

A meeting of the Board of Governors of the Federal Reserve System was held in Washington on Tuesday, March 13, 1945, at 2:45 p.m.

PRESENT: Mr. Eccles, Chairman
Mr. Ransom, Vice Chairman
Mr. Szymczak
Mr. McKee
Mr. Draper
Mr. Evans

Mr. Morrill, Secretary
Mr. Goldenweiser, Economic Adviser,
Division of Research and Statistics
Mr. Leonard, Director of the Division of
Personnel Administration
Mr. Thomas, Director of the Division of
Research and Statistics

Mr. Ransom referred to a memorandum addressed to the Board under date of March 10, 1945, by Mr. Chase, Attorney, in which it was stated that two finance companies in the St. Louis District, the Safe-way Finance Plan, Inc., and the Local Finance Company, which were registrants under Regulation W, Consumer Credit, and which were found to have been violating Regulation W in a manner which the Federal Reserve Bank believed was willful, had agreed to execute a voluntary closing agreement to close their offices from March 19 to March 23, 1945, inclusive, and that the form of agreement, which had been consented to by the registrants, followed the form used in connection with the Mitchell Clothing Company case in St. Louis in June 1943 except that, since the registrants were loan companies, they would be closed for the purpose of making or renewing loans but would be opened

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to receive payments on outstanding loans. The memorandum also stated that, if the Board approved, the Federal Reserve Bank of St. Louis would be advised by telephone, it being contemplated that the registrants would then execute the agreement and the Board would issue an order substantially in the same form as that issued in the Mitchell case suspending the licenses of the registrants for the period stated. Mr. Ransom stated that he had reviewed the record, that the investigation of the matter appeared to have been handled with exceptional care, and that the proposed action was recommended by Messrs. Parry and Brown of the Division of Security Loans.

Upon motion by Mr. Ransom, and by unanimous vote, the procedure outlined in Mr. Chase's memorandum was approved.

Chairman Eccles called attention to the fact that there had been furnished to each member of the Board a copy of a memorandum dated March 9, 1945, from Messrs. Goldenweiser and Thomas in regard to the part-time arrangement under which Mr. Alvin H. Hansen has been employed by the Board of Governors. The Chairman said that about a month ago he had raised with Messrs. Goldenweiser and Thomas the question whether this plan should be continued and had requested them to review the whole situation so that the Board would have an opportunity to consider it. The Chairman added that he felt that there was a somewhat similar question of policy with respect to the employment

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by the Federal Reserve Bank of New York of Mr. John H. Williams as Vice President on a part-time basis, but that in view of the fact that, under the existing practice of the New York Bank, the appointment of Mr. Williams was on an annual basis running to the end of the calendar year he felt that the question as to Mr. Williams might well be deferred until next fall. The Chairman pointed out that there was no question as to Professor Hansen's great ability and public spirit, nor as to the value of the work that he was doing from a public standpoint. He said, however, that he felt that there was a question of policy for the Board to consider as to the continuance of the present arrangement for several reasons. He thought that the existing arrangement had departed very materially from the original plan and intention. He pointed out that Professor Hansen's work was being carried on somewhat independently of the regular organization of the Division of Research; that it was not being done as a part of the work of, or under the direction of the head of, the Division except to the extent that certain members of the staff were assigned to assist Professor Hansen; and that, in effect, Professor Hansen was using members of the Board's staff and its office accommodations and other facilities to carry on independent projects from which he drew material for published articles and books and suggestions for proposed legislation which did not proceed through the regular channels of the Division or through the Board. He felt that Mr. Hansen was an extremely able and useful economist who

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was doing a very valuable public service and that, no doubt, he should continue in this field, but that he did not believe that the Board was justified in continuing to provide the funds to support these activities. He felt that it would be more appropriate for such activities to be financed by some independent organization, such as the American Planners Association, the Foreign Policy Association, or the Twentieth Century Fund. He would be glad, however, to have Mr. Hansen on a full-time basis as a member of the Board's organization, subject to the same general controls as any other member of the organization, or to have him available on a purely advisory basis subject to call when desired by the Board or its staff on such questions as the Bretton Woods plans or such matters as were involved in the pending Murray bill, dealing with the question of full employment, in the consideration of which the Board had been called upon to take part.

There was a lengthy discussion of the problem as presented by the Chairman, at the conclusion of which agreement was reached upon the suggestion of the Chairman that he be authorized to discuss the matter informally with Mr. Hansen at such time as he considered appropriate. It was understood that, in substance, the Chairman would advise Mr. Hansen that the Board felt that the present arrangement should be brought to an end after some reasonable period, such as 60 or 90 days, during which the Board would like to have Professor Hansen concentrate his attention upon the Bretton Woods proposals and the problem of full employment involved in the consideration of the Murray

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bill; that the Board would like to have him continue to be available, on a per diem basis, to the Board for consultation with members of the Board or its staff on such questions or other questions that might arise from time to time; and that, inasmuch as the Board held him in high regard because of his demonstrated great personal ability and contribution to public thinking, it would be glad, if he showed an interest in such an arrangement, to have him as a member of its permanent staff on a full-time basis under an appropriate designation and under the same general conditions of employment as other regular members of the staff at some agreed compensation up to an amount not exceeding \$15,000 per annum.

