

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 7, 1938

Chairman Eccles

Subject: _____

From Mr. Dreibelbis, Assistant
General Counsel.

CONFIDENTIAL

I have reviewed the legislation proposed by the Federal Home Loan Bank Board, as outlined in the draft of January 25, 1938, primarily with respect to provisions relating to the issuance and status of its obligations. For purposes of comparison, the present powers of the Home Loan Bank in this respect are outlined herein, as well as that Board's proposal in 1937.

At the end of this memorandum I have also enumerated some other matters in which you may be interested.

POWERS UNDER THE EXISTING ACT

Under the present Act Federal Home Loan Banks are authorized severally to issue debentures, bonds, or other obligations upon such terms and conditions as the Board may approve and under certain additional conditions, to issue consolidated debentures representing the joint and several obligations of all Federal Home Loan Banks. However, it is specifically provided 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.

In this connection, Section 4(n) of the Home Owners Loan Act authorizes the Home Owners Loan Corporation (1) to purchase Federal Home Loan Bank bonds, debentures or notes or consolidated 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 applied to the purchase by the Secretary of the Treasury. For the purposes of this subsection, \$300,000,000 of the authorized bond issues by the Corporation is set aside.

PROPOSAL IN 1937

It will be recalled that in the early part of 1937 the Federal Home Loan Bank Board proposed legislation designed to amend

Section 4(n) of the Home Owners Loan Act so as to provide for the allocation of the \$300,000,000 set aside therein to the purchase of shares of Federal Savings and Loan Associations and to provide that the total amount of unused bond authorization of the Corporation (\$1,500,000,000) should 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.

At the same time it was proposed that Section 14(b) of the Federal Reserve Act be amended to make bonds, debentures or other obligations issued under the provisions of the Federal Home Loan Bank Act, eligible for purchase and sale in the open market.

PRESENT PROPOSAL

It is now proposed to repeal the last sentence of Section 15 of the Federal Home Loan Act reading as follows: "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" and to add as an additional subsection to Section 11 a subsection reading as follows:

"(i) The Secretary of the Treasury, in his discretion, is authorized to purchase any obligations issued under the provisions of section 11 of this Act, or Title IV of the National Housing Act, and for such purpose the Secretary of the Treasury is authorized to use as a public-debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under the Second Liberty Bond Act, as amended, are extended to include such purchases. The Secretary of the Treasury may, at any time, sell any of the obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such obligations shall be treated as public-debt transactions of the United States. Obligations issued under the provisions of section 11 of this Act with the approval of the Secretary of the Treasury shall be fully and unconditionally guaranteed both as to interest and principal by the United States, and such guarantee shall be expressed on the face thereof. In the event of default in the payment of interest or principal of any such obligation, the Secretary of the Treasury shall pay to the holder the amount due thereon out of any moneys in the Treasury not otherwise appropriated, and thereupon to the extent of the amount so paid, the Secretary of the Treasury shall succeed to all the rights of such holder."

It will be observed that this amendment broadens the purposes for which the Secretary of the Treasury may issue government securities under the Second Liberty Bond Act to include the issuance and use of proceeds in the purchase by the Secretary of the Treasury, in his discretion, of obligations issued under the provisions of Section 11 of this Act or Title IV of the National Housing Act.

For your information, Title IV of the National Housing Act creates the Federal Savings and Loan Insurance Corporation under the direction of a board of trustees composed of five members, the members of the Federal Home Loan Bank Board constituting such board of trustees. It is authorized to borrow money and to issue notes, bonds, debentures or other such obligations upon such terms and conditions as the board of trustees may determine. Capital of \$100,000,000 was provided by subscription by the Home Owners Loan Corporation and paid in its bonds.

Thus, the Secretary of the Treasury would be authorized to purchase obligations of the Federal Home Loan Bank and the Federal Savings and Loan Insurance Corporation and to pay for them by the issuance of government securities under the Second Liberty Bond Act, as amended.

In addition, the amendment provides that obligations issued under the provisions of Section 11 of the Federal Home Loan Bank Act "with the approval of the Secretary of the Treasury shall be fully and unconditionally guaranteed both as to interest and principal by the United States, and such guarantee shall be expressed on the face thereof". Use of the phrase "with the approval of the Secretary of the Treasury" is ambiguous to the extent that it is not clear whether it applies to obligations, the issuance of which is approved by the Secretary or to obligations the guarantee of which is approved by the Secretary.

