THE FEDERAL HOME LOAN BANK BOARD

DURING THE ADMINISTRATION

OF

PRESIDENT LYNDON B. JOHNSON

NOVEMBER 1963 - JANUARY 1969

VOLUME I

PREFACE

It was my privilege to serve as a Member and as Chairman (by Presidential designation - January 26, 1965) of the Federal Home Loan Bank Board from the inception of the Administration of President Lyndon B. Johnson to the present date. I recall the President stating at the time of my designation as Chairman that it was his desire that the Board take whatever measures seemed appropriate to provide maximum protection for the peoples' savings in savings and loan associations, and to work for legislation we considered necessary to this end.

This volume records our efforts to follow and give expression to these directions. I should emphasize, however, that without the full support of the Administration, the legislative and other attainments chronicled herein would not have been realized. Thus, the accomplishments set out in this Volume I attest to the fact that the Johnson Administration has modernized the legislative foundation for the savings and loan industry and has enabled it to cope with the problems and the realities of the Twentieth Century and to be ready to move into the Twenty-First Century.

John E. Horne

John E. Horne

FOREWORD

The responsibility for writing, compiling, and editing the Board's history under the Johnson Administration was assigned to Simon H. Trevas, Executive Assistant to the Chairman. Each office head within the Board was personally responsible for the submission of material in his area of responsibility, and for its accuracy. Chairman Horne and Board Members Greenebaum and Rand reviewed the drafts and made valuable suggestions which have been incorporated herein. The end product reflects the combined knowledge and experience of the staff officials and the Members of the Board who individually, and collectively, made possible the accomplishments set out in this volume.

VOLUME I
ADMINISTRATIVE HISTORY

Introduction

The Federal Home Loan Bank Board was created by Congress in 1932 to meet the urgent needs of the housing and mortgage markets at that time. It provides aid and supervision for the thrift industry, and for the 12 District Banks serving it, in the following manner:

(1) Under the Federal Home Loan Bank Act of 1932, to provide a credit reservoir for thrift and home-financing institutions through the Federal Home Loan Banks;

(2) Under the Home Owners' Loan Act of 1933, to charter and supervise Federal savings and loan associations; and

(3) Under the National Housing Act of 1934, to direct the Federal Savings and Loan Insurance Corporation which provides insurance protection up to $15,000[1] for each savings account holder in insured institutions.

[1] Sec. 405, Title IV National Housing Act. Insurance coverage in Act as passed in 1934 was $5,000. By amendment to this section in 1950, insurance coverage was increased to $10,000; and in 1966, it was again amended by Public Law 89-695, to increase insurance coverage to $15,000.

The Board thus combines in one Federal agency, functions either similar or identical to those which in the commercial banking field are exercised by the Board of Governors of the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

The Board is made up of three members, not more than two of whom may be of the same political party. Each member is appointed by the President, by and with the advice and consent of the Senate, for full or unexpired portions of 4-year terms.

Presently, the Chairman of the Board is John E. Horne (Democrat). He was sworn in August 8, 1963, for a 4-year term expiring June 30, 1967, and was reappointed June 23, 1967, for a second 4-year term expiring June 30, 1971. He was designated by President Johnson to become Chairman on January 26, 1965. Michael Greenebaum (Democrat) was sworn in April 1, 1965, to fill an unexpired term ending June 30, 1965, and to serve a 4-year term ending June 30, 1969. Robert L. Rand (Republican) was sworn in on October 10, 1966, for a 4-year term ending June 30, 1970.

Costs of the organization administered by the Board to provide supervision derive from the industry by means of assessments made on the Federal Home Loan Banks and on the Federal Savings and Loan Insurance Corporation, and from charges made to institutions examined. Thus, although the Board restricts its expenses to limitations set each year by Congress, it receives no appropriated funds from the U. S. Treasury and is entirely self-supporting.

I
Organizational, Personnel
and Staffing Changes

I
ORGANIZATIONAL, PERSONNEL AND STAFFING CHANGES

Attached as an exhibit is an organizational chart showing the basic units of the Board. A substantial reorganization within the Board was effected in January, 1964 following a management study by the consultant firm of Booz-Allen and Hamilton, and a study and evaluation of the Board's manpower utilization program by the Civil Service Commission. Further, the reorganization was in accord with the President's statement of policy concerning effective manpower utilization.

Effective January 1, 1964, basically parallel or like functions were merged into single units. The Comptroller's Division of the Federal Savings and Loan Insurance Corporation was merged with the Board's Comptroller's Division. The FSLIC Underwriting Division and the Division of Federal Savings and Loan Operations were transferred into a new Board staff division known as the Applications Division.

To promote efficiency and relieve the Chairman of the details of certain administrative duties, an Office of Administration headed by the Executive Assistant to the Chairman was established which has direct supervisory responsibility over the divisions performing or rendering services for the various staff units, e.g. Comptroller, Administrative Services, Data Management, etc.

A new Office of Director, Federal Savings and Loan Insurance Corporation, was created which is responsible for supervising the development of plans for the settlement of insurance claims, for managing acquired assets, for the development of policy guidelines for the use of the Board and the staff, and all other proposed actions affecting the interests of the Insurance Corporation. Various staff units in the Board serve the Insurance Corporation. The Federal Savings and Loan Insurance Corporation, of course, remains intact as a separate and distinct legal entity. Other new divisions which commenced operations January 1, 1964 to increase the efficiency of the Board were the Administrative Services Division and the Organization and Methods Division.

The Division of Examinations was consolidated with the Division of Supervision into the Office of Examinations and Supervision for the purpose of improving examining and supervisory procedures, to make possible earlier identification of unsound practices, and to eliminate duplication.

The Office of the General Counsel was also reorganized in the interest of better administration by the division of its work into four separate sections dealing respectively with (1) Litigation, (2) Legislation, (3) Opinions and Regulations, and (4) General (Dockets) matters.[1]

[1] For further details of the organization and the reorganization see 29 F.R. 13544.

By an action on December 31, 1963, the Federal Home Loan Bank Board established a 12th Federal Home Loan Bank to be located in Spokane, Washington, to serve the States of Alaska, Hawaii, Idaho, Montana, Oregon, Utah, Washington, and Wyoming, and the Territory of Guam. The territory of the new Spokane Bank was formerly served by the Federal Home Loan Bank of San Francisco which remained in existence and which continued to provide the credit and other needs of member institutions in Arizona, California, and Nevada. The Portland, Oregon branch office of the Federal Home Loan Bank of San Francisco was terminated on April 5, 1964, and the Federal Home Loan Bank of Spokane commenced operations on April 6, 1964.

Following a careful evaluation by the Board, it was concluded that a separate district bank could provide more adequate credit and other services to the thrift and home financing institutions of the Pacific Northwest and adjoining areas. The Pacific Northwest was recognized as a highly unified and homogeneous region and establishment of a District Bank was aimed at effecting a closer relationship between the savings and loan associations and their reserve credit facility. Economic expansion within the region required special considerations which the centrally located Spokane Bank could provide better.[1]

[1] (FHLB Board Res. No. 17,677, December 31, 1963; FHLB Board Res. No. 17,830, February 26, 1964).