Upon motion, and by unanimous vote, the Chairman was authorized to proceed accordingly.

In connection with the foregoing action, it was agreed that the Secretary should call the matter of the terms of compensation of Mr. John H. Williams to the attention of the Board about the middle of September.

There was then brought to the attention of the members of the Board a telegram from Walter Lichtenstein, Secretary of the Federal Advisory Council, quoting a telegram from Mr. E. E. Brown, President of the Federal Advisory Council, to Chairman Eccles, as follows:

"All members of the Federal Advisory Council except Fleming who is still ill in bed and McCoy who is vacationing in Florida and therefore could not be reached have

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"approved of the following resolution and have authorized me to forward it to you as Chairman of the Board of Governors of the Federal Reserve System: 'The Federal Advisory Council considers it would be unfortunate and unwise at this time to require a 100 per cent margin on loans made for purchasing and carrying listed securities. The amount of credit now in use both by banks and brokers for such purpose is relatively small. Current purchases in the stock market are being made primarily for cash. A 100 per cent margin requirement at this time might affect the market for a short period, but once such a requirement was put into effect any restraining influence the Federal Reserve Board would have over the market through its control of margin requirements would be exhausted. Furthermore, such a requirement would tend to restrict the use of venture capital in the development of business enterprises. It would also tend to upset confidence and it very probably would cause many people to sell Government obligations and to buy less of forthcoming Government issues so that they could be in a position to buy stocks for cash. The Council desires that this statement be published in the event the Board should decide on a 100 per cent margin requirement at the time such requirement is announced. There is no objection to its publication in advance of any decision by the Board.'"

Chairman Eccles said that he had received the telegram quoted in Mr. Lichtenstein's wire and that he had had a long conversation over the telephone with Mr. Brown, during which he had brought Mr. Brown up to date on the various discussions that had taken place on the subject of proposed means of combating inflation through the alternatives of tax methods and credit controls.

As it had been agreed previously that the subject of margin requirements should be discussed at a meeting on Friday of this week, no action was taken upon the foregoing communication.

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Mr. Szymczak reported to the Board the current status of the hearings on the Bretton Woods proposals in the House Banking and Currency Committee and the expectation that hearings would be inaugurated before the Senate Banking and Currency Committee following the recess of Congress, which it is expected will cover the period from March 24 to April 10. In that connection Mr. Szymczak said that Messrs. Goldenweiser and Thurston had prepared a draft of a brief statement which might be presented on behalf of the Board whenever the occasion called for it during the hearings and asked the Chairman to review it before it was submitted to the Board for consideration.

Mr. Szymczak then reported that Mr. E. E. Brown, President of the Federal Advisory Council, was expected to testify before the House Banking and Currency Committee on the coming Friday or Monday; that, among other things, there had been informally discussed with him the Board's proposals that there be incorporated in the enabling legislation a provision for an international financial council; that Mr. Brown was favorable to such a proposal; but that he preferred slightly different language in respect to the council's relation to the governors and executive directors of the Fund and of the Bank.

After some discussion, the Chairman suggested, and the other members of the Board agreed, that it would be preferable if Mr. Brown were to defer any reference to the council until after the Chairman had presented the suggestion in the course of his testimony before

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the House Banking and Currency Committee. Under this procedure Mr. Brown, if he were so inclined, could, during his appearance before the Senate Banking and Currency Committee at a later date, call attention to the Board's proposal and express his favorable attitude, together with any suggestion that he might wish to offer as to language.

At this point Messrs. Goldenweiser, Leonard, and Thomas withdrew from the meeting.

The action stated with respect to each of the matters hereinafter referred to was then taken by the Board:

The minutes of the meetings of the Board of Governors of the Federal Reserve System held on March 12, 1945, were approved unanimously.

Letter to Mr. Rounds, First Vice President of the Federal Reserve Bank of New York, reading as follows:

"The Board of Governors approves the modification of the rule with respect to the granting of 'merit day' leave as described in the certificate enclosed with your letter of March 8, 1945."

Approved unanimously, together with a letter to the Wage Stabilization Division, National War Labor Board, transmitting a certificate of the Federal Reserve Bank of New York with respect to the procedure of granting "merit day" leave at the Bank and its Buffalo Branch.

