This is the draft after Dr. Goldenweiser had been over it and made his suggestions.

S T A T E M E N T

Re: The proposed legislation contained in Senate Bill 3874, being entitled "A Bill to Amend the Federal Home Loan Bank Act, the Home Owners' Loan Act of 1933, the Federal Reserve Act and the National Housing Act, and for other Purposes."

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The effect of this bill would be the creation under Federal auspices of a full-fledged banking system in competition with savings banks and the savings departments of commercial banks. The bill also provides for preferential treatment of institutions to which it relates in tax-exemption and insurance, and would leave them free of any limitation in the rate of return they may pay on shares which would result in unfair competitive advantages for these institutions over the established banking system.

The primary objections to the creation os such a separate banking system are that:

(1) It would place the Federal savings and loan associations and State-chartered members of the Home Loan Bank System in competition with savings banks and savings departments of commercial banks, by converting them from local cooperative thrift and home financing institutions into institutions empowered to invest in real estate mortgages of any sort, with few restrictions, and assured of being able to liquify such assets at the Federal Home Loan Banks. (§§ 1, 2, 3, 4, 8, 9)

(2) It would permit the Federal savings and loan associations and State-chartered associations insured by the Home Loan Bank System to compete on preferential terms with the institutions named above for the depositor's dollar, to the detriment and probable eventual ruin of the latter. This advantage in competion would be gained by the use of public funds, exemptions as to taxation, special insurance benefits and absence of any limitation in rate of return they pay on "shares" while rate of interest on deposits is restricted. (§ 10, taxation; §§ 18, 19, insurance)

(3) The bill contains certain provisions which are in conflict with sound policies affecting Government credit and the Federal Reserve System. (§§ 7, 13, 14 and 16)

I.

The bill would place the Federal Savings and Loan Associations and State-chartered members of the Home Loan Bank System squarely in competition with savings banks and savings departments of commercial banks, by converting them from local cooperative thrift and home financing institutions into institutions

empowered to invest in real estate mortgages of any sort, with few restrictions, and assured of being able to liquefy such assets at the Federal Home Loan Banks. (§§ 1, 2, 3, 4, 8, 9)

Section 1 of the bill would broaden the definition of a "home mortgage" from a mortgage upon a dwelling of not "more than four families" to a mortgage upon any multiple dwelling unlimited in size as to the number of families it houses, except as determined by the Federal Home Loan Bank Board. This might result in an undesirable increase in the size of individual loans and in concentration of risks and in the abandonment of the concept of such associations as mutual thrift and home financing associations.

By section 9, Federal Savings and Loan Associations would be permitted to loan as much as 30 per cent of their assets on improved real estate of any kind without regard to the $20,000 limitation upon amount and without regard to the 50-mile limit, both of which limitations ordinarily apply to home mortgage loans. At present, this authority is limited to 15 per cent of the assets of the association.

The associations would also be authorized to invest not only in obligations guaranteed as to principal and interest by the United States, but also in any other obligations approved by the Home Loan Bank Board, in addition to obligations of the United States and stock or bonds of Federal Home Loan banks, as now provided.

Sections 2 and 3 would support the enlarged lending powers of Federal as well as State-chartered member associations by liberalizing the class of securities upon which Federal Home Loan Banks are authorized to make advances to its member institutions. At present, mortgages eligible for advances are restricted to "home mortgages". These sections would completely eliminate such restrictions so as to enable advances upon the collateral security of <u>any</u> mortgage. Because the later Section 4 refers only to home mortgages, none of the further restrictions contained in Section 4 would apply to these other mortgages. Section 2 would further extend the list of collateral eligible for rediscount by Home Loan Banks to a materially different class of securities. It would include, as eligible security, not only Government guaranteed obligations and obligations of the Federal Savings and Loan Insurance Corporation but also whatever other obligations the Board might approve.

Section 4 further liberalizes the list of collateral acceptable for advances by the Home Loan Banks to member institutions by including home mortgages of longer maturities up to 25 years

instead of the present limit of 20 years. It increases the amount permitted to be advanced from $20,000 to $30,000 or such greater amount as the Board might fix by regulation. The amount, therefore, is unlimited except in the discretion of the Board. The present Board would no doubt use its discretion wisely, but it is usually the history of such legislation that such discretion once granted is used to increase the amount. No limit, even discretionary, is set upon the amount of advances on other mortgages than home mortgages. Section 4 also sets up certain restrictions on past due home mortgages, which are likewise not made to apply to other mortgages.

