



OFFICE OF THE CHAIRMAN

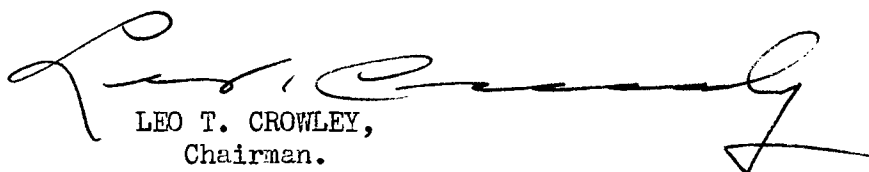
FEDERAL DEPOSIT INSURANCE CORPORATION  
WASHINGTON

February 18, 1938

My dear Marriner:

For your confidential information,  
I am enclosing a copy of our memorandum of February 17,  
addressed to Honorable D. W. Bell, Acting Director of  
the Bureau of the Budget, containing our comments re-  
garding legislation proposed by the Home Owners' Loan  
Corporation.

Sincerely yours,



LEO T. CROWLEY,  
Chairman.

Honorable Marriner S. Eccles, Chairman,  
The Board of Governors of the Federal  
Reserve System,  
Washington, D. C.

March 5, 1938.

Honorable Leo T. Crowley, Chairman,  
Federal Deposit Insurance Corporation,  
Washington, D. C.

Dear Leo:

I have considered carefully the copy of your memorandum of February 17 to Mr. Bell, Acting Director of the Budget, which was enclosed with your letter of February 18. I wish to compliment you on the memorandum which makes a very clear and effective case against certain sections of the proposed legislation sponsored by the Home Owners' Loan people.

with kind regards, I am

Yours sincerely,

M. S. Eccles,  
Chairman.

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February 17, 1938

MEMORANDUM TO:

The Honorable D. W. Bell, Acting Director  
Bureau of the Budget

Re: Proposed legislation entitled "A bill to amend the Federal Home Loan Bank Act, the Home Owners' Loan Act of 1933, the Federal Reserve Act, Title IV of the National Housing Act, and for other purposes."

Some provisions of this bill appear to effect improvements in the administrative machinery of the Home Owners Loan Corporation and related institutions and, as such, appear to be satisfactory. Many of the other provisions, however, affect the banking structure of the United States and, in the opinion of this Corporation, in an adverse or undesirable way. The Corporation believes that the proposed legislation will intensify the introduction into our financial structure of new and governmentally subsidized competitive factors, will lead to a competition in laxity among Federal supervisory agencies and between Federal and State supervisory authorities, will lower standards of banking and financial operation, will weaken the banking and financial structure, and will contribute to another breakdown of our financial mechanisms. The banking authorities have been seeking earnestly to improve standards of operation. This legislation not only will introduce practices which will make it impossible for the Federal bank supervisory agencies to continue their program of reform and improvement of standards, but also will force a relaxation of regulations in order to permit banking institutions to survive a more intensive and unsound competition promised by the provisions of this act.

Those parts of the legislation in which the Corporation has particular interest and to which it objects seek:

(a) To provide savings and loan associations with additional privileges so they can in effect transact a great deal of the business of a general banking nature rather than of a purely savings and thrift and home financing nature;

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(b) To provide duplicate and more attractive insurance facilities with Federal Savings and Loan Insurance Corporation for all institutions now eligible for insurance with the Federal Deposit Insurance Corporation.

The legislation seeks to provide savings and loan associations with additional privileges so that they can in effect transact a great deal of business of a general banking nature rather than of a purely savings and thrift and home financing nature. The sections which seek this objective are:

Section 1. Which declares it to be the policy of the United States "to promote, organize and develop local mutual thrift institutions chartered under Federal or State law to engage primarily in local home-financing under public regulation and supervision in accordance with the best practices of such institutions."

