August 7, 1946

Chairman Eccles:

The attached is an excerpt from the Board's report on the Taft Bill relating to the reduction in the assessment rate on Federal Savings and Loan Insurance. No hearings were held specifically on the bill which passed both houses, H.R. 4428, but hearings were held on an earlier bill which included a similar provision and after those hearings the Committee reported out the bill which finally passed.

G.B.V.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

March, 1946

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 and those of the Federal Reserve Banks may not be in earning assets) 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 assets other than loans of 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.

Section 303 is therefore open to objection 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 which has been advanced 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 306

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 10 years of operation, only 0.57 per cent of the insured risk. Section 306 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. In a period when losses were high, the reserve would be sadly deficient.

~~It might be argued that~~ The right to assess insured institutions for losses and operating expenses ~~could be used to meet larger losses, but apart from the fact that the Corporation has never yet used this power of assessment, it is doubtful that assessments *after* 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 con-~~

is not a substitute for adequate insurance

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

veniently 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.

One of the arguments advanced in support of this proposal in previous years was 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. However, the risk is far from being the same.

In the first place, banks insured by the FDIC as of June 30, 1945, had cash and United States Government securities totaling 112 billion dollars as against total deposits of 134 billion, leaving a balance of 22 billion as the only part of their deposits involving risk of loss to the FDIC. Capital accounts (capital, surplus, undivided profits and reserves) totaled 8 billion dollars. The ratio of capital accounts to these remaining deposits was therefore 1 to 2.7. By comparison, institutions insured by the Federal Savings and Loan Insurance Corporation, as of December 31, 1944, had cash and United States Government securities totaling 1.5 billion dollars as against total private repurchasable capital (shares), including deposits and investment certificates of 4 billion dollars, leaving a balance of 3 billion. The undivided profits and reserves of the insured institutions amounted to approximately 0.36 billion dollars, a ratio of 1 to 8. On this basis, the cushion provided by the capital accounts of institutions insured by the FDIC is three times as great as that provided in the case of accounts insured by the Federal Savings and Loan Insurance Corporation.

In the second place, the comparison of the risks should be on the basis of the insured accounts of the institutions and not their total assets. The capital accounts of institutions insured by the FDIC amounted, in 1943, to 20 per cent of the insured deposits, while the capital accounts of institutions insured by the Federal Savings and Loan Insurance Corporation amounted to only about 9 per cent of its insured accounts. In other words, a comparison on this basis, *without* taking into account the cash and United States Government securities which would tend to reduce the risk, would show that the cushion in the case of the FDIC is over twice as great as in the case of the Federal Savings and Loan Insurance Corporation.

Finally, the difference is further accentuated by the fact that, whereas virtually all of the share accounts and deposits of the institutions insured by the Federal Savings and Loan Insurance Corporation are covered by insurance, only about 38 per cent of the total deposit liabilities of insured banks are insured by the FDIC (its Annual Report for 1943 indicates that 36 billion are insured out of a total of 94 billion). This means that the effective premium rate of the FDIC is approximately ⅕ of one per cent of insured deposits. Consequently, *even if the other factors were equal,* the rate for the Federal Savings and Loan Insurance Corporation should be raised instead of lowered in order to make it comparable with that of the FDIC.

The Federal Savings and Loan Insurance Corporation has 100 million dollars of Government-furnished money. This is, in effect, a subsidy. At the present time, when the national debt is so great and such earnest efforts are being made to increase Government receipts it would be more prudent to permit the rate to remain where it is with the ultimate view of repaying this 100 million dollars to the Treasury when possible, rather than to reduce the rate in the face of all the factors outlined above.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis