

For Release on Delivery  
Monday, July 22, 1968  
9:30 a.m., E.D.T.

FEDERAL CHARTERING OF SAVINGS ASSOCIATIONS:  
A Central Banking Perspective

Remarks By

Andrew F. Brimmer  
Member  
Board of Governors of the  
Federal Reserve System

Before the

81st Annual Convention of the  
Michigan Savings & Loan League

Grand Hotel  
Mackinac Island, Michigan

July 22, 1968

FEDERAL CHARTERING OF SAVINGS ASSOCIATIONS:  
A Central Banking Perspective

By  
Andrew F. Brimmer\*

Representatives of commercial banks, mutual savings banks, and savings and loan associations have raised a number of questions about the position of the Federal Reserve Board with respect to Federal chartering of mutual savings banks or similar institutions. Some of these questions have arisen from a genuine lack of information regarding the Board's views. However, some inquiries are not questions at all -- but critical comments in opposition to the Board's stance on the issue. As a rule, most commercial bankers apparently feel that the Board, rather than favoring the concept in principle, should oppose the proposal in its entirety. In contrast, many savings bank and savings and loan officials seem to feel that the Board, while not objecting to the proposal in principle, has raised so many reservations that its basic position is actually negative.

Given these widely diverging views with respect to what the Federal Reserve Board's attitude is (or should be) on the proposal for Federal chartering of mutual savings institutions, an explanation of the Board's actual position may serve a useful purpose. Briefly stated, the Board:

Favors in principle Federal chartering of mutual savings associations.

Believes that such institutions (including Federally-chartered savings and loan associations) should be

---

\*Member, Board of Governors of the Federal Reserve System. I am indebted to several members of the Board's Staff for assistance in the preparation of these remarks -- especially to Mr. Robert M. Fisher, Mr. James L. Kichline, Mrs. Barbara N. Opper, and Miss Mary Ann Graves.

able to offer a wider range of instruments to attract savings and should be able to invest in a wider range of assets.

Believes that strengthening of savings institutions would improve the cyclical stability of mortgage flows.

Does not support the granting of increased operational flexibility for such thrift institutions unless they are also made to carry burdens comparable to those borne by commercial banks with respect to reserve-type requirements, taxation of income, and limitations on branching.

Would probably still have serious reservations about some of the most recent proposals contained in the omnibus housing bill now before Congress to broaden the authority of savings and loan associations without correcting the existing inequities.

#### Federal Charter Proposals in Perspective

The position of the Federal Reserve Board on Federal charters for mutual savings banks has evolved over the years from one of questioning the desirability of such legislation to "no objection in principle" to the proposal. However, the Board has raised critical questions about particular provisions of the various legislative proposals to authorize Federal charters.

It will be recalled that some version of a Federal charter bill has been on the agenda of every Congress beginning with the 86th. In assessing some of the earlier bills, the Board generally felt that such legislation would essentially redirect -- rather than increase -- the flow of savings. It doubted that the public interest would necessarily be served by the rearranging of saving, financial, and competitive relationships among financial institutions that would follow the establishment of Federal mutual savings banks. In the few years just prior to 1967, the Board adopted the general position that it had "no objection in principle"

to the proposed legislation. To some extent, this modification reflected changes in subsequent versions of the proposal to incorporate some of the recommendations made by the Board.

But changes in the composition of the Federal Reserve Board and the evaluation of changing financial conditions also play a part in the evolution of the Board's position. Thus, in July 1967, in a report to the House Banking and Currency Committee on H.R. 10745, embodying one version of the proposition, the Board stated that it

" . . . has no objection in principle to legislation that would authorize Federal charters for mutual savings banks and thus extend to savings banks a dual system similar to that under which commercial banks and savings and loan associations operate. However, enactment of [H.R. 10745] would . . . furnish many existing mutual thrift institutions with an opportunity, by converting into Federal savings banks, to enlarge the scope of their competition with commercial banks without bearing, in a comparable manner, the burdens applicable to such banks insofar as reserve-type requirements and taxation are concerned. ."

This is the last public official comment on the Federal charter proposal by the Board. However, although still later forms of the measure have appeared, there is no reason to believe that the Board's position has changed. Against this background, we can examine more closely the Board's views on a number of the issues raised by the efforts to authorize Federal charters for mutual savings banks and similar associations.

#### Factors Favoring Federal Charters

The granting of Federal authority to charter mutual savings associations would open the way for both savings banks and converting savings and loan associations to increase their over-all efficiency and

to improve their competitive strength. All of the proposals would authorize Federally chartered savings institutions, whether formerly mutual savings banks or S&L's, to be chartered in all 50 states, including 32 states in which mutual savings banks are not now permitted to operate. Leaving aside for the moment the questions of parity with commercial banks with respect to reserve requirements, branching and taxation, it seems evident that more -- rather than less -- competition should lead to increased efficiency in the mobilization and investment of the nation's savings. Allowing mutual savings banks (along with commercial banks and savings and loan associations) to be eligible for Federal charters should contribute to this goal.