This provision presumably will take precedence over Section 5 (e) of the Home Owners' Loan Act of 1933 which provides some restraint. This measure taken in conjunction with Section 5 (j) of the Home Owners' Loan Act, as amended, would permit virtually without restraint the organization of these associations with capital supplied in part by the United States government. State bank supervisory authorities have expressed their concern over the present policy followed in the chartering of Federal Savings and Loan Associations. Federal bank supervisory agencies also are concerned over the chartering policies of the Federal Home Loan Bank Board. This amendment approves their policies and actions and removes all restraint upon them. The activities of the Federal Home Loan Bank Board along this line should be curtailed rather than expanded.

Section 17. Which amends Section 4 (n) of the Home Owners' Loan Act of 1933, to provide an additional \$300,000,000 for the purchase of obligations of Federal Home Loan Banks thus releasing the entire original \$300,000,000 for investment in full paid shares of savings and loan associations. As of November 30, 1937, approximately \$250,000,000 of the \$300,000,000 were subscribed for shares of savings and loan associations. In the case of Federal Savings and Loan Associations approximately one-fourth of the shares have been subscribed to by the Federal government. The fostering and forcing of the organization of Federal Savings and Loan Associations by use of public funds is contrary to the spirit and intent of local thrift associations. Facilities for thrift are available throughout the country through the medium

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of State savings and loan associations, savings banks, savings departments of commercial banks, credit unions, cooperative banks and postal savings offices.

Section 18. Which amends Section 5 (e) of the Home Owners' Loan Act of 1933, to provide for institutions in which people may safely invest their funds and provide that the institutions may be called Federal Savings Associations. Insertion of the word "safely" implies as a matter of public policy that all other institutions are not safe and smacks of an attempt at propaganda. The proposal to permit the institutions to call themselves Federal Savings Associations is an attempt to capitalize upon the record and reputation of the savings banks of the country and thereby to increase the competitive appeal of the institutions and to create in fact savings banks under Federal charter.

Section 19. Which amends Section 5 (c) of the Home Owners' Loan Act of 1933 by broadening considerably the powers of those institutions with regard to investment in securities so that the operations might partake more nearly of the nature of a general savings bank business.

Section 20. Which amends Section 5 (h) of the Home Owners' Loan Act of 1933, to exempt shares and income thereon of Federal Savings and Loan Associations and Federal Savings Associations from all taxation and the burden thereof, except surtaxes, inheritance, estate and gift taxes. The statement of officials of the Home Owners' Loan Corporation to the effect that this provision is necessary to enable Federal Savings and Loan Associations to meet competition and provide low cost funds for housing is incorrect. So far as we know, no other savings institution or group of institutions enjoy such exemption. As a consequence of this provision these Federal institutions would be given a real competitive advantage. Three hundred dollars of the income received from a building and loan association in any one year used to be exempt from Federal income taxes. This exemption has been repealed and all such income is taxable.

The section also makes accounts in these associations acceptable for all fiduciary, trust and public funds the investment or deposit of which shall be under the authority or control of the United States or any officer or officers thereof. The provision would act as an example to State authorities to provide comparable privileges for trust and similar funds.

Section 25 which amends Section 5136 of the Revised Statutes provides that national banks may invest in shares and accounts of Federal Savings and Loan Associations which are insured by the Federal Savings and Loan Insurance Corporation. The Federal Deposit Insurance

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Corporation is opposed to the acquisition of such assets by its insured banks. In effect it constitutes a pyramiding of credit.

The affect of the provisions listed above may be summarized briefly, as follows:

