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FEDERAL RESERVE BOARD
WASHINGTON

May 15, 1916.

Memorandum for the Board:

As requested, I have made a brief analysis of the provisions of the Federal Farm Loan Act, as it passed the Senate.

This Act was referred to the Banking and Currency Committee of the House, and the Committee's report appears to be a substitute bill which will have to be made the subject of a separate analysis in order to show the changes made in the substance of the Senate bill.

I assume that the Board will desire this analysis after the House Bill has been passed.

In analyzing the Senate Bill I have not attempted to outline all the details of operation, but merely to show the fundamental provisions and the general plan of operation.

Respectfully,

M. C. ELLIOTT,

Counsel.

ANALYSIS OF FEDERAL FARM LOAN ACT AS
PASSED BY THE SENATE.

* * *

May 12, 1916.

THE FEDERAL FARM LOAN BOARD.

The Act provides for the creation of a bureau in the Department of the Treasury to be known as the Federal Farm Loan Board which consists of five members including the Secretary of the Treasury, who is made an ex-officio member and chairman. The four appointed members receive salaries of \$10,000 each. All salaries and expenses are paid out of the general funds of the Treasury.

This board is authorized to employ attorneys, experts, etc., in the same manner as the Federal Reserve Board. The employees are not under civil service. It makes an annual report of its operations to Congress. Its general powers, as summarized in Section 20 are substantially as follows:

- (a) To organize and charter Federal land banks, national farm loan associations, and joint-stock land banks.
- (b) To review and alter at its discretion the rate of interest to be charged by Federal land banks.
- (c) To authorize the issue of farm loan bonds.
- (d) To make rules and regulations respecting charges made to borrowers on loans, for appraisal, examining titles, etc.
- (e) To require reports of condition and to make examinations.
- (f) To prescribe the form and terms of farm loan bonds.
- (g) To require Federal land banks to pay to other Federal land banks their equitable proportion of sums advanced to pay the coupons on bonds issued by such banks.

(h) To exercise general supervision over -

- (1) Federal land banks,
- (2) National farm loan associations,
- (3) Joint-stock land banks.

FEDERAL LAND BANKS.

The Federal Farm Loan Board is empowered to divide the continental United States into twelve districts to be known as Federal land bank districts to be designated by number, and to create and organize in each district a Federal land bank with a capital stock of not less than \$500,000.

Board of Directors: A temporary board of five directors is appointed by the Federal Farm Loan Board during the preliminary organization of these banks. This board is later replaced by a board of five directors, three of which are elected by the farm loan associations and two are appointed by the Federal Farm Loan Board, one of the two so appointed being designated as chairman.

Capital Stock: If, within ninety days after the subscription books are opened, any part of the minimum capitalization of \$500,000 has not been subscribed, by individuals, firms or corporations or by the States, the Secretary of the Treasury is required to subscribe for the balance on behalf of the United States. This subscription, however, is later repaid to the United States when a sufficient amount of stock is sold to other subscribers. Ten per cent of each \$100,000 worth of stock subscribed is invested in bonds of the United States not later than two years after the payment of such subscription.

These banks may act as Government depositaries and fiscal

agents of the Government.

Powers: They are given the usual corporate powers and among others the following special powers:

- (1) To issue farm loan bonds;
- (2) To purchase first mortgages on farm lands within the district;
- (3) To deposit first mortgages with a registrar as security for farm loan bonds;
- (4) To receive and set apart for expenses and profits one per cent interest on endorsed mortgages;
- (5) To acquire and dispose of real and personal property under certain conditions;
- (6) To make deposits with Federal reserve banks or member banks and to receive interest on the same;
- (7) To receive deposits from farm loan associations, but not to pay interest thereon;
- (8) To borrow money;
- (9) To buy and sell United States bonds.

Restrictions: Such banks are not permitted *

- (1) To accept ordinary demand deposits except from its stockholders;
- (2) To make loans on farm mortgages except through farm loan associations;
- (3) To accept other than first mortgages;
- (4) To issue bonds in excess of twenty times the amount of its capital and surplus;
- (5) To receive any commission or charge not authorized by the Act.

NATIONAL FARM LOAN ASSOCIATIONS.

These associations are organized by persons desiring to

borrow money on farm mortgage security. Their directors are elected in the same manner as national bank directors. Their officers, other than the Secretary-Treasurer, serve without pay, unless the Federal Farm Loan Board approves a salary. The Secretary-Treasurer acts as custodian of its funds depositing same in such banks as the board of directors may designate; pays over to borrowers sums received for their account from the Federal land banks upon first mortgages, and is the active officer of the association.

Subscribers: The incorporators of such an association must consist of ten or more natural persons who are the owners or who are about to become the owners of farm land, qualified as security for a mortgage loan. They execute an organization certificate which is submitted to the Federal land bank, and, acting upon the recommendation of the Federal land bank, the Federal Farm Loan Board issues a charter.

The loan desired by each subscriber must not exceed \$10,000 nor be less than \$200, and the aggregate must not be less than \$20,000. The borrower must subscribe to stock in a sum equal to five per cent of the desired loan.

These associations may be organized with limited or with unlimited liability. The capital stock is issued in shares of \$5 each to borrowers, and this stock is held by the associations as collateral security for the loan made, but the borrower may receive dividends accruing and payable on such stock, and when the loan is repaid the stock is canceled and the subscription is repaid or it may

be credited on the loan when the balance has been paid. The capital stock of these associations may be increased from time to time as additional loans are desired, and may be reduced to any sum not less than five per cent of the unpaid principal of mortgages held.