The transformation of the character of the Federal Savings and Loan Associations from that of mutual thrift and home financing associations to that of a separate banking system is carried further by a change in name provided for in Section 8. Section 8 would abandon the name "Federal Savings and Loan Association" now used and would substitute the title of "Federal Savings Association." This abbreviated name could only foster confusion in the minds of the public, whereas titles similar to the one now used have long been identified with mutual institutions for home financing.

Sections 1, 2, 3, 4, 8, and 9, therefore, so broaden the field of operation of members of the Home Loan Bank System, whether Federally or State-chartered, as to completely take away their character as mutual thrift and home financing associations and would transofrm them into a separate banking system.

II.

The bill would permit the Federal Savings and Loan Associations and State-chartered associations insured by the Home Loan Bank System to compete on unfair terms with other established institutions for the depositor's dollar to the detriment if not the eventual ruin of the latter. The use of public funds, exemptions as to taxation, unwarranted insurance benefits and the absence of limitations on rate of return on shares would constitute the means by which this advantage in competition would be gained.

Federal savings and loan associations are already exempted from Federal taxation and are protected from any discriminatory taxation which might be imposed by any State, county, municipal or local taxing authority. Moreover, shares of Federal savings and loan associations are now exempted from Federal income taxation. Section 10 of this bill goes a good deal farther, and exempts shares of the Federal associations from any State and local income and personal property taxes. The associations themselves are

further exempted from all but real property taxes imposed by States and other taxing authorities. It would be further provided that all Federal taxation of any State-chartered building and loans, savings and loan, or homestead association or cooperative bank should be on the same basis as that here prescribed for Federal savings and loan associations, that is, complete exemption for the associations and exemption of their shares from Federal normal income taxes. By another new provision, the shares of Federal savings and loan associations would be made lawful investments and acceptable security for fiduciary, trust, and public funds.

The tax provisions of this section have two kinds of effects. In the first place, as regards Federal taxation, they give State-chartered building and loan associations and their shareholders an advantage over banks and their stockholders and depositors, which is equivalent to that already enjoyed by Federal savings and loan associations. It should be borne in mind that neither national or State banks are exempt from Federal income taxation, nor are dividends on their stock and interest on their deposits exempt from Federal normal income taxation. Such exemptions, already enjoyed by Federal savings and loan associations and their shareholders, are now to be extended to State-chartered building and loan associations.

Secondly, as regards taxation by the States, the bill would create a preferential tax status for Federal savings and loan associations over both banks and State-chartered building and loan associations. Here it should be remembered that national banks, State banks, and State-chartered building and loan associations are none of them free from such franchise and other taxes as may be imposed by the States. Nor are the depositors of national and State banks, or the shareholders of State-chartered building and loan associations, free from such income taxes as may be imposed by the States. In both these respects the bill would give Federal savings and loan associations and their shareholders new advantages. It appears to be the purpose of section 10 to force all States which levy any taxation upon State building and loan associations or their shareholders to abandon such taxation or to cause such State institutions to operate under a serious competitive disadvantage with Federal associations. However, even if such taxation were abandoned by the States, national and State banks would still be left at a new competitive disadvantage in relation to building and loan associations.

Section 10 in its tax feature is doubly unwise at this time because of the President's announced intention with respect to the elimination of tax exemptions all future Government securities and of all Federal and State salaries. It is argued that the National Mortgage Association was exempted from taxation by a similar measure.

It should be noted that such provisions as to the National Mortgage Association were made under very different circumstances, as an emergency measure and that the National Mortgage Association, by the terms of its charter, cannot engage in competition with either banks or building and loan associations in the making of home mortgage loans.

The second part of section 10 makes insured shares of Federal associations lawful security for "fiduciary trust and public funds, etc." In this connection, it may be pointed out an insured deposit in a bank cannot be so used but this provision could permit such use of "shares" of a Federal savings and loan association and thus would, in this particular, elevate the status of insured shares of building and loan associations above that of insured deposits in banks.