II
Program Changes

II
PROGRAM CHANGES

Insurance Reserve Requirement

For many years following World War II the demand for housing resulted in a strong demand for mortgage money, which demand was reflected in the favorable financial condition of member institutions. Retained earnings remained at favorable levels, net worth tended to be reasonably well maintained, and weak assets (an indication of unfavorable lending) were inconspicuous. During this period a member institution, irrespective of its growth, could satisfy the reserve requirements by placing 10 percent of its net income into reserves provided it had reserves which were equal to a specified percentage of savings accounts at the beginning of the year. Under these rules, an association that grew rapidly could dilute its reserve position sharply while actually increasing the need for reserves because of increased risk.

During 1962 and 1963 it became apparent that a steady rise in dividend rates at member institutions was causing a reduction in the amount of net income available for transfer to reserves. One of the disturbing elements in the upswing in dividend rates was that those institutions paying higher rates grew more rapidly which, in turn, further diluted the net worth position. A general increase in the volume of foreclosures and in weak assets further underscored the need to discard the then-existing concepts underlying the reserve regulation and to base reserve requirements on concepts related to current conditions and needs.

To accomplish this, regulations governing reserve requirements[1] for member institutions were amended December 30, 1963, to make growth in specified assets (total assets less cash and Government securities) the basis for allocation to reserves from net income. It also added a requirement that increases in scheduled items (slow loans and property acquired by foreclosure) should be covered by credits to reserves equal to 20 percent of scheduled items. This was designed to assure maintenance of adequate reserves and limit the decline in net worth position.

Failure to comply would give the Federal Savings and Loan Insurance Corporation the right to impose penalties, including restriction of the association's dividends.[2]

Penalties for failure to comply with the reserve requirements were not automatic, but were determined by evaluating each association on a case by case basis. To clarify this procedure, a policy statement was issued in March, 1965, prescribing certain criteria for evaluating institutions failing the reserve requirements, and for determining the extent of limitation of dividends or other action to be taken by the Board. This was clarified further in a policy statement of June, 1966.[3]

1 (12 C.F.R. Sec. 563.13)
2 (sec. 563.13, supra.)
3 (30 F.R. 4251, 31 F.R. 8777)

Because of increasingly severe competition for savings, especially from the commercial banking industry, the Board in 1966 adopted an amendment liberalizing the reserve requirements for that year and to that extent relaxing the limitation on dividends for the affected associations. This policy was extended through 1968.

To encourage failing institutions to correct deficiencies of operations promptly, it was desirable to provide for more specifically directed supervision. Therefore, by amendment in 1967, the Federal Savings and Loan Insurance Corporation was authorized to make its approval of a certain dividend rate conditional on compliance, by the association failing the reserve requirement, with certain terms tailored to fit the situation.[1]

New Supervisory Techniques

(a)

The growth in number and in resources of savings and loan institutions in recent years and the resulting importance of the industry in the general economy demanded marked changes in the approach and the technique of examining and supervision. Of increasing importance is the need for alertness on the part of supervisory authorities to situations in institutions showing signs of weakness in lending and collection, property management, operating practices, and adherence to law and regulation.

[1] (sec. 563.13, supra)

To achieve greater timeliness, supervision has been decentralized and greater authority has been given the examiners, changing them from mere fact-finders as heretofore to permit them to state their evaluations, opinion, and conclusions in their reports and to tell the managing officer during the examination where the corrections should be effected. Likewise, the Supervisory Agent has been given authority to take any action necessary except in cases that are believed to require direct action by the Board. These steps further the objective of increasing preventive supervision by calling timely attention of persons responsible for the affairs of an institution to the deviations from generally accepted practice.

(b)

The systematic evaluation of substantive matters relating to the financial condition and operation of each association was introduced in mid-1964 through the initiation of rating of each association. The examiner making the examination, the Chief Examiner of the district, and the Supervisory Agent, each in turn rate the condition, policies, practices, trends, and end-results of significant materiality of factors such as competition, lending, credit, appraisal, collection, operating results, records and controls, reserve position, condition of assets, adherence to law and regulation, and management. The facts developed in the examination provide the support for any adverse rating. A composite rating for the association takes into account the degree of deviation from accepted standards or from necessary requirements in one or more factors.

The rating form has been expanded to record the opinion of each rater as to the need for supervisory appraisals, establishment of specific reserves for indicated losses, and such matters as possible cease-and-desist action, the use of subpoenas, and examination of affiliates to obtain information. The orderly recording of opinions in these areas provide greater assurance that consideration has been given to these important tools of supervision by each person involved and to assure that where action is indicated the matter will be satisfactorily resolved at the appropriate level of authority. An audit by the Board's Washington staff that full consideration has been given to any matter of importance completes the process. The judgmental ratings aim to further the cooperative efforts at all levels, with the end-objective to point up the relative seriousness of each case and to identify readily those which require prompt attention.

(c)

The Board's concern for prompt and effective supervision arises from its responsibility to maintain the confidence of the public in the soundness of the industry. Accordingly, to better discharge this responsibility, a list was started of associations in the most serious situation or in a situation that may develop readily to that point and of other associations that require more than normal supervisory surveillance. The list is being maintained in a so-called "problem book" for the information of the Board Members. In this manner the Board Members are able personally to follow the situation in these cases, and the supervisory and related developments that are taking place. Through a periodic review of all such cases with the staff or a review at various intervals of individual cases, if warranted, the Board Members give advice and counsel to the staff.

(d)

Competent appraisals are essential to sound management and operations of savings and loan associations. Each loan made by an association is required to be supported by a written report disclosing fair market value of the real estate security. As a normal part of the regular examination, a check is made to determine that an association's appraisals conform to generally accepted standards of appraisal techniques and procedures.

In 1963, the Board inaugurated a program whereby, in certain cases, appraisals of a representative cross section sampling of recent loans were tested. In May 1966, the Board issued a policy statement[1] setting forth guidelines for the appraisal of the assets of an insured institution. This policy statement was based on recommendations made to the Board by the Special Advisory Committee on Appraisal Policies

[1] (12 C.F.R. 571.1)

and Practices, which committee, made up of representatives of the appraisal profession and the savings and loan business, was created by the Board Chairman late in 1965. The policy statement retains many of the features of the 1963 "test" appraisal program, but includes a number of new features. The new statement recognizes a wide range of services beyond those of actual appraisal of property. These include such matters as audit of an institution's appraisal policies and practices, review or preliminary survey of security properties, and test appraisals of selected properties. In the latter, selection of properties to be appraised is governed by the purpose of the appraisal, which may be to make a sampling, to test property securing substandard loans, to evaluate the security property of specified classes or types of loans, or to effect some other purpose. This policy reflects the Board's view that reliance on the soundness and integrity of appraisals is indispensable and that standards for internal appraisals should be equivalent to those required by members of national professional organizations.

Early in 1966, the Board put into effect a regulation[1] requiring an institution to appraise each parcel of real estate acquired as a result of foreclosure or voluntary deed in lieu thereof.

[1] (12 C.F.R. 563.17-2)

The regulation provides for the write-down of the book value of the asset if such book value exceeds fair market value as shown by the appraisal.

The regulation also provides for the reevaluation of assets in connection with each examination. Where assets are represented or secured by real estate, reevaluation must be accomplished by means of an appraisal. If an overvaluation of assets is disclosed, the association may be required to write-down the book value of the overvalued assets. Generally, such write-down is accomplished by the establishment of a specific reserve, which reserve is not included as a part of net worth for the purpose of determining compliance with reserve regulations.

The program of periodic reevaluation of assets and the write-down of overvalued assets provides an accurate estimate of the true value of an association's mortgage loan portfolio. More importantly it recognizes immediately probable and potential losses, and by removing such losses from net worth provides a clear picture of true net worth and the extent to which an association will be able to absorb losses as yet unknown.

New Approaches to Maintain Liquidity of the Federal Savings and Loan Insurance Corporation and in Disposition of Assets

To avoid the well known cost and disruptive impact of receivership and liquidation of financial institutions, the Board from its earliest days has followed the policy of preventing, when feasible, the failure of an insured institution by having the Insurance Corporation grant financial aid. Prior to 1960, such aid frequently took the form of a cash contribution. During the early 1960's such default-prevention aid generally took the form of a purchase of a substantial part - in a few instances, all - of an association's assets. Even though these default prevention tools continue to be used, the Board has since 1965 placed greater emphasis upon coupling financial aid with a merger of the "sick" institution into a sound one. Currently, the Corporation assists by "backstopping" the operation under an agreement to underwrite asset losses upon liquidation, and, in some cases, to underwrite unusual operating losses. In addition, there are a few instances where a part of the assets are purchased by the Corporation, but these to date have involved minimum amounts of cash. Cash expenditures in connection with default prevention actions have very substantially decreased by this technique.

Although the preservation of Corporation liquidity is of primary importance, Section 406(f) of the National Housing Act provides that no contribution may be made if the cost thereof is greater than would be the cost of liquidating the institution. In August, 1967, the Federal Home Loan Bank Board hired independent consultants and appointed a committee (two savings and loan industry leaders and a representative of the Bureau of the Budget) to study the Corporation's default prevention policies and aid agreements, and to make recommendations. After the completion of such review, the evaluators were of the opinion that no basic change in its methods was merited.

Section 406 of the National Housing Act of 1934 contemplates that the Insurance Corporation will acquire and dispose of various types of assets in fulfilling its primary function of insuring the accounts held by savers in insured institutions. Prior to April, 1963, there had been few instances wherein the Insurance Corporation had found it necessary to acquire more than a nominal number of realty assets in the performance of its default prevention functions. In general, assets purchased from those institutions which were threatened with default consisted of marginal, as opposed to grossly inflated mortgage loans. Under these circumstances, the mortgage paper was usually saleable at a price and the liquidation consisted of waiting for the best offer obtainable in the open market.

Beginning with the acquisition of assets in 1963 of an Illinois institution, there has been a marked deterioration in the quality of the assets the Corporation has acquired in the performance of its prevention-of-default efforts. More often than not, there is little correlation between the book value at which the asset is acquired and the market value at which it must be sold. In many instances, the real estate assets remaining in a problem association are located in blighted or economically distressed areas. In some cases loans were originated under circumstances involving fraud, dishonesty, and self-dealing. A high proportion of the loans and real estate owned so acquired is the subject of extremely complex litigation and the process of liquidating these loans includes many functions other than the simple sale of loans and real estate owned to the highest bidder. For example: In early 1968 the Board authorized the supervisory merger of a Chicago institution in imminent danger of default as a result of its policy of specializing in loans to "ghetto" real estate operators. In order to facilitate the merger, the Corporation was required to purchase outright a large group of loans and real estate owned wherein the following common characteristics soon became apparent:

The majority of such loans were made on two and three flat detached masonry structures from 40 to 70 years old located in the Lawndale District of near west side Chicago. The defunct institution had made full value loans to a group of real estate speculators. The speculators almost simultaneously sold the properties to Negroes who would otherwise have been unable to obtain mortgage financing. The speculators sold on real estate contract terms, usually at prices from $10,000 to $15,000 higher than their original purchase or mortgage value. In addition to a cash downpayment, seldom less than $2,000, the speculator also derived a monthly income from the real estate contract substantially in excess of his monthly payment obligation under the mortgage.

Now racial tension prevails in the Lawndale area, the City of Chicago is strenuously enforcing building and housing codes, and mounting pressure is being applied to the speculators to convey title to the real estate to the contract purchaser actually in residence. When pressure becomes severe enough, the speculator simply ceases making regular mortgage payments, secure from any personal liability because the note and mortgage run to a bare land trust wherein neither trustees or beneficiaries are personally liable. In the instances cited, the Corporation is undertaking to obtain title for the contract purchaser, refinancing the sale through FHA insured institutional lenders. FHA values usually exceed conventional market values, but in order for the property to qualify for FHA loan insurance it must be certified as complying with municipal codes, be structurally sound and not otherwise in violation of various FHA requirements. The difficulties encountered in facilitating such "sales" are enormous.

From January 1, 1964 to June 30, 1968, protective action was taken in 30 cases involving savings accounts of almost $1 billion, and involved a variety of procedures and methods including acquisition of assets, contribution agreements, loan agreements and 5 receiverships.

In analyzing each asset, either acquired or subject to protective agreement, the necessity for liquidity must be balanced against the desire to minimize losses (or maximize recoveries). And the Board follows that course of action which comes closest to meeting both criteria. Methods and techniques for meeting these objectives vary. Real property owned by the Corporation is offered for sale on the open market. Sale of major assets may be by a formal sealed bid under conditions assuring wide market exposure and sale at the highest price and best terms obtainable in the open market. Negotiated sales are also quite common, particularly in those instances where problems of title, zoning, construction, or financing make the asset difficult to market.

Some innovative plans have been developed since 1964 to aid in the disposition of such assets. The Corporation sells loans and real estate contracts which it makes or acquires, issuing its guaranty on the top twenty percent of such loans and contracts. Nine hundred and ninety-nine parcels aggregating $16.7 million have been sold subject to Federal Savings and Loan Insurance Corporation guaranty since initiation of the plan in mid-1965.

Several large project sales programs have been undertaken for subdivisions of single family residences utilizing VA guaranteed and/or FHA insured private financing. Such sales can make the assets more marketable and enhance the Federal Savings and Loan Insurance Corporation's cash recovery.

In Chicago, Cincinnati, and Newark, the Corporation is also working directly with FHA's Division of Multi-family Housing in rehabilitating structurally sound, older apartment buildings located in blighted or "ghetto" areas. Action has been taken, also, to facilitate FHA refinancing of many of the mortgages and real estate contracts it has acquired on one-and-two-family properties located in economically distressed inner city areas. In this program the objective is to place the present occupant in title to the property, while at the same time obtaining FHA-insured private financing in order to curtail the Federal Savings and Loan Insurance Corporation's contingent liabilities in high-risk areas.

Chicago is the only metropolitan area where these liquidation functions are performed with our own personnel. This results from our extensive involvement with problem and defunct institutions in that area. Elsewhere problem institutions have been or are being merged into strong local institutions, with the Corporation either buying outright the marginal assets of the disappearing association or guaranteeing the successor institution against certain specified losses and/or expenses in the latter's administration of said marginal assets. Our problems in Chicago however, were further compounded by the fact that Illinois does not permit financial institutions to maintain branch offices. Since a successor institution could not maintain as a branch the office of the problem association, mergers in that state become more difficult to arrange. In either situation, the successor institution acts in the capacity of a servicing agent for the assets to which the Corporation has taken title.

Policy on Bank Advances

A staff report revealed, in late 1963, that a number of associations borrowing from the Federal Home Loan Banks had a higher ratio of slow assets than the Board considered reasonable. In the following year, therefore, the Board adopted a policy gearing Bank advances and lines of credit for member institutions specifically to the quality of members' portfolios, and by letter dated November 5, 1964, advised all the Federal Home Loan Bank Presidents of that policy.

By 1965 it was apparent that various policies related to Bank advances had developed over the years and needed to be codified in a clear statement to make the ground rules clear. The Board, therefore, issued a general policy on Bank advances[1] setting forth the requirements for compliance with the broad purposes and legislative intent of the act and with sound economic practices. One of the significant positions taken in this policy statement was that advances would not be extended for needs which, in the Board's opinion, could be met from the member's own resources.

[1] (30 F.R. 10168)

Early in 1965 the Board discovered evidence of unsound economic practices in the tendency for certain associations to seek funds more for the sake of rapid growth of their institution than for meeting any strong demand in the mortgage market. Escalation of dividends was a common method for achieving this end. At the same time, these associations were seeking maximum advances from the Federal Home Loan Banks. In such cases, the Board had to consider whether or not Bank advances would only add to the excess of funds already present. Therefore, the Board determined that it should not extend advances to members who increased their dividend rates until it could evaluate the situation. On April 1, 1965 the Board announced restrictions on borrowings, and set a policy that prescribed uniform procedures for evaluating each case.

Because of increasing competition from commercial banks and other factors, including the loss in effectiveness of this techhique as a tool, the policy relating Bank advances to dividends being paid by member associations was suspended on July 1, 1966. Altogether, the 1966 experience demonstrated that the Board needed authority to control rates directly.

By April, 1966, heavy withdrawal of savings from associations put a heavy drain on their liquidity. The Banks needed to obtain large amounts of funds in the financial market to replace these withdrawals. It was evident that Bank advances to associations for expansion purposes, in addition to replacing withdrawals, would have to be curtailed. A policy letter[1] was, therefore, issued on April 20, 1966 to all Banks stating that, to meet members' liquidity needs, Banks should require borrowers to keep loan commitments down to reasonable levels, apply net savings receipts to repay withdrawal advances, and avoid conversion of withdrawal advances to expansion advances. Expansion advances were nevertheless permitted for members who could qualify.

Modification in Issuance of Consolidated Bond Offerings

Early in 1965, a modification was made in the timing of Federal Home Loan Bank System offerings of consolidated bonds and notes. Maturity dates and subsequent issue dates were changed from midmonth to the 25th of the month to improve coordination of System financing operations with those of the Treasury and other Federal agencies. Also, the somewhat later date of offering permits the System to have the benefit of the first few business days in the month on which to base estimates of financing needs.

In its financing operations, the Bank System participated in a Government-wide program announced by the President early in September of 1966 designed to reduce the credit demands made on the economy by Federal agencies. Among other things, this program called for limiting sales of securities in financial markets to the minimum

[1] Copies of letters to Bank Presidents setting out Board policy maintained in Office of Federal Home Loan Bank Operations

necessary for essential operations. As a result of the Bank System's participation in this program, and earlier coordination of System financing with the Treasury Department, public sales of Bank obligations after July of 1966 fell below the amount required to refund maturing obligations. In view of the critical nature of the System's financing requirements, however, necessary funds were obtained by selling System obligations direct to Government investment accounts. In this manner the System raised $590 million during August, September, and October of 1966.

Subsequently, $125 million of the $625 million issue of System obligations offered in January of 1967, was sold directly to Government investment accounts as was $250 million of a $550 million offering in June 1968.

Qualifications for Public Interest Directors of Federal Home Loan Banks

Under law and regulations the Board appoints 4 directors from each bank and the bank members elect 8 directors for each bank except the New York bank district where an additional elective director is authorized for the members of that bank representing the Commonwealth of Puerto Rico. In August of 1965 the Board issued a brief statement of policy concerning the qualifications for those directors of the Banks appointed by the Board to represent the public interest.

The statement stressed that appointees should have achieved such eminence in their fields of endeavor - such as commerce, finance, education, law, medicine, or government - that their stature and background would enable them to view management and trusteeship responsibilities in the broad context of national interests. It further emphasized that the appointment of persons whose activities presented a possibility for conflict of interest would be avoided.[1]

Initial Capital and Pledge and Escrow of Capital for New Associations

(a) Initial Capital

The term "initial capital requirements" refers to the savings accounts of Federal or State-chartered mutual associations and State-chartered permanent stock institutions and, for the latter, also includes permanent stock and paid-in surplus. The requirements have a two-fold purpose -- they demonstrate confidence and support of the public in the new association and they give assurance that the association will have an adequate operating base for expenses, dividends, and reserve allocations. Further, the permanent stock and paid-in surplus requirement represents a reasonable investment by the owners in the light of anticipated future growth.

[1] (FHLB Board Minutes, July 29, 1965)

Following a study of the adequacy of initial capital requirements for applicants for insurance or for Federal charter, the Board, in December 1963, adopted a schedule of minimum initial capital requirements related to population of the area in which the applicant is located.[1]

(b)
Collection of Initial
Capital Subscriptions

Prior to 1966, new Federal associations were required to collect the full amount of their required initial capital in advance of insurance while State-chartered institutions were allowed a grace period of 30 days to collect these funds. To afford equitable treatment to both State-chartered and Federal institutions, the Board, on February 23, 1966, adopted revised requirements. They provide that each type of institution may become insured after a minimum of 10% of the required number and 20% of the required amount of subscriptions have been collected. Those collections include all accounts required to be pledged against potential operating or other losses during the first five years of operation. A period of 30 days is granted following insurance to collect the balance of the required initial capitalization.[2]

(c)
Escrow of Permanent Stock

Difficulties arising from the sale of control of permanent stock institutions during the early years following insurance led the Board to adopt, in December of 1963, a mandatory requirement for a

[1] and [2] Files maintained in Office of Applications contain background material.

five-year escrow of permanent stock. The purpose of this change was to control ownership to the extent that individuals approved by the Board as initial permanent stockholders would continue to control the institution during its formative years. This escrow is required as a standard condition for approval of insurance applications of permanent stock applicants.[1]

(d)
Pledge Agreements

A standard requirement for the issuance of new Federal charters or the insurance of a new State-chartered institution is that 10% of the required initial capital be pledged and held in escrow for the first few years of operation. This requirement is deemed necessary to cover any losses in the operation of a new association. On June 9, 1966, the Board revised the forms of pledge and escrow agreements[2] to incorporate improvements that past experience had indicated desirable, e.g. eliminating 3 year provisional release, and extending the escrow period of pledged capital from 5 to 6 years.

Mobile Facilities

Effective January 23, 1966, the Board amended the Rules and Regulations for the Federal Savings and Loan System[3] to provide for the establishment of mobile facilities by Federal associations at 2

1 Specimens of these agreements are maintained in the Office of Applications.
2 Specimen agreements in Office of Applications.
3 (12 C.F.R. 545.14-4)

or more locations in nonurban areas in the same state as the association's home office and within its regular lending territory. The purpose was to bring the services offered by Federal associations to areas not adequately served by other FSLIC insured institutions and yet where full-time operation was not feasible. Associations granted such authority must have the mobile facility open for business at the same location on the same day or days not to exceed 2 days of each week aggregating a total of not less than 4 hours a day.

Mergers

All mergers of Federal savings and loan associations or mergers of State-chartered institutions into Federal savings and loan associations must receive the prior approval of the Board. In addition, under the Rules and Regulations for Insurance of Accounts, any increase in the insurable accounts of a State-chartered insured association or of a Federal association resulting from a merger, a consolidation or a bulk purchase of assets in exchange for assumption of savings account liabilities, must receive the prior approval of the Board. In 1965 the Board conducted a study to assure that standards adopted by the Board would be consistent with Supreme Court decisions dealing with anti-trust situations. In 1966 it appointed a special committee to study other problems and procedures relating to mergers; and in March of 1967, the Board adopted and published statements of policy describing the criteria applied by the Board in acting upon such applications. In November 1967, clarifying amendments to those statements of policy were adopted[1].

The Board, in its statements of policy on mergers, has declared that before approving a merger it will examine the legality under the antitrust laws and its economic impact on the market structure, on the allocation on mortgage funds, and on operating efficiency. Other factors evaluated include the management and the organization of the acquiring institution, the probable financial condition of the resulting institution, the fairness of the terms of the merger, the retention of directors or officers of the institutions, and any consideration given to individuals involved. Where such factors do not provide a clear basis for a determination of the merits of the proposed merger, the alternatives short of merger that have been explored by the disappearing institution are reviewed by the Board. The Board's statement also declares that the Board usually will not favor a merger that would eliminate the only independent, local, insured institution in a community, if that institution has the ability to continue its service to the community as an independent organization.

[1] (12 C.F.R. 556.2 and 571.5)

Drive-In and Pedestrian Facilities

In order to clarify the type of facility that qualifies as a drive-in or pedestrian facility of a Federal association and the type of functions that may be performed at such a facility, the Board published a ruling on the subject, which became effective on May 17, 1968.[1]

[1] (12 C.F.R. 555.12)

III
Operating Methods

III
OPERATING METHODS

Except for an operating change set out in the next paragraph, significant changes in operating methods in the Office of Examinations and Supervision have already been discussed in Program Changes. The changes were included under that heading because they involved substantive changes involving basic policy considerations.[1]

For many years the Board had undertaken through its field examiners to audit each association examined. Later it modified its practices so that (1) internal audit standards prescribed by the Board, adopted by savings and loan associations and approved by the Board, could be utilized in lieu of an audit by Board Examiners, and (2) public accountants or auditors who followed prescribed standards established by the Board, could perform audits for associations desiring to avail themselves of such services.

Effective January 1, 1968, by regulation[2] the option referred to in (2) above no longer obtained, but in lieu of such option, all FSLIC insured associations are now required to be audited at least once in each calendar year by auditors employed by the associations at its own expense. The audit is still required to be performed in a manner satisfactory to the Board and in accordance with general policies established by the Board.

[1] (See NEW SUPERVISORY TECHNIQUES - pp. 8-13)
[2] (12 C.F.R. 563.17-1)

The other area of significant changes in operating methods occurred in the processing of applications for new charters and branches in the Office of Applications. The volume and complexity of applications for branches of existing Federal savings and loan associations had been substantially increasing for several years prior to 1964. A review of the problem indicated that many applications were frivolous, multiple and unworthy. Also that the members of the Board were obliged to spend a great deal of their time reviewing applications which should have been screened out long before coming to the Board for consideration.

After an intensive study in this area, a complete revision of the procedures for handling such applications was adopted in December of 1964.[1] These new procedures were designed to expedite these applications and make more efficient use of the Board's personnel. By prescribing eligibility requirements many applications which previously ran the full gamut up to, and including, Board disapproval were eliminated. For example, under the new regulations, an association is not eligible for a branch if it has been in operation for less than three years, or if less than 12 months has elapsed since its most recently approved unopened branch, or if it has other branch applications which the Board has not yet acted upon.

[1] (12 C.F.R. 545.14; Internal Processing Procedure, 32 F.R. 14346)

To clarify further eligibility standards, the Board on September 18, 1965 issued a policy statement on location of branch offices, the circumstances under which branches would have to be established and the disapproval of any application for a branch in a state other than where the home office of an association is located.

To expedite the processing of new applications for the organization of new Federal associations, to reduce workload and to provide more uniform processing by Supervisory Agents of the Board, a revised procedure was adopted by the Board on May 19, 1965.[1] The revised procedures place greater responsibility on the staff and the end result is to make possible a more prompt disposition of applications with less inconvenience to members of the public concerned in these proceedings.

In the interests of uniformity and efficiency, a two-year study of the processing of applications for insurance from State-chartered savings and loan associations was completed in 1967, with the adoption, by the Board of a completely revised procedure, effective July 7, 1967. The new procedure brought the processing of such applications more closely in line with the handling of applications for Federal charter and provided for formal hearings at the Federal level.[2]

[1] (12 C.F.R. 543; 32 F.R. 14345)
[2] (12 C.F.R. 562; 32 F.R. 14348 and 14349)

IV
Inter-Agency Relations

IV
INTER-AGENCY RELATIONS

(a)

The Coordinating Committee on Bank Regulations comprised of the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation and Chairman of the Federal Home Loan Bank Board was announced by Treasury Secretary Fowler on July 6, 1965. He stated the committee was to further the President's direction for an exchange of views and accommodation of differences between banking agencies.

This committee meets regularly and has made possible both of the President's directions, namely, an exchange of views and an accommodation of differences. For example, from an exchange of views in this committee a much greater unity in approach has developed in areas such as the advertising on rates for savings, in supervisory techniques and in the coordination of supervisory data. Also, a coordinated approach was successfully utilized in supporting the passage of the Financial Institutions Supervisory Act of 1966, and the enactment and subsequent extension of the Rate Control Act.

(b)

Under an April 1965 Participating Agency Service Agreement between the Board and the Agency for International Development, the Office of International Home Finance (OIHF) was established to assist AID in the development and implementation of foreign policies designed to improve housing conditions in the less developed countries by establishing in these countries specialized systems of thrift and home financing. Prior to that date there was an informal agreement to offer technical assistance when circumstances permitted.

Specifically, the new office was called upon to develop and, in part, conduct training programs and briefing sessions for visiting foreign executives and government officials interested in the problems of home finance, and to provide AID with a continuing source of technical consultation and support.

The Office of International Home Finance has arranged training sessions of varying length and intensity, for 285 participants from Argentina, Brazil, Chile, Iran, Korea, Malaysia, Nicaragua, Peru, Philippines, Ryukyus, Thailand, and the United Arab Republic. On the technical assistance side, many OIHF-nominated experts (often specialists from within the agency) have been accepted by AID for temporary duty in the less developed countries. Their assignments have ranged from the drafting of legislation and regulations for new savings and loan systems, to evaluation of the daily operations of those in their relative incipience. Countries benefiting from this Board technical support service have been Argentina, Bolivia, Costa Rica, Chile, Dominican Republic, Ecuador, El Salvador, Nicaragua, Nigeria, Panama, and Venezuela.

Before year-end 1965, a major new dimension was added to the operating scope of OIHF. The Housing and Urban Development Act of 1965 contained an amendment to the Home Owners' Loan Act to permit Federally-chartered savings and loan associations to invest up to one percent of their assets in loans guaranteed by the President (acting through AID) under Section 224 of the Foreign Assistance Act of 1961, as amended.[1] More to the point, this meant that Federal associations (and, given the subsequent authority, State-chartered savings and loan associations, by many States) were now eligible to participate as investors in the AID Latin American Housing Investment Guaranty Program.

The tight money situation in 1966, however, caused a slow-down in industry participation. However, in April 1966, AID announced that it would welcome applications from Latin American builders, savings and loan associations, and FHLBB equivalents for a newly-authorized $100 million in guaranty authority.

Latin response to the April announcement was overwhelming. AID received applications totaling $600 million by the September deadline for filing and spent the best part of the next fifteen months conducting feasibility reviews and selecting out the best applications for approval. Letters of Advice (guaranty commitment letters) were mailed by AID to the approved Latin American borrowers starting in late 1967, and it was in the early months of 1968 that

[1] (See 12 C.F.R. 545.6-20 for implementing regulations)

eligible U. S. associations, now pretty well recovered from the 1966 "credit crunch," had both loanable funds available for the AID Guaranty Program and a wide range of investment opportunities open to them.

By October 16, 1968, U. S. associations had committed $29.4 million for the long-term financing of AID-guaranteed loans in Chile, Peru, Jamaica, Guatemala, Venezuela, Paraguay, Mexico and Ecuador.

V

Legislative Relations

V
LEGISLATIVE RELATIONS

Pursuant to the President's suggestion that each agency have a full-time staff member for Congressional liaison, a new position of Assistant Secretary for Congressional Liaison in the Office of the Secretary to the Board was established on July 1, 1965. The Chairman's appointee had a previous background as Chief Clerk of the Subcommittee on Housing of the House Committee on Banking and Currency, and as Legislative Assistant to the Chairman of that Committee.

The Assistant Secretary for Congressional Liaison was charged with the responsibility of representing the Board with individuals or committees of the Congress, conveying and interpreting the Board's position, handling Congressional inquiries and correspondence and keeping the Board abreast of changes in existing legislation or proposed new legislation affecting the Board's interests.

VI
External Operations

VI
EXTERNAL OPERATIONS

Officers and Directors - Fiduciary Responsibility

The case of Reich v. Webb[1] upheld the right of the Board to enforce common law fiduciary responsibilities of officers and directors of savings and loan associations. Prior to this decision the Board on the basis of earlier opinions of General Counsel was of the view that officers and directors of savings and loan associations were fiduciaries of their depositors' funds and as such were held to a higher degree of trust than officials in a mercantile corporation. This decision by an Appellate Court not only confirms earlier views but establishes a legal precedent which may be a valuable tool for the Board in the years ahead.

Aid to Major Disaster Areas

The largest single natural disaster to hit the United States since the passage of the Federal Disaster Act was the earthquake and seismic sea waves which devastated coastal areas of Alaska on March 27, 1964. The State was immediately declared a major disaster area and the Office of Emergency Planning field office in Anchorage became the focal point for coordinating and directing all Federal Disaster assistance activities in Alaska.

[1] (U. S. Ct. of App. 9th Cir. - 8/16/64)

The Federal Home Loan Bank Board took several actions on March 30, 1964, to furnish emergency financial assistance for the rehabilitation and reconstruction of properties in the disaster-stricken areas of Alaska. In essence, they extended the lending areas of all insured associations in the 12th District to include Alaska, and doubled the amount of funds which any member institution of the Federal Home Loan Bank System could borrow for mortgage expansion purposes to invest in loans in Alaska.

The President of the Federal Home Loan Bank of Spokane was immediately advised of these actions of the Board and was requested to extend to member institutions in the distressed area the concern of the Board and every offer of assistance. Member institutions also were informed that maximum leniency and forbearance might be extended to borrowers whose properties were damaged by the earthquake.[1]

In April 1965, sections of the States of Illinois, Indiana, Iowa, Michigan, Minnesota, Ohio, and Wisconsin were declared distressed areas by the President because of flood and tornado damage. The District Banks of Chicago, Cincinnati, Des Moines, and Indianapolis were requested to offer every assistance, and to encourage members to extend leniency and forbearance to borrowers whose ability to meet their commitments to savings and loan associations had been impaired by the disaster.

[1] (FHLB Board Res. No. 17,980, March 30, 1964; FSLIC - 1,779, March 30, 1964)

In September 1965, sections of the States of Florida and Louisiana were declared major disaster areas by the President because of destruction resulting from Hurricane Betsy. The Board responded by temporarily liberalizing certain credit policies to assist in the anticipated need for funds for reconstruction and rehabilitation within the stricken area.[1]

During 1967, the Board cooperated with the Office of Emergency Planning in the following four Bank Districts in which disaster areas had been declared by the President: Indianapolis - because of tornadoes in the County of Kent, Mich.; Chicago - because of tornadoes in the Counties of Boone, Cook, and Lake, Illinois; Spokane - because of floods in Alaska; and Little Rock - because of Hurricane Beulah, and the tornadoes which followed, in 24 counties of Texas.[2]

Study of Savings and Loan Industry

Rapid expansion of the savings and loan industry and its growing place as an important financial intermediary in our economy emphasized the need for a complete study of this industry and the Board's functions relative to it. This need was accentuated by events in recent times culminating in difficulties for the home mortgage market. The Board therefore obtained authority for the study through Public Law

[1] (FHLB Board Res. No. 19,403, September 13, 1965; FHLB Board Res. No. 19,404, September 14, 1965)

[2] (FHLB Board Res. No. 20,599, May 3, 1967; FHLB Board Res. No. 20,817, August 18, 1967; FHLB Board Res. No. 20,904, September 29, 1967)

89-426, which approved expenditure of $500,000 for the project. A professional staff of 21 persons was assembled from various universities under the direction of Professor Irwin Friend of the University of Pennsylvania. Topics for research included: the background of the industry; its place in the economy; its financial soundness and liquidity; branching and merging; industry's reaction to the Board's supervisory actions; the impact of Board policies on housing demand and cyclical stability; possible improvements in the structure of the industry; and analysis of the Board's regulatory procedures. The study is not scheduled for completion before January 1969.

VII
Changes or Emphasis of
Character of Mission

VII
CHANGES OR EMPHASIS OF CHARACTER OF MISSION

We believe that changes or emphasis referred to in the above heading are reflected in Title II (Program Changes), and again in Title VIII (Legislation and Implementing Regulations), to follow.

In addition to the foregoing, there has been at least a shifting of emphasis to support the Administration's goal of providing decent, adequate housing for low and moderate income families. Early in 1967, the Chairman wrote to all members of the Federal Home Loan Bank System[1] calling their attention to pertinent provisions of the section 221(d)(3) program administered by FHA and encouraging their consideration. Following that date, by speeches by Board Members before industry groups their participation in these programs designed to provide housing for low and moderate income families was encouraged. In the first issue of the Board's new publication,[2] the featured article entitled "S & L Roles In Financing Lower Income Housing" dealt with all the existing programs in this area and reviewed some of the provisions of the Housing and Urban Development Act of 1968 in which the savings and loan industry could take an active role.

[1] Letter of Chairman Horne, March 2, 1967
[2] The Journal of the Federal Home Loan Bank Board, Vol. I - June, 1968 pp. 9-14

Some of the response has been encouraging, and when we consider the dynamic growth of the industry, participation by it should be of significant help. It should be of interest, too, that during the period beginning December 1963 and continuing through June of 1968 the following growth pattern was established:

Item	December, 1963	June, 1968
Number of insured associations	4,149	4,474
Total assets	$103 billion	$144 billion
Mortgage loans outstanding	$ 87 billion	$122 billion
Savings capital	$ 88 billion	$124 billion
Number of savers	34 million	43 million

Hopefully, the skills and resources of this viable industry will help make a substantial contribution to the social objectives of the Administration's goals in this area.

VIII
Legislation and
Implementing Regulations

VIII
LEGISLATION AND IMPLEMENTING REGULATIONS

Legislative Goals

The legislative goals of the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation at the beginning of the Johnson Administration can best be summarized by the statement made by the Chairman before the House Banking and Currency Committee on February 5, 1963, at the start of the 88th Congress.

He stated that one of the primary considerations confronting the Board at that time was the revision and modernization of section 5(c) of the Home Owners' Loan Act of 1933, which provides lending authority for Federal savings and loan associations. Although the relevance of some of the powers already contained in that section was questioned, it was pointed out that much new lending authority could be added to provide further outlets for more effective investment of funds by Federal associations.

Another critical area in which he felt major improvements were needed was that of supervision and enforcement. With regard to Federal associations, the Board's disciplinary authority was limited to the alternatives of either a protracted hearing procedure or seizure of the association. The first was too slow and cumbersome and the second was much too severe. It was recommended that a simpler and less severe but more prompt technique be added to the Board's supervisory authority.

With reference to State-chartered associations, the Board had the power, under section 407 of the National Housing Act, to terminate insurance of accounts. However, aside from the termination alternative as a means of enforcement, there was only the technique of persuasion. Here, too, it was recommended that the Board be provided with some intermediate powers.

In another area pertaining to State-chartered institutions, there was the problem of holding companies. Under the legislation in effect at that time, the Board had only minimum powers over savings and loan holding companies. Therefore, the Board wanted powers in the Insurance Corporation similar to those granted to the Federal Reserve Board under the Bank Holding Company Act.

The Board had already proposed legislation to the Bureau of the Budget to provide authority for Federal associations and other members of the Federal Home Loan Bank System to act as trustees of stock bonus, pension, and profit-sharing plans, including Keogh Act plans for self-employed individuals.

In addition, the Board had sent a proposed bill to the Bureau providing for an increase in the limit on insurance of accounts. It was felt that the then $10,000 limit was too low and that an increase to $25,000 would be in the public interest. Another important legislative recommendation was the amendment of section 5A of the Federal Home Loan Bank Act to give the Board broader authority to regulate the liquidity practices of associations having membership in the Bank System. It was also suggested that the National Housing Act be made more explicit with regard to the conditions and standards which State-chartered institutions would have to meet in order to qualify for FSLIC insurance of accounts.

Finally, it was recommended that the Board or the Insurance Corporation be authorized to require approval by it before a State-chartered institution could establish a new branch or merge with another State-chartered institution. It was pointed out that the Federal banking agencies already had such authority.

88th Congress (1963 - 1964)

The only major legislation affecting the Board during the 88th Congress was contained in the Housing Act of 1964. The enrolled bill was approved September 2, 1964, as Public Law 88-560. The provisions of the Housing Act of 1964 which affected the Board were contained in section 701(d) and in title IX of the act.

Section 701(d) amended sections 11(h) and 16 of the Federal Home Loan Bank Act to permit the Federal Home Loan Banks to invest in participations and other instruments issued by the Federal National Mortgage Association, as well as in FNMA obligations, and to use such investments for reserve purposes.

Title IX contained a number of amendments liberalizing the lending and investment authority of Federal savings and loan associations.

Section 901 amended section 5(c) of the Home Owners' Loan Act of 1933 and section 403(b) of the National Housing Act by increasing the regular lending territory from 50 to 100 miles, and section 902 amended the same section to authorize Federal associations to invest without limitation in mortgage loans of up to $40,000 on single-family dwellings, an increase of $5,000 from the prior limitation. Section 903 amended that section to provide new and broader investment authority for Federal associations in urban renewal projects, and section 904 added to section 5(c) definitions of "real property" and "real estate" to permit Federal associations to invest in loans on the security of leaseholds extending at least 15 years beyond the maturity of the debt.

Section 905 added to section 5(c) a provision authorizing Federal associations to invest up to 1% of its assets in the stock or other securities of service corporations, and section 906 amended section 10(b) of the Federal Home Loan Bank Act to permit the banks to accept, as collateral security for advances, mortgage loans of up to $40,000 and with maturities of up to 30 years, increases from the prior limitations of $35,000 and 25 years.

Section 907 amended section 5(c) of the Home Owners' Loan Act to broaden the authority of Federal associations to invest in Government and municipal obligations, section 908 amended that section to increase from $3500 to $5000 the maximum amount which Federal associations were authorized to invest in home improvement loans, and section 910 amended section 5(c) to authorize Federal associations to invest up to 5 percent of their assets in loans for the payment of expenses of college or university education.

Finally, section 909 of P. L. 88-560, amended title IV of the National Housing Act by adding a new section 409 providing that savings accounts insured by the FSLIC are lawful investments and can be accepted as security for public funds of the United States and fiduciary and trust funds under the authority of the United States or any officer.

89th Congress (1965 - 1966)

The Housing and Urban Development Act of 1965, which further increased the lending and investment authority of Federal associations, was enacted during the first session of the 89th Congress. The enrolled bill was approved August 10, 1965, as Public Law 89-117.

Section 201(b)(3) of that law amended section 5(c) of the Home Owners' Loan Act of 1933 to authorize Federal associations to invest in loans or participations in land development loans secured by mortgages insured under the new title X of the National Housing Act.

It also authorized Federal associations to invest up to 1 percent of assets in loans guaranteed by the President under § 224 of the Foreign Assistance Act of 1961, as amended, which authorizes the guarantee of certain loans made to assist the development and growth of housing in Latin America.

Section 1110(a) liberalized the authority of Federal associations to make loans, under section 5(c), on college, university, or hospital facilities, and, section 1110(b) amended the same section to liberalize the authority of Federal associations to make leasehold loans by reducing the minimum term of leaseholds eligible for such loans from the existing figure of 15 years beyond the maturity of the debt to ten years beyond such maturity.

Section 1110(c) also amended section 5(c) to require the prior approval of the Board for the establishment of branches or moving of offices by savings and loan associations organized or doing business in the District of Columbia, and for the establishment of branches or the moving of offices in the District by other savings and loan associations.

