchase of not exceeding six months, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage

and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board. Provided, that any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest, and obligations issued pursuant to the provisions of the Federal Home Loan Bank Act, as amended, may be bought and sold without regard to maturities but only in the open market."

Present Form of Subsection (n), Section 4, Home Owners' Loan Act

(n) The Corporation is authorized to purchase Federal Home Loan Bank bonds, debentures, or notes, or consolidated Federal Home Loan Bank bonds or debentures. The Corporation is also authorized to purchase full-paid-income shares to Federal Savings and Loan Associations after the funds made available to the Secretary of the Treasury for the purchase of such shares have been exhausted. Such purchases of shares shall be on the same terms and conditions as have been heretofore authorized by law for the purchase of such shares by the Secretary of the Treasury: Provided, That the total amount of such shares in any one association held by the Secretary of the Treasury and the Corporation shall not exceed the total amount of such shares heretofore authorized to be held by the Secretary of the Treasury in any one association. The Corporation is also authorized to purchase shares in any institution which is (1) a member of a Federal Home Loan Bank, or (2) whose accounts are insured under title IV of the National Housing Act, if the institution is eligible for insurance under such title; and to make deposits and purchase certificates of deposit and investment certificates in any such institution. Of the total authorized bond issue of the Corporation \$300,000,000 shall be available for the purposes of this subsection, without discrimination in favor of Federally chartered associations, and bonds of the Corporation not exceeding such amount may be sold for the purposes of this subsection.

Proposed Amendment to Subsection (n), Section 4, Home Owners' Loan Act

Section 17. The last sentence of subsection (n) of Section 4 of Home Owners' Loan Act of 1933, as amended, is amended to read as follows:

"Of the total authorized bond issue of the Corporation, \$300,000,000 shall be available for the purchase of shares, certificates of deposit or investment certificates of any member or insured

institution as hereinbefore authorized, without discrimination in favor of Federally chartered associations, and bonds of the Corporation not exceeding such amount may be sold for such purposes; and the total amount of unused bond authorization of the Corporation shall be available for the other purposes of this subsection and bonds of the Corporation not exceeding such amounts may be sold, subject to the approval of the Secretary of the Treasury, for such purposes; and any funds realized by the Corporation upon, or from the sale of, investments made under the provisions of this subsection in Federal Home Loan Bank bonds, debentures, or notes, or consolidated Federal Home Loan Bank bonds or debentures may be reinvested by the Corporation at any time in said bonds, notes and debentures."

APPENDIX B

Relevant Provisions of the Reilly Bill

SEC. 11. Section 15 of the Federal Reserve Act, as amended, is further amended by adding the following two new sections:

"SEC. 15b. Any Federal Reserve bank may, under rules and regulations not inconsistent herewith prescribed by the Board of Governors of the Federal Reserve System, buy debentures or bonds issued pursuant to the provisions of section 11 of the Federal Home Loan Bank Act, as amended.

"SEC. 15c. Any Federal Reserve bank may, subject to regulations not inconsistent herewith prescribed by the Board of Governors of the Federal Reserve System, make loans to Federal home loan banks upon the security of notes or notes secured by mortgage or other real-estate lien taken by such Federal home loan banks pursuant to the Federal Home Loan Bank Act, as amended, and any Federal Reserve bank is authorized to rediscount such notes and notes secured by mortgage or other lien on real estate with the endorsement of such Federal home loan banks."

SEC. 12. Paragraph (b) of section 14 of the Federal Reserve Act, as amended, is hereby further amended so as to read as follows:

"(b) Every Federal Reserve bank shall have power to buy and sell, at home or abroad, bonds and notes of the United States, bonds of the Federal Farm Mortgage Corporation having maturities from date of purchase of not exceeding six months, bonds, debentures, or other obligations issued under the provisions of section 11 of the Federal Home Loan Bank Act, as amended, bonds issued under the provisions of subsection (c) of section 1465 of this title and having maturities from date of purchase of not exceeding six months, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage, and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board: Provided, That any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities but only in the open market."