

Mrs. Post

May 4, 1933

Mr. Donald Thompson
Acting Chief
Division of Research and Statistics
Federal Deposit Insurance Corporation
Washington, D. C.

Dear Don:

Enclosed is a copy, as you requested, of Chairman Eccles's letter of February 15 to Mr. Bell. You will, of course, note the confidential nature of this letter.

Very truly yours,

Woodlief Thomas,
Assistant Director of
Research and Statistics

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February 15, 1938.

Mr. Daniel W. Bell,
Acting Director of the Budget,
Treasury Department,
Washington, D. C.

Dear Mr. Bell:

Receipt is acknowledged of your letter of February 3, 1938, requesting my views with respect to a proposed 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", particularly on those sections which relate to the Federal Reserve Board, investments by national banks, and to the issue and guarantee of securities.

The matters to which you particularly refer are covered in sections 11(b), 11(c), 17, 23, 24 and 25 of the proposed bill.

Sections 11(b) and (c) would provide for full guarantee by the United States of obligations of the Federal Home Loan banks. You will recall that under date of June 7, 1937, the Board of Governors addressed a letter to you commenting upon a proposal then pending to authorize a further issue of the guaranteed bonds of the Home Owners Loan Corporation to purchase obligations of the Federal Home Loan banks, in which the following appeared:

"We consider it important that no further authorization to issue bonds fully guaranteed by the United States be made at the present time. The bulk of the outstanding guaranteed bonds were issued for emergency lending purposes with the expectation that they would automatically be retired from repayment of the loans thus financed." "...permanent participation of the Government in the financing of the Federal Home Loan Banks...seems to us undesirable and contrary to the Administration's policy of retiring as fast as possible from credit operations that should in normal times be carried on by private agencies".

My views remain as therein stated. I am firmly of the opinion that the Government should not finance directly or indirectly the making of short term advances to savings institutions in normal

times. Furthermore, since Federal Home Loan banks floated \$78,000,000 of their consolidated debentures at very favorable terms in 1937, it would seem that consideration of whatever question there may be regarding the adequacy of the Home Loan Bank System's power to function as a reservoir of funds for temporary and emergency accommodation, may be postponed until such time as it may be faced in the light of conditions then prevailing.

Section 17 would make available to the Home Owners Loan Corporation an additional \$300,000,000 of its authorized bond issue for the purpose of purchasing obligations of the Federal Home Loan banks. As \$300,000,000 of the total authorized bond issue of the Corporation has already been set aside to purchase Federal Home Loan bank obligations and full-paid income shares of Federal Savings and Loan Associations, this amendment would have the effect of adding an additional \$300,000,000 to the already created revolving fund. In this connection, it would seem especially undesirable to prepare now for future emergency conditions affecting the Federal Home Loan Bank System through the use of an agency created for the entirely different needs of a previous emergency period.

Section 23 would amend section 13 of the Federal Reserve Act to make Federal Home Loan bank obligations eligible for collateral for 15 day advances by the Federal Reserve banks to member banks. This is unnecessary since member banks are now permitted, under section 10(b) of the Federal Reserve Act, to borrow from the Federal Reserve banks on any sound assets.

Section 24 would amend paragraph (b) of section 14 of the Federal Reserve Act to permit Federal Reserve banks to buy and sell obligations of the Federal Home Loan banks in the open market. The primary purpose of the open market operations of the Federal Reserve System is to increase or decrease the reserves of member banks and thereby to expand or contract the available base for member bank deposits, which are the principal element in the nation's supply of money. Authorization to use various types of securities which may at times be in need of support in the System's open market operations will result in pressure on emergency occasions to make purchases for the sake of market standing of the securities. Such purchases are likely to conflict with the main objectives of open market operations. In recent years open market operations of the System in securities have been conducted entirely by the purchase and sale of direct obligations of the United States. The addition of obligations of the Federal Home Loan banks to those which the System is authorized to buy or sell in the open market is therefore neither necessary nor desirable.