Letter to Mr. Rounds, First Vice President of the Federal Reserve

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Bank of New York, reading as follows:

"The Board of Governors approves the change in the personnel classification plan of the Federal Reserve Bank of New York, involving an increase in the maximum annual salary for the position of Chauffeur-Guard, as indicated in the certificate submitted dated March 9, 1945."

Approved unanimously, together with a letter to the Wage Stabilization Division, National War Labor Board, transmitting a certificate of the Federal Reserve Bank of New York with respect to a salary increase at the Bank.

Letter to Mr. Rice, Vice President of the Federal Reserve Bank of New York, reading as follows:

"The Board of Governors approves the changes in the personnel classification plan of the Federal Reserve Bank of New York, involving the elimination of three positions in the Service Department, as submitted with your letter of March 7, 1945."

Approved unanimously.

Letter to Mr. Meyer, Assistant Cashier of the Federal Reserve Bank of Chicago, reading as follows:

"This is in reply to your letter of February 23, 1945, requesting approval of increases in the salaries of 28 employees who have reached the maximums for their positions under the personnel classification plan.

"The Board of Governors approves the payment of salaries to the 28 employees, reflecting increases up to the amounts shown in the last column of the list submitted with your letter of February 23. This approval is subject to receipt of an appropriate certificate to support the increases under the salary stabilization regulations."

Approved unanimously.

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Letter to the "Potsdam Bank and Trust Company", Potsdam, New York, reading as follows:

"The Board is glad to learn that you have completed all arrangements for the admission of your bank to membership in the Federal Reserve System and takes pleasure in transmitting herewith a formal certificate of your membership.

"It will be appreciated if you will acknowledge receipt of this certificate."

Approved unanimously.

Memorandum dated March 10, 1945, from Mr. Thomas, Director of the Division of Research and Statistics, stating that with the approval of Mr. Szymczak arrangements had been made with the Alderson Reporting Company to receive a copy of a daily transcript of the hearings being held on the Bretton Woods proposals by the House Banking and Currency Committee, and recommending that the amount necessary to cover the cost of the transcript at the rate of 25 cents a page be added to the appropriate item in the 1945 nonpersonal budget of the Division of Research and Statistics.

Approved unanimously.

Drafts of letters to Senator Wagner and Congressman Spence, Chairmen of the Banking and Currency Committees of the Senate and House of Representatives, respectively, reading as follows. These letters had been prepared at the request of Chairman Eccles for submission to the Board for approval with the understanding that they would not be sent until the bills mentioned in the letters were taken

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up for consideration by the respective committees:

Letter to Senator Wagner

"This letter is in response to your request of for the opinion of the Board of Governors on the merits of bills S. 103, S. 179, and S. 180.

"As you know, the bills S. 179 and S. 180 are identical with S. 756 and S. 757 respectively, which were before the 78th Congress, and S. 103 is the same as S. 1034 in the 78th Congress, except that its effective date is later and it omits a provision waiving unpaid dividends due from the Federal Savings and Loan Insurance Corporation to the Home Owners' Loan Corporation.

"In letters dated May 22 and December 16, 1944, we set forth our objections to the bills which were before the 78th Congress. Since the present bills are the same, with the exception indicated and since we have seen no grounds for changing our position, we repeat here substantially what we said in our letter of December 16, 1944, with only such changes as are required by the changed numbers of the bills and the narrower effect of S. 103.

S. 180 and section 1 of S. 179

"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. 180 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-per-cent-of-assets limitation (in addition to the existing authority to lend on business property under the 15-per-cent-of-assets limitation). More importantly, however, S. 180 would exempt any loan insured under the National Housing Act (as now drawn or as hereafter amended) from the 15-per-cent-of-assets limitation and the 50-mile limit.

"We have no objection 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,

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"on the security of notes alone; (2) the proposed provision permitting Federal associations to make loans on homes beyond 50 miles under the 15-per-cent-of-assets limitation. Similarly, we have no objection to the corresponding provisions of section 1 of S. 179 in so far as they would authorize Federal Home Loan Banks to discount loans made under these provisions of S. 180, so amended. Also, we should have no objection to the provisions of S. 180 and of section 1 of S. 179 in so far as they permit Federal associations and the Home Loan Banks to make and 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. 180 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-per-cent-of-assets limitation.

"We also believe that the financing of large-scale rental housing should continue to be subject to the 15-per-cent-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-per-cent-of-assets limitation, the Board, by regulation,

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"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. 180 and section 1 of S. 179, should not be enacted.

Section 2 of S. 179

"The purpose of section 2 of S. 179 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 advances to 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-per-cent-of-assets limitation, as already pointed out herein, and therefore that should not be encouraged by giving such paper, when discounted at a Home

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"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

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"inconsistent with the nature of share accounts and the uniform charter provisions of Federal associations governing withdrawals.

"We object to section 2 of S. 179, 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 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 3 of S. 179

"Section 3 of S. 179 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.