The special powers of these associations consist of the right -

- (1) To indorse and to discount with Federal land banks first mortgages;
- (2) To receive from such banks funds to be loaned to its shareholders;
- (3) To acquire and dispose of real and personal property under certain conditions;
- (4) To issue certificates of deposit at four per cent per annum against deposits or current funds, convertible into farm loan bonds when presented at the Federal land bank of the district in any multiple of \$25.

This stock carries with it the double liability of shareholder.

In the unlimited farm loan association the subscriber enters into a contract to become individually liable for all contracts, debts, and engagements of the association in addition to his liability on the stock.

Loans Made by Federal land banks: Loans made by Federal land banks are subject to the following restrictions:

- (1) They must be secured by first mortgages on farm land located in the district;
- (2) Each mortgage must contain an agreement for repayment under the amortization plan;
- (3) They must run for not less than five nor more than sixty years;
- (4) Payment may be anticipated by the borrower on interest payment periods at any time after five years;

- (5) Interest rate limited to six per cent.
- (6) Loans may be made -
 - (a) For the purchase price,
 - (b) For equipment, fertilizers, live stock, etc.
 - (c) For buildings and improvements,
 - (d) For discharge of existing mortgages.
- (7) Loans limited to fifty per cent of the appraised value of the land;
- (8) Applicant must state his intention to become within six months engaged in the cultivation of the land mortgaged;
- (9) Loans to one borrower not to exceed \$10,000, nor to be less than \$200;
- (10) Application to be made in form approved by the Federal Farm Loan Board;
- (11) Borrower to pay ten per cent simple interest on defaulted payments;
- (12) The borrower must stipulate that if any portion of the loan is expended for purposes other than those specified in application, or if he fails to comply with terms of application, the loan shall at the option of the mortgagee become due and payable.

JOINT STOCK LAND BANKS.

Joint stock land banks possess substantially the same powers as Federal land banks. They may be organized by any number of natural persons not less than ten. They may begin business with a capitalization of \$250,000 in states of less than two million inhabitants. The Government of the United States is not authorized to purchase or subscribe to any part of their capital stock. They are not subject to the restrictions above enumerated on loans made by Federal land banks, except that they are prohibited from receiving

any commission or charge not authorized by the Act. The board of directors may consist of more than five members. The Federal Farm Loan Board has a more limited supervision over these banks than it has over Federal land banks. Bonds issued by these banks and known as joint stock land bank bonds are limited to fifteen times the amount of the capital and surplus. They are not subject to all the restrictions of farm loan bonds, but are based upon first mortgages and are in form prescribed by the Farm Loan Board. They are known as "joint stock bonds."

MISCELLANEOUS PROVISIONS.

The Act provides for examiners who are required to make regular examinations of the banks and associations and whose salaries are paid out of the general funds of the United States Treasury. It provides for appraisal committees to determine the value of the land offered as security and for a registrar to hold the securities against which farm loan bonds are issued.

The usual penalties applicable to bank officers are incorporated in the Act. The provisions of Section 22 of the Federal Reserve Act are likewise incorporated.

Farm loan bonds may be purchased by Federal reserve banks or member banks, by trustees or fiduciaries, and by the postal savings trustees.

Acceptances or obligations of member banks secured by such bonds are made eligible for discount by Federal Reserve banks.

These banks and associations are required to carry twenty-five per cent of their earnings to a surplus or reserve account until this account is equal to twenty per cent of their capital. Where national farm loan associations have not been organized in any locality after one year from the passage of the Act and it appears to the Federal Farm Loan Board that they are not likely to be organized, the Board may authorize Federal farm banks to make loans through approved agents.

One hundred thousand dollars is appropriated for organization expenses.

Every Federal land bank and every national farm loan association, including the capital stock and reserve or surplus therein and the income derived therefrom, is exempt from Federal, State, municipal and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of Section eleven and Section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, are deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom are exempt from Federal, State, municipal and local taxation.

R E S U M E '

The general plan of operation appears to be that, when farm owners or prospective farm owners desire to borrow money for the cultivation or improvement of farms or to pay off the purchase price of such land or to discharge existing liens, ten or more may unite to organize a farm loan association, subscribing and paying for capital stock in such association equal to five per cent of the loans desired. Through this association an application is made to the Federal land bank. This application must recite that the borrower is engaged or intends to engage in the cultivation of farm land. The Federal land bank may thereupon make loans to the farm loan association on the security of first mortgages to the extent of fifty per cent of the appraised value of the land in question. All of such mortgages must run for a period of at least five years and not exceeding sixty years, and must contain an agreement for the payment of a fixed number of semi-annual^{or annual}/~~in-~~ installments sufficient to provide for an agreed rate of interest during the term and for the payment of the principal during and at the end of the term on the usual amortized plan.

In order to increase their loanable funds Federal land banks may deposit first mortgages with a registrar as collateral security for bonds issued by such banks. These bonds which are engraved by the Bureau of Engraving and Printing under direction of the Comptroller of the Currency are issued in denominations of \$25, \$50, \$100, \$500, and \$1,000. They have interest coupons attached payable semi-annually and bear a rate of interest not to

exceed five per cent. The bonds so prepared are deposited in the Treasury and sub-treasuries to be held subject to the order of the Federal Farm Loan Board.

When loans are repaid to the Federal land banks or to the joint stock land banks the proceeds are used -

- (a) To pay off farm loan bonds as they mature,
- (b) To purchase such bonds,
- (c) To loan on first mortgages,
- (d) To purchase United States Government bonds,
- (e) To be held by the registrar as security for the payment of such bonds.

5/15/16.