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Section 25 would amend section 5136 of the Revised Statutes to make shares in the Federal Savings and Loan Associations lawful investments for national banks. This would furnish access to funds held by national banks payable by them upon demand or relatively short notice and is completely foreign to the idea of "mutual or cooperative thrift".

As pointed out in the Board's letter to you of June 7, 1937, "Two views may be taken of the functions of the Federal Home Loan banks; (1) they may serve as reservoirs of funds for the accommodation of their member institutions; (2) they may pursue a permanent and 'normal' policy of supplying their member institutions with funds to be used to increase their earning assets and thus to pyramid their earnings and their debts."

Consideration of the proposed measure as a whole indicates that the Federal Home Loan Bank Board contemplates taking the latter course, not only with respect to advances from the Home Loan banks but also by opening up other sources of funds to be employed by their member institutions. Such a policy, in my opinion, is fraught with grave dangers to the financial and economic conditions of the future in that it will result in many institutions having greatly reduced or exhausted borrowing powers at just the juncture when it would be most needed, namely during periods of disturbance when investors in these institutions may find it necessary to withdraw their funds.

The bill seems clearly to depart from the concept of Federal Savings and Loan Associations as "local mutual or cooperative thrift and home financing institutions" and tends to establish a separate banking system with its obligations on a plane with commercial deposits payable upon demand but with its assets invested in long term obligations.

The declaration of policy provided in section 1 of the proposed bill unduly emphasizes the part played by building and loan associations in financing residential construction and exaggerates the need of giving further encouragement to these associations.

Section 2 of the bill would broaden the definition of a "home mortgage" which is now limited to dwellings of for not more than 4 families by permitting the Board to include dwellings for such greater number of families as it might fix by regulation.

Sections 7 and 8 would permit Federal Home Loan banks to make advances to Federal Savings and Loan Associations and other members on non-home mortgages.

Section 10 would permit the Board, by regulation, to make mortgages in excess of \$30,000 eligible as collateral for advances by Federal Home Loan banks.

Section 19 would, within the discretion of the Board, permit Federal Savings and Loan Associations to make loans in excess of \$50,000 on one property and to hold 30 per cent (instead of 15 per cent) of their assets in mortgages on any improved real estate without regard to the limitation on the size of the loan or to the limitation that the property must be within 50 miles of the home office.

Section 20 would make shares of Federal Savings and Loan Associations lawful investments for fiduciary and public funds under the control of the United States.

Section 27 would provide that the limitation of \$5,000 upon the total insurance which any insured member may obtain would not apply to non-profit or governmental organizations.

Collectively all of these amendments seem to look to greatly expanded activities as well as powers upon the part of Federal or other associations and are inconsistent with their character as "local mutual or cooperative thrift and home financing institutions".

Section 33 reduces 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 for insurance of accounts and (b) to enable insured institutions to meet competition and provide low rates on home loans", and

Section 35, in the discretion of the Corporation, would permit settlement of claims against the Federal Savings and Loan Insurance Corporation in cash.

The insurance of share accounts in building and loan associations by the Federal Savings and Loan Insurance Corporation and especially the amendments now proposed appear to involve an

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assumption that such shares are or should be the equivalent of bank deposits. The proposal to settle claims in cash would result in conferring the same degree of liquidity upon investors' shares in building and loan associations as is now conferred upon insured bank deposits, although such shares generally pay dividends of 4 per cent and represent investments in long term obligations, whereas bank deposits pay much lower or no interest and are offset by much more liquid obligations.

Furthermore, since the risks of holding shares in building and loan associations are inherently greater than those of holding bank deposits, as indicated by the higher rates of dividends paid to association shareholders; and since the Federal Savings and Loan Insurance Corporation does not receive the same large proportion of premium payments based on uninvested assets of accounts over \$5,000 as the Federal Deposit Insurance Corporation receives in premium payments based on deposits over \$5,000, it would seem that the annual premium charge upon insured institutions should be increased rather than decreased.

Sincerely yours,

M. S. Eccles,
Chairman.

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