"Mr. Fahey stated last year that the authorizations granted by this section are to be used only in emergencies. It seems to us, then, 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.

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"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 made full use of 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

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"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. 103

"The Capital stock of the Federal Savings and Loan Insurance Corporation was subscribed by the Home Owners' Loan Corporation which exchanged its bonds for an equivalent amount of stock. The dividends on the stock were to cancel the interest payments on the bonds. It is our understanding that the Home Owners' Loan Corporation has called the bonds which it exchanged for the Insurance Corporation stock, and it seems reasonable to us that the capital structure of the Insurance Corporation should be reexamined. The effect of the arrangement which was in force while the Home Owners' Loan Corporation bonds were outstanding was to give the Insurance Corporation free use of its capital. If it is the intent of Congress that Government corporations should have free use of the Federal funds which make up their capital, it seems proper to us that the Insurance Corporation should be relieved of the obligation to pay dividends to the Home Owners' Loan Corporation now that it does not receive offsetting interest from the bonds.

"We are in sympathy, however, 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.

Section 2 of S. 103

"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.

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"Section 2 of S. 103 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.

"Mr. Fahey pointed out last year that the right of the Corporation to assess insured institutions for losses and operating expenses was retained in S. 1034 (although the maximum rate of assessment was also reduced by one-third), and this right is also retained in S. 103. He argued 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 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 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 argued last year 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 took 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 maintained 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 was 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

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"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 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. 103 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. 179 and S. 180 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

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"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."

Letter to Congressman Spence

"This is in reply to your request of for the opinion of the Board of Governors on the merits of the bills H.R. 593, H.R. 594, and H.R. 595 which are now before your committee.

"As you probably know, these bills are substantially the same as three bills, S. 1034, S. 757, and S. 756 respectively, which were before the 78th Congress and on which the Board commented in two letters, one dated May 22 and the other dated December 16, 1944. The only differences between the present House bills and the three bills which were before the Senate last year, are that (1) H.R. 594 omits a provision which was in S. 757, changing the word 'other' to 'any' in subsection (c) of section 5 of the Home Owners' Loan Act (a provision to which we did not object); and (2) the preamble of H.R. 593 is more explicit than was that of S. 1034.

"Since these bills are substantially the same as the bills we commented on last year, and since we have seen no reason to change our position on them, we repeat here, with only necessary minor changes, what we said in our letter of December 16, 1944 addressed to Senator Radcliffe.

H.R. 594 and section 1 of H.R. 595

"Under existing law, a Federal savings and loan association may not (1) make loans for the improvement or repair

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"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. H.R. 594 would exempt any loan insured under the National Housing Act (as now drawn or as hereafter amended) from the requirement that loans must be secured by mortgages, the 15-per-cent-of-assets limitation, and the 50-mile limit.

"We have no objection to 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 or to the corresponding provisions of section 1 of H.R. 595 in so far as they would authorize Federal Home Loan Banks to discount loans made under these provisions of H.R. 595, so amended. Also we should have no objection to the provisions of H.R. 594 and of section 1 of H.R. 595 in so far as they permit Federal associations and the Home Loan Banks to make and 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 H.R. 594 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-per-cent-of-assets limitation.

"We also believe that the financing of large-scale rental housing should continue to be subject to the 15-per-cent-of-assets limitation. Such financing is essentially

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"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-per-cent-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 H.R. 594 and section 1 of H.R. 595, should not be enacted.

Section 2 of H. R. 595

"The purpose of section 2 of H.R. 595 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 advances to 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

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"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-per-cent-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 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

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"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.

"We object to section 2 of H. R. 595, 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 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 3 of H.R. 595

"Section 3 of H.R. 595 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

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"Treasury to purchase obligations of the Federal Savings and Loan Insurance Corporation, with a corresponding limitation on amount.

"Mr. Fahey stated last year that the authorizations granted by this section are to be used only in emergencies. It seems to us, then, 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

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"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 made full use of 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 H.R. 593

"In his support of S. 1034 last year, Mr. Fahey said 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

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"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 H.R. 593 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, 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.

Section 2 of H.R. 593

"The reserve which Congress has said should some day reach 5 per cent of the Federal Savings and Loan Insurance

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"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 H.R. 593 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 pointed out last year that the right of the Corporation to assess insured institutions for losses and operating expenses was retained in S. 1034 (although the maximum rate of assessment was also reduced by one-third), and this right is also retained in H.R. 593. He argued 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 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 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 argued last year 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 took 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 maintained 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.

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"If we assume that Mr. Fahey was 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 H.R. 593 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

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"passages of H.R. 594 and H.R. 595 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."

Approved unanimously, with the understanding that the letters would not be sent until the bills mentioned therein were taken up for consideration by the respective committees.

Thereupon the meeting adjourned.

Obester Morris
Secretary.

Approved:

W. C. ...
Chairman.