Miss Egbert

June 13, 1947

PERSONAL AND CONFIDENTIAL

Honorable A. L. M. Wiggins,
Under Secretary of the Treasury,
Washington, D. C.

Dear Lee:

I am enclosing a copy of a letter which the Board is sending to Senator Tobey, the Chairman of the Banking and Currency Committee of the Senate, covering certain bills sponsored by the Savings and Loan and the Home Loan Bank groups.

I am sure that the Treasury is interested in this legislation and, accordingly, will be interested in reading the Board's reply. I believe that you, as a former banker, will be in complete harmony with the Board's position.

Sincerely yours,

(Signed) Marriner

M. S. Eccles,
Chairman.

Enclosure

MSE/mg

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Federal Reserve Bank of St. Louis

June 13, 1947

Honorable Charles W. Tobey, Chairman,
Committee on Banking and Currency,
United States Senate,
Washington, D. C.

Dear Senator Tobey:

This is in response to Mr. Hill's letter requesting an opinion as to the merits of the bills S. 1176 and S. 1178 which have been referred to the Senate Committee on Banking and Currency. These bills are substantially the same as H. R. 2800 and H. R. 2799, recently passed by the House of Representatives. The bills S. 804 and S. 1149 are similar in certain respects to S. 1178.

For the reasons discussed below, the Board believes that none of these bills should become law in their present form. One of these bills, S. 1176, would substantially extend the lending power of Federal savings and loan associations by permitting them to make unsecured loans for a wide variety of purposes. The second bill, S. 1178, would have the effect of making a gift of nearly 36 million dollars from the United States Treasury to the Federal Savings and Loan Insurance Corporation, and would reduce the premium rate for insurance by that Corporation from one-eighth to one-twelfth of one per cent.

S. 1176 would amend section 5 of the Home Owners' Loan Act so as to permit Federal savings and loan associations to invest up to 15 per cent of their assets in loans insured under Title I of the National Housing Act, in loans guaranteed or insured as provided in the Servicemen's Readjustment Act of 1944, or in other loans for property alteration, repair, or improvement, so long as no such loan exceeded $1500. The purpose of this amendment is to remove, as far as loans of the types named are concerned, the present requirement that all loans made by Federal associations must be secured by first liens on real estate or by share accounts.

The Board has previously said that it has no objection to permitting Federal associations to make loans for property alteration, repair, or improvement insured under Title I of the National Housing Act and secured by notes alone. We are opposed, however, to permitting

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these institutions to make unsecured loans which are not insured or to make loans for purposes completely unrelated to real estate, such as would be eligible under the Servicemen's Readjustment Act. As we have pointed out on other occasions, such extensions of lending powers take these associations along the road to the general banking business, but without subjecting them to the restrictions which have been found to be essential to a sound banking system.

Section 3 of S. 1178 would authorize and direct the Insurance Corporation to retire its capital stock, using for this purpose all its assets in excess of 150 million dollars. However, the total amount paid as dividends on the stock would be deducted from the amount to be paid to the Home Owners' Loan Corporation for the retirement of the stock. Moreover, the amount of the capital stock would continue to be available to the Insurance Corporation by virtue of a requirement that, on the initiative of the Insurance Corporation, the Secretary of the Treasury would purchase obligations of the Insurance Corporation equal to the amount of capital stock thus retired.

It may be well at this point to recall that the Federal Savings and Loan Insurance Corporation was created by Title IV of the National Housing Act, enacted June 27, 1934, with a capital of 100 million dollars, and that the Act provided that the capital should be supplied through an exchange of 100 million dollars of the bonds of HOLC for the stock of the Insurance Corporation, that the stock should yield dividends to HOLC at a rate equal to the interest rate on the bonds and that the dividends should be cumulative.

We are in agreement with the general purpose of Section 3 of S. 1178, which is to retire the Government capital of the Federal Savings and Loan Insurance Corporation, but we do not believe that it is in the public interest to forgive the dividends due from the Insurance Corporation to the HOLC. If the effect of forgiving these dividends were merely to give the Insurance Corporation free use of its capital, we should not object, since this course has been followed with many Government corporations.

The effect of forgiving these dividends, however, would be to make a gift of close to 36 million dollars from the United States Treasury to the Federal Savings and Loan Insurance Corporation, over and above the free use of its capital. Each year since 1934 the HOLC has paid in cash to the Insurance Corporation 3 million dollars as interest on its bonds. Since June 30, 1935, however, the Insurance Corporation, instead of repaying the 3 million dollars as dividends, has credited this amount to an account which appears in the balance sheet as "Reserve for Contingencies."

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At the end of 1946 this account showed a balance of 34.5 million dollars, and on June 30, 1947, it will show a balance of 36 million. Section 3 of S. 1178 would, in effect, remove the statutory liability of the Insurance Corporation for dividends and thus enrich the Insurance Corporation by 36 million dollars.

Section 4 of S. 1178 would reduce the insurance premium of the Insurance Corporation from one-eighth of one per cent to one-twelfth of one per cent of the total amount of all accounts of the insured members of the institution plus any creditor obligations of the institution, and would reduce the rate of assessment to meet losses and operating expenses likewise from one-eighth of one-twelfth of one per cent. In this connection, it should be remembered that, under Title IV of the National Housing Act as originally enacted in 1934, each institution was to pay an annual insurance premium calculated as one-fourth of one per cent. This premium was to be paid each year in which the reserve fund of the Insurance Corporation was less than 5 per cent of the insured accounts and creditor obligations of all insured institutions. The Corporation was also authorized to assess insured institutions each year for losses and expenses of the Corporation, in an amount not to exceed the insurance premium. By the Act of May 28, 1935, the premium rate and assessment rate were reduced from one-fourth of one per cent to one-eighth of one per cent, but the other provisions were left unchanged.

In any discussion of reduction of the insurance premium, the treatment of the above-mentioned "Reserve for Contingencies" of 36 million dollars is important, since this reserve -- paid by HOLC as interest on its bonds -- amounts to almost half of the total reserve of the Insurance Corporation. Thus, when advocates of a reduction of the insurance premium say that the reserves of the Corporation amount to almost 1.4 per cent of the insured liability, they are counting these funds, which should be paid to HOLC, as being available to meet insurance claims. If this reserve is disregarded, as it seems to us it properly must be in this connection, the reserves of the Corporation amount to about six-tenths of one per cent of the insured liability.

In view of the intent of Congress, expressed in the statute at a time when the premium rate was set at one-fourth of one per cent, that the Corporation's reserve should be built up to 5 per cent of the insured liability, it seems clear that no sound grounds exist for reducing the insurance premium at this time.

The Board appreciates the fact that, should insurance claims at any time exceed the reserve built up by the Corporation out of operating

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revenues, the United States Treasury will have to assume the liability as a matter of public policy, and that at such a time it matters little whether the Corporation borrows from the Treasury, uses money owed to the Treasury, or impairs the capital owned by the Treasury. The Board feels very strongly, however, that while it can, the Corporation should be allowed to build up reserves, and that these reserves should be built up out of revenue and not from public gifts.

Very truly yours,

(s) M. S. ECCLES

M. S. Eccles,
Chairman.

RW:GHC:ewe
6/11/47

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