Section 18 would further foster unfair competition by granting unwarranted insurance benefits. This section provides a reduction in premium for insurance for Federal and other insured associations from the present rate of 1/8 of 1 per cent to 1/12 of 1 per cent. While it is true that 1/12 of 1 per cent is the current rate of Federal Deposit Insurance Corporation, the risks of the two types of insurance are not comparable for three reasons.

(1) The assets of building and loan associations are normally upon a long-term basis and are not as liquid as those of banks, and as a corallary the shares of Federal associations and building and loan associations are not intended to be and are not as liquid as bank deposits.

(2) Secondly, the two rates are not comparable in that the uninsured portion of deposits in insured banks upon which banks pay premiums or assessments is much greater than the uninsured liability in insured building and loan associations. This means that the average effective rate of assessments upon insured deposits in banks is much higher than 1/12 of 1 per cent.

(3) Finally, the Federal Deposit Insurance Corporation insures only the deposits of banks. The net worth of banks, represented by stockholders' interest in capital and surplus, constitutes a cushion of protection for depositors. No such cushion is present in building and loan associations, whose liabilities are almost entirely capital liabilities and not at all deposit liabilities. It is these capital liabilities to the shareholders which are insured by the Federal Savings and Loan Insurance Corporation.

The bill goes still farther in putting the insurance of building and loan association shares upon the same basis as insurance of savings deposits. Section 19 provides that in the event of default by a Federal association the insurance corporation shall have the option to make payment in full in cash or upon a schedule as therein set out.

This provision further exemplifies the concept held by some that shares of Federal Associations possess the same liquidity as do savings deposits. It is noteworthy that this theory of similarity of shares and deposits seems to be an underlying theory of this bill. If this be true, and the distinction in liquidity between the two is to be disregarded and eliminated, then certainly the bill attempts to create a new system of banks.

At the present time building and loan associations are not regarded as being as liquid as banks. Conclusive evidence is given by the rates of return permitted to be paid, and actually paid, by building and loan associations upon their shares, which are much higher than the rates of interest permitted to be paid upon savings deposits. If building and loan associations are to be given an artificial liquidity, this discrepancy in rate of return will constitute another serious competitive disadvantage for national and State banks.

Summarizing this group of sections (§§ 10, 18, and 19), it is clear that a decided advantage is proposed to be given Federal associations over other competing institutions by permitting public funds to be invested in their shares, by special exemptions from taxation and by unwarranted parity of rates of insurance premium and treatment of insured accounts, together with permission to pay a higher rate of return upon shares than is allowed as interest on savings deposits. This would result either in the growth of unsound banking practices or in mortality among those institutions competing with the favored Federal associations.

III.

The bill contains certain provisions which are in conflict with sound policies affecting Government credit and the Federal Reserve System.

Section 7 of the bill would give authority to the Home Owners' Loan Corporation, in addition to authority previously given, to purchase up to $250,000,000 of Home Loan Bank bonds and debentures and obligations of the Federal Savings and Loan

Insurance Corporation, making use of funds raised by issuance of the fully guaranteed bonds of the Home Owners' Loan Corporation.

One purpose of this amendment is to ensure the availability of funds to the Federal Home Loan Banks for the making of advances to their member associations, both Federal and State-chartered. The Home Loan Banks have excellent credit standing in the securities markets, in which they have floated four issued of securities in the space of one year. These securities have not been backed by the United States but have rested solely upon the advances made by the Home Loan Banks to their members.

The other purpose of section 7 is to make Government credit available to the Federal Savings and Loan Insurance Corporation. This purpose ties in with the proposed lowering of the insurance premium rates, and is simply designed to shift the burden of insurance liability from the shoulders of the insured associations and their shareholders to the shoulders of the Federal Government.

Moreover, since the Home Owners' Loan Corporation was created for emergency purposes, it would seem inappropriate to finance a permanent organization through the medium of such a temporary agency.

Next among the sections in conflict with sound banking policies is section 13, which provides that national banks may purchase for their own account shares and accounts of Federal Savings and Loan Associations and other institutions insured by the Federal Savings and Loan Insurance Corporation. The question arises first as to whether or not such securities should find their way into the portfolios of national banks. At any rate, if such a provision be enacted, it should be considered in connection with national banking legislation.

Section 14 also comes into conflict with policies affecting the Federal Reserve System in that it expressly authorizes 15-day advances by Federal Reserve banks to member banks upon the member banks' promissory notes secured by any obligations issued pursuant to the provisions of the Home Loan Act.