Federal chartering should also enable the newly chartered institutions to hasten the development of a much wider range of instruments -- not redeemable on demand -- to compete for savings. In particular, all thrift institutions could use a kit of instruments which would permit them to offer premium interest rates to marginal, interest-sensitive investors to attract funds -- without having to make an across-the-board increase in dividends or interest rates on all other accounts. In recent years many thrift institutions (sometimes with the encouragement of supervisory authorities) have fashioned a wide spectrum of certificate and bonus accounts, with maturities ranging from six months to over 14 years. Nevertheless, Federal charters would undoubtedly further broaden these options.

Similarly, the thrift institutions' opportunities to diversify their portfolios would be widened by Federal chartering. Because they traditionally obtained virtually all of their funds from individuals whose savings were not particularly sensitive to variations in interest rates,

mutual savings banks and S&L's normally were able to invest in long-term, relatively nonliquid assets -- of which residential mortgages were the prime example. However, over the last few years, partly spurred by growing competition from commercial banks, thrift institutions have had to compete for the funds of savers who are becoming increasingly interest rate-conscious. Thus, these institutions have a much greater need for liquid assets and for assets with maturities far shorter than those characteristic of mortgages.

The consequences of thrift institutions (particularly savings and loan associations) relying on a narrow range of savings instruments and on mortgages as the principal investment outlet were amply demonstrated in 1966. As market yields rose in that year under the impact of monetary restraint, thrift institutions found themselves increasingly unable to compete for funds. Being heavily invested in mortgages with long maturities and fixed interest charges, they were not able to expand their earnings to allow payment of rates to depositors and account holders in line with rates of return obtainable on deposits in commercial banks and on open market securities. In contrast, the earnings of commercial banks, reflecting the latter's more diversified and more rapidly maturing portfolios, adjusted more promptly to changes in market interest rates. Furthermore, because thrift institutions have possessed inadequate liquidity reserves, they have been unable to maintain a steady outflow of funds into mortgages as the inflow of savings shrank.

Given these deficiencies in thrift institutions, a shift in the flow of savings into market securities as interest rates rise must necessarily

have an adverse impact on the mortgage market. During recent years, mutual savings banks and savings and loan associations have altogether supplied about three-fifths of total net private residential mortgage financing. Consequently, constructive steps taken to strengthen their ability to compete for savings under changing monetary conditions would also help to maintain the availability of mortgage funds and to stabilize activity in the homebuilding industry. Federal chartering of mutual savings banks and similar associations would constitute such a constructive step.

Principal Objections to Particular Features of Federal Charter Proposals

As mentioned above, while the Federal Reserve Board in recent years has approved in principle the Federal chartering of mutual savings banks, it has consistently questioned provisions of any charter bill that -- while providing broader powers more in line with those of commercial banks -- failed to narrow existing competitive advantages over commercial banks relative to reserves, liquidity requirements, and taxation. Although the Board has not commented on the most recent legislative efforts to broaden the powers of savings and loan associations, it is obvious that the latest proposals suffer from the same weaknesses to which the Board has objected in the past. Although the House Banking and Currency Committee in late June refused to allow the most recent version of the Federal charter bill (H.R. 13718) to go forward as part of the Administration's housing bill, the Committee did approve a significant broadening of powers for Federally-chartered savings and loan associations. The provisions include:

The authority to accept "deposits" and pay interest.

The authority to issue notes, bonds, debentures or other securities (except capital stock).

- The permission to invest in certificates of deposit (CD's) issued by FDIC-insured banks.
- The authority to finance small single-family homes (vacation homes, etc.) up to \$5,000 as a home improvement loan.
- The permission to make loans to finance mobile homes.
- The authority to make loans secured by investments or loans which are otherwise legal for the S&L's.

All of these provisions were included in the omnibus housing bill recently approved by the House. If they are enacted into law, their implementation would be subject to the terms of an association's own charter and to regulations promulgated by the Federal Home Loan Bank Board. Nevertheless, the statutory changes alone would represent significant gains for Federal S&L's. The right to accept deposits and pay interest would involve changes of substance and not simply in terminology. They would be able to accept deposits for fixed, minimum or indefinite periods of time, in the form of passbooks, time certificates of deposit, and "other evidences of savings accounts." Unless the FHLBB gave its specific permission, no association could delay payments to savers for more than 30 days. Apparently only one major recommendation of the S&L industry was not accepted by the House Banking and Currency Committee -- which was the request for authority to finance home furnishings, a power that would put S&L's directly into the consumer credit business.

In adopting the above proposals to broaden the powers of Federal S&L's, the Committee took no steps at all to correct the inequities which already exist between these institutions and commercial banks. Thus, S&L's could enlarge the scope of their competition with commercial banks without having to meet comparable reserve requirements and while paying substantially lower Federal income taxes.