Federal Savings and Loan Associations or Federal Savings Associations, with or without a considerable part of their shares subscribed for by the Home Owners' Loan Corporation, and certainly if precedent means anything advertising that they are backed by the Federal government, enjoying tax exemption for their shareholders and permitted to pay higher rates of return to shareholders than banks are permitted to pay to savings depositors, would force all savings and loan associations and all savings banks either to federalize or to seek to obtain authority to pay higher rates of return to shareholders and depositors than would be wise in order to off-set the advantages of tax exemption. The introduction of new subsidized competitive institutions into the picture will produce serious dislocations and will result either in excess facilities or in increased mortality of institutions, or both, the cost of which would ultimately fall upon the communities involved. Enactment of these proposals would have the tendency to force commercial banks to discontinue their savings departments and business. Quite aside from the merits of any proposal to separate the commercial and savings business of a bank, recognition should be given to the nature of our existing institutions and reform undertaken only after a careful study of the problems involved and with a clear appreciation of the nature of the adjustments to be made. In our opinion these proposals are irresponsible and would drive a large number of commercial banks out of business by depriving them of a considerable part of their funds and of their revenue.

If the practice continues of exempting all worthy activities from taxation there will ultimately be no tax revenue.

The proposals seek to provide duplicate and more favorable insurance facilities with the Federal Savings and Loan Insurance Corporation for all institutions now eligible for insurance with the Federal Deposit Insurance Corporation. The sections which seek this objective are:

Section 4. Which amends Section 4 (a) of the Federal Home Loan Bank act, to make eligible for membership in the Federal Home Loan Bank System any institution which makes a mortgage loan, that is, commercial

banks. This would include banks members of the Federal Reserve System which enjoy the rediscount privileges of that System, and insured banks not members of the Federal Reserve System. The latter group of banks may now secure such privileges with the Federal Reserve System, with the permission of the Board of Governors of the Federal Reserve System, in accordance with the provisions of Section 19, Subsection (c), paragraph 4, of the Federal Reserve Act, as amended. Regulation A of the Board of Governors of the Federal Reserve System in effect makes any good asset eligible and acceptable for rediscount or as collateral for borrowing at Federal Reserve banks. While some improvement in borrowing facilities of banks may be desirable, the Corporation does not look with favor upon the proposed method of providing them.

Section 30. Which amends Section 403 of the National Housing Act, to make eligible for insurance in the Federal Savings and Loan Insurance Corporation institutions eligible for membership in the Federal Home Loan Bank System, that is, commercial banks as provided for in Section 4 above.

Section 27. Which amends Section 401 (c) of the National Housing Act, to provide for unlimited insurance on accounts of corporations, associations, or other organizations operated primarily for religious, philanthropic, charitable, educational, fraternal, governmental or other purposes and similar organizations not operated for profit. The effect of this provision is to make it possible for institutions insured with the Federal Savings and Loan Insurance Corporation to seek and obtain public funds, that is, deposits of governmental bodies, as well as funds of the other types of organizations mentioned, on more favorable competitive terms than can be offered by the banks. Such funds would be insured up to 100 percent in institutions insured with the Federal Savings and Loan Insurance Corporation and only up to \$5,000 in banks insured with the Federal Deposit Insurance Corporation. Banks may not pay interest on deposits of public funds unless such funds are in the form of time certificates, in which case they can pay only up to 2 1/2 percent depending upon the maturity of such certificates. Officials could deposit the funds in institutions insured with the Federal Savings and Loan Insurance Corporation where in practice they would be withdrawn on demand and could receive as much as 4 percent thereon. The provisions of this section definitely open the way for dangerous practices in a competition to acquire the deposits of public funds which would not be savings at all but would in fact be demand deposits. The amount of public funds involved was about \$3,500,000,000 on June 30, 1937.

Section 35. Which amends Section 405 (b) of the National Housing Act, to permit the Federal Savings and Loan Insurance Corporation to pay insured claims in cash, or by credit in a new insured account in

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another insured institution, or with three-year 2 percent negotiable debentures. The effect of this provision is to remove for the purposes of insurance any difference between insurance in commercial banks and the insurance in these savings institutions and to make available to depositors in these institutions a debenture which would most likely command a premium in the market thus increasing the attractiveness of this insurance feature. Two percent is slightly above the market rate for comparable obligations at the present time, thus assuring a premium to recipients. We have no doubt that if market developments should eliminate the premium Congress would be requested to permit the Corporation to adjust the rates.

Section 33. Which amends Section 404 of the National Housing Act, provides an assessment of  $1/12$  of 1 percent of total liabilities as against  $1/8$  at the present time. The Federal Deposit Insurance Corporation assessment rate is  $1/12$  of 1 percent of the total deposits. Inasmuch as only 43 percent of the deposits of banks are protected by insurance and the percentage coverage in these thrift associations is undoubtedly much higher than in the banks as a whole it would appear that the present effective rate of assessment is much higher in the banks than it is in savings and loan associations. The proposed reduction does not seem to be based upon a study of the risks involved in insuring mortgage loans. The experience in the State of New York with the guaranty of mortgage loans and the loss experience in commercial banks on real estate mortgages would seem to indicate that institutions, all or a major part of whose funds are invested in real estate mortgages, are greater risks than institutions whose investments are diversified in the manner which is general among insured commercial banks. The difference of one-twenty-fourth of 1 percent would not greatly reduce the rate which is charged by Federal Savings and Loan Insurance Associations on their home loans. Here is a conspicuous example of competition in laxity through lowering of insurance rates for the purpose of obtaining competitive advantages.

This section also provides for the creation of separate funds. Our own experience indicates that the purpose of such a provision is to increase the attractiveness of insurance to mutual savings banks.

Section 28. Which amends Section 402 (a) of the National Housing Act, to change the name of the Federal Savings and Loan Insurance Corporation to the Federal Savings Insurance Corporation. The effect of this provision would be to increase the confusion in the public mind with regard to the difference between the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, and to identify the latter more definitely with the savings banking system.

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To summarize, these provisions would give the Federal Savings and Loan Insurance Corporation a tremendous competitive appeal as against the Federal Deposit Insurance Corporation. Institutions insured by the former would pay no higher premiums. They would not be restricted as to payment of interest on deposits to the extent that they are under the Federal Deposit Insurance Corporation. They could pay interest on public funds freely whereas under the Federal Deposit Insurance Corporation they are restricted. Public funds would be insured 100 percent; under the Federal Deposit Insurance Corporation insurance is limited to \$5,000. Pay-offs would result in some slight advantage to depositors under the Federal Savings and Loan Insurance scheme. The restrictions and limitations imposed under the Federal Deposit Insurance Corporation are the result of painful experience on the part of the banking system over many years. These proposals ignore that experience.

Other provisions of the proposed legislation would, in our opinion, create rediscount and open-market facilities which would duplicate, to a considerable extent, those of the Federal Reserve System and enable the Home Loan Bank Board to make advances to commercial banks on terms which might, for competitive reasons, be made more attractive than the monetary policy of the Federal Reserve System would desire. While this is a matter which is of more direct concern to the Federal Reserve System than to the Federal Deposit Insurance Corporation, we are inclined to question the desirability of creating elaborate duplicate machinery.

The provisions to which we have reference are:

Sections 7, 8 and 9. Which amend Section 10 (a) of the Federal Home Loan Bank Act to permit Federal Home Loan Banks to make advances upon security of any obligation approved by the Home Loan Bank Board. If the Federal Home Loan Banks were created for the purpose of facilitating home financing it would not seem necessary to provide them with general rediscount powers, unless it was intended to attempt to create a rival system to the Federal Reserve.

Section 11. Which amends Section 11 of the Federal Home Loan Bank Act to permit Federal Home Loan Banks to buy and sell any obligations whatever subject to regulations of the Federal Home Loan Bank Board, authorizes the Treasury to buy without limit any obligations issued under Section 11 of the Federal Home Loan Bank Act and provides for the guarantee of principal and interest of such obligations. (The total of such guaranteed obligations at the present time would not exceed \$750,000,000. If mutual savings banks and commercial banks were members of the system the

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maximum of such obligations would be increased to about \$1,250,000,000.) While the matter lies somewhat outside our province, we are in general opposed to the use of the Federal guarantee of principal and interest of obligations of Federal or other agencies.

LEO T. CROWLEY,  
Chairman.