June 7, 1939

Honorable Henry B. Steagall,
Chairman, Banking and Currency Committee,
House of Representatives,
Washington, D. C.

Dear Mr. Chairman:

This is in reply to your letter of June 6th, requesting my views respecting H. R. 5535, a Bill "To amend the Federal Home Loan Act, Home Owners' Loan Act of 1933, Title IV of the National Housing Act, and for other purposes."

In the outset, I wish to say that I am in sympathy with the original objectives of the Home Loan Banks as reservoirs of funds for the accommodation of their member institutions and with the original objectives of their member institutions as local mutual thrift and home-financing associations. I do not believe, however, that the permissible activities of Federal Savings and Loan Associations and other member institutions of Federal Home Loan Banks should be expanded so far beyond their original character as local mutual thrift and home-financing associations as to allow them to transact a large amount of general banking business. Nor do I believe that the liabilities of such associations should be given a degree of liquidity comparable to that of bank deposits by providing preferential insurance facilities for their shares. The proposed Bill contains a number of far reaching provisions leading to these ends and, in my opinion, its enactment would tend to establish a separate and complete banking system which would compete on favored terms with savings banks and the savings departments of commercial banks. I, therefore, do not favor its enactment.

Regarding those provisions of the Bill which would expand the powers of these institutions beyond their character as local mutual thrift and home-financing associations and would permit them to transact additional business of a general banking nature, the following may be noted:

Section 1 of the Bill would support any past or future enlargement of the lending powers of State-chartered member associations, as well as Federal Savings and Loan Associations, by liberalizing the class of collateral securities upon which Federal Home Loan Banks are authorized to make advances to their member institutions. At present, mortgages eligible for advances are restricted to "home mortgages". This section would completely eliminate any such restriction so as to authorize advances upon the security of <u>any</u> first mortgage. Section 2 would further extend the list of eligible collateral to a materially different class

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of securities, which would include not only Government-guaranteed obligations and obligations of the Federal Savings and Loan Insurance Corporation and of the Federal Home Loan Banks, but also whatever obligations a member association might lawfully have available.

Section 8 of the Bill would allow Federal Savings and Loan Associations, under proper authorization from the Federal Home Loan Bank Board, to place 15 per cent of their assets (in addition to 15 per cent now allowed to be invested in first mortgages with no restrictions) in residential mortgages of any sort - not necessarily "home mortgages" - within a 50 mile radius. This would appear to be a justifiable change but the restrictions of that section would apply only to Federally-chartered institutions. The lending powers of State-chartered institutions are governed by State law and the amendments proposed in section 1 would therefore encourage the latter to expand their activities to other fields instead of continuing as local mutual thrift and home-financing associations. Therefore, it would be desirable to place in section 1 restrictions upon advances by the Federal Home Loan Banks similar in terms to those which would be placed in section 8 upon the types of mortgages in which Federally-chartered associations are authorized to invest.

Section 8 also allows Federal Savings and Loan Associations to invest their assets in any securities that are legal investments for fiduciary and trust funds and are approved by regulations of the Federal Home Loan Bank Board. This is justified as permitting associations to employ additional funds "when satisfactory home mortgage loans are not available"; but there appears to be no reason for permitting Federal Home Loan Banks to make advances upon such securities, as is done in section 2, if such securities are to be merely temporary investments and the associations are to continue as home financing institutions.

Section 11 of the proposed Bill would change the name of the "Federal Savings and Loan Insurance Corporation" to "Federal Savings Insurance Corporation" thereby giving additional impetus to the transformation of the character of Federal Savings and Loan Associations from a system of local mutual thrift and home-financing associations into a separate banking system.

Regarding those provisions of the Bill which, by providing preferential insurance facilities, would give the liabilities of such associations a degree of liquidity comparable to that of bank deposits and would permit them to compete on unfair terms with other established institutions for deposits, the following may be noted:

Section 14 would foster unfair competition by granting unwarranted insurance benefits. It would reduce the 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 the Federal Deposit Insurance Corporation, the risks of the two types of insurance and the rates which should be charged for such insurance are not comparable, for three reasons:

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

(2) The uninsured portion of deposits in insured banks, upon which banks pay premiums, is much greater than the uninsured liability in building and loan associations. This means that if the premium collected was calculated with respect to the deposits insured, the rate actually would be much higher than 1/12 of 1 per cent.

(3) The Federal Deposit Insurance Corporation insures only the deposits of banks. The net worth of banks, represented by the stockholders' interest in capital and surplus funds, constitutes a cushion for the protection of the depositors and the Corporation. The Federal Savings and Loan Insurance Association insures withdrawable or repurchasable shares, investment certificates, or deposits, with the result generally that a fewer percentage of losses upon the part of one of its insured institutions will expose it to loss than is so in the case of the Federal Deposit Insurance Corporation. The risk, therefore, is greater and the premium should be higher if it is to be kept on a self-sustaining basis.

Section 16 of the Bill would go still further in placing the insurance of building and loan association shares upon the same basis as savings deposits. It provides that in the event of default by a Federal or other insured association, the Insurance Corporation would have the option of making payment "in full in cash". Moreover, the holder of an "insured account" would in any case have the option of receiving "at least" 10 per cent thereof in cash, and the balance in interest-bearing debentures rather than in noninterest-bearing obligations as under the existing law.

An analogy between the shares of Federal and other savings and loan associations and savings deposits seems to be the underlying theory of these sections of the Bill. Such associations, for the most part, are mutual in character. Their liabilities are evidenced largely by obligations purchased by individuals seeking to make an investment rather than a deposit. They purchase these obligations because they expect a higher rate of return than can be obtained upon a savings deposit and in fact the rates of return permitted to be paid and actually paid by building and loan associations upon their shares are much higher than the rates of interest permitted to be paid upon savings deposits. Such investors should not expect to obtain the same degree of liquidity as in the case of a savings deposit because building and loan associations, at the present time, are not expected to be and are not regarded as being as liquid as banks. If such associations are to be given an artificial liquidity, this discrepancy in the rate of return will constitute another serious competitive disadvantage for national and State banks and will result

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either in the growth of unsound banking practices or in mortality among the institutions competing with the favored Federal and other savings and loan institutions.

For the foregoing reasons, I am, as already stated, opposed to the enactment of the Bill.

Sincerely yours,

(Signed) M. S. Eccles.

Marriner S. Eccles.

JPD:ebb
6/7/39

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