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December 16, 1944.

Honorable George L. Radcliffe,
United States Senate,
Washington, D. C.

Dear Senator Radcliffe:

You have kindly permitted us to file a reply to Mr. Fahey's statement dated August 7, 1944 in which he attacks the position we took in our letter to Senator Wagner of May 24, 1944 opposing the passage of the bills S. 756, S. 757 and S. 1034. We still believe that it would be unwise for Congress to enact these bills in their present forms. However, after careful consideration of Mr. Fahey's statement and a reexamination of the entire matter, we wish to set down specific objections to the present bills, to indicate those purposes with which we can agree, and to suggest changes which would make some of the provisions acceptable to us.

S. 757 and section 1 of S. 756

Under existing law, a Federal savings and loan association may not (1) make loans for the improvement or repair of homes except on the security of a mortgage; (2) make loans on homes located more than fifty miles from the association's home office; or (3) make an aggregate amount of loans on real estate other than homes in excess of 15 per cent of its assets. S. 757 would permit a Federal savings and loan association (1) to make loans for the improvement and repair of homes on the security of notes alone, provided they are insured under the National Housing Act; (2) to make loans on homes located more than 50 miles from its home office under the 15-percent-of-assets limitation (in addition to the existing authority to lend on business property under the 15-percent-of-assets limitation). More importantly, however, S. 757 would exempt any loan insured under the National Housing Act (as now drawn or as hereafter amended) from the 15-percent-of-assets limitation and the 50-mile limit.

We are willing to withdraw our previous objections to (1) the proposed authority for Federal associations to make repair and modernization loans which are insured under Title I of the National Housing Act, on the security of notes alone; (2) the proposed provision permitting Federal associations to make loans on homes beyond 50 miles under the 15-percent-of-assets limitations. Similarly, we have no objection to the corresponding provisions of section 1 of S. 756 in so far as they would authorize Federal Home Loan Banks to discount loans made under these provisions of S. 757, so amended. Also we should have no objection to the provisions of section 1 of S. 756 in so far as they permit the Home Loan Banks to accept as collateral for advances under section 10(a) home mortgages insured by the Federal Housing Administration with maturities up to twenty-five years.

We do not believe, however, that the remaining provisions of S. 757 should be enacted. Savings and loan associations have traditionally been local thrift and home financing institutions, gathering investment funds of individuals from the local community and lending them out to home owners and prospective home owners within the local community. This is clearly the basic function which Congress intended Federal savings and loan associations to perform, although it permitted them, as a matter of operating flexibility, and to meet unusual situations, to engage in other lending activities within well-defined limits.

We believe this element of flexibility is proper and useful, but if operations now permitted as exceptions to the rule should become the general rule, the basic function described above would be fundamentally altered. We feel, therefore, that the loans made on properties outside the association's locality (i.e. beyond 50 miles) should remain within the 15-percent-of-assets limitation.

We also believe that the financing of large-scale rental housing should continue to be subject to the 15-percent-of-assets limitation. Such financing is essentially different from the financing of homes for owners and prospective owners. The borrower, in the case of rental housing, is not a home owner. He is an investor in a business enterprise just as is the hotel owner. Thus the financing of large-scale rental housing is essentially business financing, which it was never contemplated savings and loan associations would undertake. The Federal Home Loan Bank Board has, we think quite properly, recognized this fact, because, although the present law would permit Federal savings and loan associations to make any non-home loan within the 15-percent-of-assets limitation, the Board, by regulation, has imposed severe restrictions on the rental housing loans which they may make. It has limited such loans to 50 per cent of appraised value, except in the case of small apartments (5 to 12 families) for which the limit is 60 per cent, even though they are insured under the National Housing Act.

For these reasons we feel that the blanket authorization of Federal savings and loan associations to lend any amount anywhere on insured mortgages, which is contemplated by S. 757 and section 1 of S. 756, should not be enacted.

Section 2 of S. 756

The purpose of section 2 of S. 756 is to increase the amount of money which the Federal Home Loan Banks may borrow in the money market by widening the range of Bank assets on the basis of which debentures may be issued. The law as it now stands restricts the amount of debentures which the System may issue to the amount of advances to members secured by loans of the types prescribed by Congress in section 10(a) of the Federal Home Loan Bank Act. Thus, the power of the Home Loan Banks to obtain funds in the money market is geared to the volume of the loans of the member institutions secured by loans of the best type, namely, loans which qualify under section 10(a). It seems obvious that the present provision furnishes the Home Loan Bank System with borrowing capacity more than adequate to enable member institutions to meet the demand for such loans in communities where share accounts are insufficient. Within the limitation which relates debentures to capital, the Home Loan Banks can now issue debentures on a one-for-one basis for the entire amount of 10(a) loans rediscounted. In what way could a demand arise which could not be met under the present provision? Only if member institutions should wish to rediscount other types of paper (or obtain unsecured advances) in considerable volume. Such other paper would include mortgage loans on business properties, apartment houses, and other non-home properties, as well as loans made on the security of share accounts. It seems apparent that Congress did not intend that such paper should form the basis for obtaining additional funds in the market. With the possible exception of loans on the security of share accounts, this is a type of financing that should be held within the 15-percent-of-assets limitation, as already pointed out herein, and therefore that should not be encouraged by giving such paper, when discounted at a Home Loan Bank, the same access to market funds as is enjoyed by 10(a) paper. In fact, the power to include such other paper in the debenture base would have the inevitable effect of eliminating the relative desirability of loans under section 10(a) which are clearly the most appropriate type of loan for mutual thrift and home financing institutions.

The proposed amendment would also include in the debenture base of the System all Government obligations owned directly by the Federal Home Loan Banks. This provision would permit Government obligations, including those held as part of the Banks' reserves, to be counted in the debenture base.

The present law in our opinion is over-generous in providing that required reserves may be invested in earning assets (the reserves of commercial banks must be in cash and those of the Federal Reserve Banks in gold or gold certificates) and the proposed amendment would go even further by allowing the reserves to be again multiplied by forming a base for the issuance of debentures.

There is nothing in the present law which restricts the power of the System to raise money to perform the functions it was established to perform, namely, to provide a reservoir of funds on which member institutions can draw when the demand for sound home mortgage loans in their communities exceeds the amount of share investment. Without issuing debentures, the Banks can make advances out of their own capital, as well as from deposits they may have from member institutions which have more share capital than mortgage loans. When demands on the Banks exceed these resources, the System may borrow from the money market the entire amount of section 10(a) advances from the Banks to their members.

Bearing in mind that Federal savings and loan associations are forbidden by law to accept deposits and that the holder of a share in such an institution should not expect the same liquidity as the owner of a deposit in a commercial bank, it seems obvious that the Federal Home Loan Banks should not need to raise funds on the basis of loans other than the types described in section 10(a) of the Federal Home Loan Bank Act. The most likely use for such funds would be to make unsecured advances to member institutions to enable them to meet demands for share withdrawals - an operation which is clearly inconsistent with the nature of share accounts and the uniform charter provisions of Federal associations governing withdrawals.

We object to section 2 of S. 756, therefore, on the following principal grounds: first, because it would broaden the base for debentures in such a manner as to encourage lending by member institutions of types which are inappropriate for local mutual thrift and home financing institutions; second, because, by including paper not conforming to section 10(a) as well as Government obligations owned directly by the Federal Home Loan Banks, whether as part of their reserves or not, it would make available to the Banks far more funds than they need in order to perform their functions; and third, because it is desirable that the reserves of the Federal Home Loan Banks, which are already invested in earning assets, should not be used as a basis for further generation of credit.

The argument that the Federal Home Loan Banks have not participated as fully in the financing of the war as they would if Government obligations could be included in the debenture base is not convincing. The Treasury has said repeatedly that it does not want institutions to borrow money in order to purchase Government bonds.

Section 3 of S. 756

Section 3 of S. 756 contains two proposals which must be considered separately: the first authorizes the Secretary of the Treasury to purchase obligations of the Federal Home Loan Banks or the Federal Home Loan Bank System in amounts not to exceed three times the total of the capital stock, reserves, and surplus of the Federal Home Loan Banks; the second authorizes the Secretary of the Treasury to purchase obligations of the Federal Savings and Loan Insurance Corporation, with a corresponding limitation on amount.

Since Mr. Fahey states that the authorizations granted by this section are to be used only in emergencies, it seems to us that the legislation should be worded so as to indicate this purpose. The unqualified authorization now contained in the proposal implies (despite the discretion lodged in the Secretary of the Treasury) that general support of the obligations of the Federal Home Loan Bank System is to be given by the United States Treasury. We feel that no such implication should be given. On the other hand, there is merit to the suggestion that it would be undesirable in the public interest for Home Loan Banks to be unable to meet maturing obligations due to a temporary emergency. We have no objection, therefore, to a provision permitting the Secretary of the Treasury, if he determines that the market situation warrants such action, to retire from the market such maturing obligations as the System cannot redeem without undue sacrifice and giving him power to negotiate with the Federal Home Loan Bank Board such terms and conditions as he feels to be desirable for the protection of the Treasury in connection with such action.

With regard to the second proposal, the law under which the Federal Savings and Loan Insurance Corporation operates now provides that insured institutions shall pay premiums, which shall cease when the reserve of the Corporation reaches 5 per cent of the insured risk, but the Corporation is authorized to assess each insured institution additional premiums equal to the amount of all insurance claims and operating expenses. (The required insurance premium and the maximum annual assessment are each one-eighth of one per cent of the insured accounts and creditor obligations of the insured institutions.) These provisions would indicate that the Congress contemplated that the premium would be used to provide the reserves and that the assessment would be used to pay losses and expenses.

However, the Corporation has never exercised its right to assess, with the result that, in effect, insurance losses and operating expenses have come out of the reserve. At the end of the fiscal year 1943 the reserve was only slightly more than one-half of one per cent of the insured risk, or one-tenth as large as Congress determined the reserve should ultimately be.

We feel that, if the Treasury is to guarantee the ability of the Corporation to meet its insurance contracts, it should be called upon to do so only after the Corporation has in good faith used the facilities already furnished by Congress for providing adequate reserves, as set forth below.

We should have no objection, therefore, to a measure which authorized the Secretary of the Treasury to purchase obligations of the Corporation provided that: (1) The Secretary determines that a reasonable market for the Corporation's obligations does not exist; (2) The obligations purchased by the Secretary shall bear interest at a rate which, in the judgment of the Secretary is a fair rate, having in mind the Corporation's normal market; and (3) The Corporation has already placed in effect a program of crediting to the reserve each year a sum sufficient to build up its reserve to five per cent of the insured risk within a period to be set by Congress, but preferably not more than ten years.

Section 1 of S. 1034

In his support of S. 1034, Mr. Fahey says that the effect of the provision waiving dividends due to the Home Owners' Loan Corporation from the Savings and Loan Insurance Corporation would be to grant the Federal Savings and Loan Insurance Corporation free use of its capital as was done for the Federal Deposit Insurance Corporation when dividends from Federal Deposit Insurance Corporation to the Treasury were eliminated.

Congress did provide the Federal Savings and Loan Insurance Corporation with its capital free of cost. It directed that the Home Owners' Loan Corporation acquire the entire capital stock of the Insurance Corporation by exchanging Home Owners' Loan Corporation bonds for Federal Savings and Loan Insurance Corporation stock, and that the money paid as interest by Home Owners' Loan Corporation on its bonds be returned to Home Owners' Loan Corporation by Federal Savings and Loan Insurance Corporation as dividends. The Home Owners' Loan Corporation has paid 3 million dollars to the Federal Savings and Loan Insurance Corporation each year since 1934, but since 1935 the Federal Savings and Loan Insurance Corporation has paid no dividends to Home Owners' Loan Corporation. Instead, it has placed 3 million dollars each year in a special reserve for contingencies, which now amounts to 27 million dollars. Section 1 of S. 1034 would remove the Insurance Corporation's liability to Home Owners' Loan Corporation for this 27 million dollars and would transfer this amount to the reserve which Federal Savings and Loan Insurance Corporation is required by law to build up. The Home Owners' Loan Corporation would thus be forced to bear a loss of 27 million dollars which is not properly chargeable to its operations.

We are in sympathy with the suggestion of the Secretary of the Treasury that a uniform policy be adopted for the treatment of public money used by Government corporations. Since the Home Owners' Loan Corporation is in process of liquidation and has already called the bonds which were issued in exchange for the stock of the Federal Savings and Loan Insurance Corporation, Congress might well direct the Secretary of the Treasury to purchase the stock of the Federal Savings and Loan Insurance Corporation from the Home Owners' Loan Corporation, and make whatever rules it deems best for the reimbursement of the Treasury in the future.

We see no good reason, however, for the waiving of the dividends which have been accrued contrary to the clearly expressed intent of Congress. Since insured institutions stop paying insurance premiums to Federal Savings and Loan Insurance Corporation as soon as the reserve reaches 5 per cent of the insured risk, the effect of such a gift by

Congress to the reserve of the Federal Savings and Loan Insurance Corporation would be to relieve the insured institutions of the obligation to pay premiums amounting to the 27 million dollars, plus interest for a number of years.

We do not believe that Congress should make such a gift to private lending institutions at the expense of the Federal Treasury which will bear any losses which Home Owners' Loan Corporation shows on liquidation.