It is further proposed (Section 23 of draft) to amend Section 13 of the Federal Reserve Act to make obligations issued pursuant to the provisions of the Federal Home Loan Bank Act eligible as collateral to member bank 15 day notes.

It is also proposed to amend Section 14 of the Federal Reserve Act by making bonds, debentures or other obligations issued under the provisions of the Federal Home Loan Bank Act having maturities from date of purchase of not exceeding six months eligible for purchase in the open market. This is the same proposal as made in 1937 except that, in 1937, no limitation with respect to maturity was suggested.

It is also proposed to amend the last proviso of such section wherein the purchase of 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 or interest, are authorized without regard to maturities by including "obligations issued pursuant to the provisions of the Federal Home Loan Bank Act, as amended". This proposal was also made in 1937 and would seem to be unnecessary under any circumstances if such obligations are to be fully and unconditionally guaranteed as suggested.

It is also proposed to amend Subsection (n) of Section 4 of the Home Owners Loan Act of 1933, referred to above, to provide that, of its total authorized bond issue, the Home Owners Loan Corporation shall make available, subject to the approval of the Secretary of the Treasury, an additional \$300,000,000 for the purchase of obligations issued under Section 11 of the Federal Home Loan Bank Act. It would also provide that any funds realized by the Home Owners Loan Corporation upon, and from the sale of, investments made under the provisions of such subsection might be used for the purchase of additional obligations.

OTHER PROVISIONS OF THE PROPOSED LEGISLATION

Underlying the proposed legislation is the thought that the Federal Home Loan Bank System "provides the only reserve established by the Government for the stabilization and protection of the home mortgage debt of the country". The proponents refer to the ability of the Federal Reserve System to support the banking system and to the authority of the Secretary of the Treasury to provide funds for the Federal Deposit Insurance Corporation by the purchase of its obligations; to the authority of the Federal Farm Mortgage Corporation and other corporations of the Farm Credit Administration; to the status of debentures issued under the National Housing Act, as amended, relating to their guarantee and exemption from taxation; and to the authority of the Secretary of the Treasury to purchase obligations of the Reconstruction Finance Corporation. From this premise it is argued that the Federal Home Loan Bank System should be placed on a basis of equality with these other instrumentalities.

On the whole, it may be said that the proposal seeks to broaden the scope of activity of the System, as well as its power.

This is illustrated in the broad declaration of policy which the proponents seek to have declared by Congress in section 1 of the proposed legislation. This proposed declaration of policy is taken largely from the President's message to Congress of November 27,

1937 in connection with the National Housing Act, to which is added certain declarations relating to the Federal Home Loan Bank System and the Federal Savings and Loan System.

Other sections of the Act in which you may be interested are:

Section 2, which would broaden the definition of a "home mortgage" which is now limited to a dwelling of for not more than four families, by permitting the Federal Home Loan Bank Board to include dwellings of such greater number of families as it might fix by regulation.

Section 4, which would broaden the scope of membership which presently includes any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company or savings bank, by including any other type of institution approved by the Board engaged in making home mortgage loans.

Section 18, which would permit the designation of "Federal Savings and Loan Associations" as "Federal Savings Associations" on the grounds that there is much discontent with the long title.

Section 20, which would amend subsection (h) of Section 5 of the Home Owners Loan Corporation Act of 1933 to provide for a basis of taxation for Federal Savings and Loan Associations and relieve "them and their savers and investors from all taxation, except that savers and investors in them will be subject to surtax, inheritance, estate and gift tax".

Section 28, which would change the name of the "Federal Savings and Loan Insurance Corporation" to "Federal Savings Insurance Corporation".

Section 33, which would reduce the insurance premium rate of the Federal Savings and Loan Insurance Corporation from 1/8th of 1 per cent to 1/12th of 1 per cent, (a) to bring the insurance premium more nearly in line with that charged by the Federal Deposit Insurance Corporation and (b) to enable insured institutions to meet competition and provide low rates on home mortgages.

In reviewing the many provisions of the proposed legislation, I have discussed only such provisions as seem to me perhaps to be of interest to you. There may be others which, not knowing precisely the scope of the review which you desire, I may have overlooked and I will be glad to give the further details of the proposal more study if you desire.

Respectfully submitted,



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Assistant General Counsel.