Concerning reserve-type requirements, the version of the Federal charter proposal embodied in H.R. 13718 specifies that -- in addition to an initial reserve and an on-going valuation or similar reserve -- a Federal savings association would have to maintain a liquidity reserve of between 4 and 10 per cent of its deposits and borrowings, as determined by the FHLBB for different classes of associations. Such a reserve could be held in the form of one or more of the following assets: cash, time and savings deposits, U. S. Government securities, obligations of certain Federal agencies and international institutions, general obligations of any state, certain bankers' acceptances, or FHL Bank stock. The FHLBB, however, could specify no minimum cash reserve requirement. In contrast, the FHLBB was authorized to specify a minimum cash reserve under H.R. 10745, on which the Board expressed its views in July, 1967, in a letter to the House Banking and Currency Committee. The Board itself has gone beyond this point to suggest the use of flexible secondary reserve requirements for thrift institutions. As mentioned above, the need for such reserves is strongly supported by the experience of thrift institutions in 1966. However, the latest version of the Federal charter bill (H.R. 13718) makes no provision for secondary reserves.

The failure of the various Federal charter proposals to include provisions for tax treatment of the savings institutions commensurate with the broadened asset and liability provisions has been one of the principal objects of criticism by the Federal Reserve Board. No such provision is included in H.R. 13718. In fact, House Report 1042 accompanying the bill as reported by the House Banking and Currency Committee

noted explicitly (p.30) that " the bill makes no amendment or other reference of any kind to the Federal tax laws, ." In commenting on the bill, the Treasury Department indicated that the Federal savings institution established under H.R. 13718 would be taxed under the Internal Revenue Code as savings and loan associations rather than as mutual savings banks.

The question remains, however, whether it would be equitable for competitive and tax purposes to treat the new institutions on a par with savings and loan associations which have asset and liability authority much more narrow than the newly chartered institutions would enjoy. Moreover, even now Federal income tax payments by thrift institutions -- particularly by mutual savings banks -- fall considerably short of what Congress anticipated when it adopted the Revenue Act of 1962, one provision of which was aimed at the more equitable taxation of savings banks and S&L's. The 1962 Act aimed for an effective tax rate on net income of both types of institutions roughly equal to one-half the effective rate paid by commercial banks. This target implied tax rates for thrift institutions in the range between 15 and 18 per cent, compared with the approximately 30 per cent rate that commercial banks had been paying prior to 1962. As it happened, taxes as a percentage of net income for S&L's have approximated the target visualized in the 1962 Act; but for mutual savings banks, the short fall has been considerable. For example, tax rates for commercial banks in the last few years have remained in the neighborhood of 30 per cent. Those for S&L's rose sharply to a range of 14 to 17 per cent during the years 1963-66, from 0.3 per cent in 1962. In contrast, the tax rate for mutual savings banks, which was also at 0.3 per cent in 1962, never

rose above 4 per cent in the four years following enactment of the tax-equality measure in 1962. To some extent, the low tax rates paid by mutual savings banks reflect changes in the composition of their portfolios as well as deficiencies inherent in the 1962 tax law. But whatever the reason, the Federal Reserve Board feels strongly that such inequities in the taxation of thrift institutions compared with commercial banks should not be perpetuated in a new Federal charter scheme.

#### Minor Reservations

In commenting on different versions of the proposal, the Board has also criticized the perpetuation of other inequities among depository-type institutions that are unwarranted, including branching powers and investments in equity securities. Under H.R. 13718, it continues to be true that powers to branch or invest in equity securities would not be the same for both Federal savings associations and commercial banks -- contrary to the Board's recommendation. In the first place, a Federal savings association could branch in any state where branching was permitted either for state-chartered commercial banks or for state-chartered thrift institutions. Secondly, an association could hold corporate stock, under certain conditions, in aggregate amounts up to 50 per cent of its reserves, surplus, and undivided profits.

The Board expressed a minor objection to one feature of the Federal charter bill as formulated in H.R. 10745 (which also is applicable to H.R. 13718). It is that a Federal savings association could conceivably enter into savings deposits contracts without reserving the right to require any prior notice of withdrawal. In contrast, commercial banks under the

Board's Regulation Q must insert such a provision in each savings account contract. Such a provision would also be applicable to all savings accounts in Federal S&L's under amendments included in the House version of the omnibus housing bill.

The Board has criticized another provision (also found in H.R. 13718) that would prohibit a Federal savings association from converting into a commercial bank for at least 10 years. The only merit such a provision might have, the Board felt, is to minimize chances for inequitable distributions of surplus in connection with the conversion of a mutual-type institution into a stock-type institution. If this is the purpose, a better approach would be statutory requirements that a plan be developed " that (1) would prohibit the distribution of any surplus with respect to deposits made within one year prior to approval of the conversion by the depositors or by directors, whichever occurs earlier, and (2) would require 'time weighting of deposits' over at least a five-year period for the purpose of determining the amounts of surplus distributions. "

#### Concluding Remarks

In conclusion, let me repeat. Steps to broaden the asset and liability options of thrift institutions (particularly S&L's) should be encouraged. Such a broadening in their authority would strengthen their competitive position in the mobilization of savings and would be of considerable assistance in the stabilization of the residential mortgage market.

However, moves to liberalize the powers of Federally chartered thrift institutions should be taken in conjunction with measures to

reduce the inequities among such institutions and commercial banks with respect to reserve and liquidity requirements, taxation and branching. Unfortunately, the most recent proposals contained in the omnibus housing bill now before Congress do not meet these twin objectives.