<u>Section 2 of S. 1034</u>

The reserve which Congress has said should some day reach 5 per cent of the Federal Savings and Loan Insurance Corporation's insured risk was, on June 30, 1944, after ten years of operation, only 0.57 per cent of the insured risk. Section 2 of S. 1034 would reduce the insurance premium due from insured institutions by one-third, and would consequently slow down the rate at which the reserve is accumulated. Transfer of the dividends due Home Owners' Loan Corporation to the reserve would, of course, raise the ratio of reserve to liability, and might advance the date at which the full reserve might be reached. This should not, however, divert attention from the fact that the income available for reserves would be reduced substantially, and, in a period when losses were high, would be sadly deficient.

Mr. Fahey points out that the right of the Corporation to assess insured institutions for losses and operating expenses is retained in S. 1034 (although the maximum rate of assessment is also reduced by one-third), and argues that this power could be used to meet larger losses. Apart from the fact that the Corporation has never yet used this power of assessment, it is doubtful that assessment <u>after</u> large losses have started would be effective in yielding the amount of revenue that would be required (since the amount of assessment for any one year is limited) or could, in such a period of widespread strain, be conveniently paid by the institutions. Indeed, it is contrary to all insurance principles to attempt to assess the insured after the risk insured against has materialized.

Mr. Fahey argues that the risk insured by the Federal Savings and Loan Insurance Corporation is about the same as that insured by the Federal Deposit Insurance Corporation, and that therefore the premiums should be similar. He takes issue with our statement that Federal Deposit Insurance Corporation's risk is lower because there is a considerable cushion between the Federal Deposit Insurance Corporation and its insured risk in the form of the capital, surplus, undivided profits, and reserves, of a commercial bank to which there is no counterpart in the institutions insured by Federal Savings and Loan Insurance Corporation. He maintains that the savings and loan associations have similar capital accounts and that the ratio of these accounts to total assets is about the same for institutions in the two insurance systems.

If we assume that Mr. Fahey is correct in saying that there is a cushion between the Federal Savings and Loan Insurance Corporation and its insured institutions similar to the cushion which protects the Federal Deposit Insurance Corporation, the comparison between the two should be based on the insured accounts of the institutions and not on their total assets. The capital accounts of institutions insured by the Federal Deposit Insurance Corporation amounted in 1942 to almost 25 per cent of the insured accounts, while the capital accounts of institutions insured by the Federal Savings and Loan Insurance Corporation amounted to only 9 or 10 per cent of its insured accounts. In other words, a comparison would show that the cushion in the case of the Federal Deposit Insurance Corporation is over 2-1/2 times as great as in the case of the Federal Savings and Loan Insurance Corporation.

It has been asserted (by Mr. Kreutz of the National Savings and Loan League, for example) that the risk assumed by the Federal Savings and Loan Insurance Corporation is less than that of the Federal Deposit Insurance Corporation because the former insures only the ultimate safety of share accounts and makes no attempt to insure their liquidity. Under the procedure which Federal Savings and Loan Insurance Corporation has adopted for meeting insurance claims, however, liquidity is in effect insured. The Corporation pays cash to operating institutions for share accounts which they issue to holders of insured accounts in liquidating institutions, but whether the holder of the transferred account obtains cash immediately is apparently not within the direct control of the Corporation, although to date, institutions have apparently been ready to permit withdrawals on demand. Under this procedure the Corporation will be able to meet its insurance contracts in time of stress only if it has adequate cash or other liquid resources, and we feel it cannot have these resources unless it builds its reserves more quickly than it has built them up to now.

For these reasons, therefore, we are opposed to the passage of S. 1034 and all of its provisions. If the law at which it is aimed is to be amended, we feel it should be by the addition of a requirement that the reserve of 5 per cent of potential liability be built up by a given date.

We have made suggestions which, we think, make some passages of S. 756 and S. 757 acceptable in the public interest. For the remainder of the bills, we feel as we did on May 24, 1944 when we said:

> The Board is in sympathy with what it understands to have been the original objectives of the Federal Home Loan Bank System whereby Federal Savings and Loan Associations and similar institutions would supply the need for local mutual thrift and home financing institutions, and Federal Home Loan Banks would act as reservoirs of funds for the accommodation of their member institutions. The Board believes that the enactment of these bills would represent

a material departure from these objectives. On the one hand, high dividend rates to shareholders plus the insurance of their investment in such shares would tend to attract funds far beyond those incident to local mutual thrift and home financing programs. On the other hand, broadened powers would offer investment outlets for such funds equally beyond the scope of the original objectives. Thus, their enactment would constitute a step in the direction of establishing a separate and complete banking system with an opportunity to compete for ordinary banking deposits on favored terms.

Sincerely yours,

(Signed) M. S. Eccles.

M. S. Eccles,
Chairman.