Section 1110(d) amended section 404 of the National Housing Act by adding a new subsection (h) which will enable the FSLIC to obtain, in case of need, additional liquidity by calling on institutions insured by it to make deposits in the Corporation, up to a limit of 1% of the withdrawable savings in such institutions.

In the second session of the 89th Congress, two pieces of significant legislation were enacted. The first was Public Law 89-597, an act providing for the regulation of maximum rates of interest or dividends payable by banks and savings and loan associations on deposits or share accounts. As H.R. 14026, this legislation was passed by the House on September 8, 1966, and by the Senate on September 15, 1966. It was approved September 21, 1966.[1]

Section 4 of that Act amended the Federal Home Loan Bank Act by adding a new section 5B. This provision for the first time gave the Board clear legislative authority to place limits on rates of dividends or interest that could be paid on shares, deposits, or withdrawable accounts by all institutions insured by the FSLIC and by members of the Federal Home Loan Bank System (except those insured by the FDIC). This authority was parallel to that exercisable by the Federal Reserve Board and the FDIC over commercial banks.

As indicated by the Senate Report[2] the legislation authorizes, but does not require, the financial regulatory agencies to establish differentials in the maximum interest and dividend rates that may be paid by savings and loan associations and other thrift institutions, as compared with commercial banks.

[1] See earlier remarks under "PROGRAM CHANGES" relating to effect of escalating dividend practices

[2] (S. Rept. No. 1601)

Although this legislative authority was originally limited to a one-year period, it has been twice extended for an additional year (until September 22, 1969) by Public Law 90-87, approved September 21, 1967, and Public Law 90-505, approved September 21, 1968.

The provisions of section 4 of Public Law 89-597 were implemented by regulations adopted by the Board almost immediately after the approval of the legislation.[1]

The other significant legislative action of the 2nd session of the 89th Congress was the Financial Institutions Supervisory Act of 1966, Public Law 89-695, approved October 16, 1966. Title I of the act amended section 5(d) of the Home Owners' Loan Act of 1933 and sections 407 and 408 of title IV of the National Housing Act to strengthen and make more effective the supervisory and regulatory authority of the Board as to Federal savings and loan associations and institutions insured by the FSLIC.

This act provided the much-needed intermediate tools for taking supervisory action without the necessity of terminating insurance, canceling membership in the Bank System, or seizure of the institution.

The legal weapons heretofore available placed the Board in a dilemma of whether to resort to procedures that were time consuming and cumbersome so that substantial injury could occur,

[1] The regulations governing members of the Federal Home Loan Bank System are contained at 12 CFR Part 526, and those governing institutions insured by the FSLIC are contained at 12 CFR Part 569

or procedures leading to termination of insurance, a futile remedy if it had to be used, requiring a notice, a correction period, a hearing, recommended decision, and possible court appeals. The process literally could consume years and if at the end a termination order became effective, the Federal Savings and Loan Insurance Corporation remained liable for existing accounts for two more years, whatever happened to the association.

The new legislation authorized the Board to institute cease-and-desist proceedings and proceedings for the suspension and removal of officers and directors of insured institutions for stated grounds. Of especial significance was the choice of remedies available to the Board so that it could take timely action when circumstances warranted speedy action in the public interest. Final regulations implementing these provisions were adopted by the Board, effective April 21, 1967.[1] In addition, a regulation requiring reports of changes in control of insured institutions[2] was adopted, effective November 15, 1968.[3]

Title II of the act provided similar authority to the Federal banking agencies in their respective areas of jurisdiction. Titles I and II expire on June 30, 1972. Title III amended sections 401 and 405 of the National Housing Act to increase the maximum

1 (12 CFR Parts 550 and 556)
2 (implementing subsection 1 of section 407)
3 (12 CFR § 563.18-1)

amount of insurance of accounts coverage from \$10,000 to \$15,000 and give the Board authority to clarify and define the insurance coverage. The FDIC was given similar authority under title III.

Proposed regulations redefining insurance coverage, prepared jointly with the FDIC, were published for comment in the Federal Register in January, 1967. In July, the Board adopted the new regulations in final form, completely revising Parts 561 and 564 of the Rules and Regulations for Insurance of Accounts.[1] Parallel regulations were adopted at the same time by the FDIC. The new regulations became effective on September 1, 1967, with the provision that the insurance coverage under the previous rules and interpretations would continue in effect, concurrently with the changed coverage under the new rules, until April 15, 1968.

Under the provisions of section 1016 of the Demonstration Cities and Metropolitan Development Act of 1966[2] the Board was authorized, utilizing the services of the Administrator of General Services Administration, to acquire in the name of the United States real property in the District of Columbia and to construct and equip a building and facilities suitable and adequate as quarters for the Board and agencies under its supervision. The funds for the land, building and equipment were to be furnished by the respective Federal

[1] (12 CFR Parts 561 and 564)
[2] Public Law 89-754, approved November 3, 1966

Home Loan Banks and apportioned by the Board among the banks in proportion to the total assets of the respective banks. The Board under the law is to repay the Federal Home Loan Banks over a period of 25 years.

Following suitable site studies, a selection was made of the site bounded by 3rd and 4th Streets, and D and E Streets, in Northwest Washington, D. C., together with a strip of land along the easterly portion of 3rd Street between E and D Streets and adjacent to the new center leg of the inner-loop freeway system in the District of Columbia. Preliminary site and building plans were approved by the National Capital Planning Commission on August 9, 1968 and approval in the Fine Arts Commission is now pending. It is anticipated that bids will be solicited for the construction of the building by the summer of 1969.

90th Congress (1967 - 1968)

A milestone in the regulation of the savings and loan industry by the Federal Home Loan Bank Board was reached when President Johnson signed into law, on February 14, 1968, the Savings and Loan Holding Company Amendments of 1967[1] providing for the comprehensive regulation of savings and loan holding companies.

[1] (Public Law 90-225)

The new law amended Section 408 of the National Housing Act[1] which was enacted on September 23, 1959, and was popularly known as The Spence Act.[2] The stated purpose of The Spence Act was to promote and preserve local management of savings and loan associations by protecting them against encroachment by holding companies.

In accordance with the mandate of The Spence Act,[3] the Board conducted a full and complete survey of the operations of savings and loan holding companies and submitted a report thereon, together with legislative recommendations, to Congress on May 31, 1960. The Board's staff thereafter continued its study of savings and loan holding company operations and prepared proposed implementing legislation. Bills embodying the Board's drafts were introduced in the 88th Congress and the 89th Congress but no hearings were scheduled or action taken prior to their respective adjournments.

President Johnson in his Economic Report of January 26, 1967 to the Congress renewed the recommendation made in his 1966 Economic Report for stronger regulation for savings and loan holding

[1] (12 U.S.C. 1730a)
[2] (Public Law 86-374, 86th Congress)
[3] (Section 408(g)(2))

companies, and early in 1967 the Board again submitted a draft of a bill to both Houses of Congress. The bill embodying such draft was introduced by Senator Sparkman in the Senate on April 14, 1968 as S. 1542.[1] An identical bill was introduced by Congressman Patman in the House as H.R. 8696.[2]

Hearings on S. 1542 before the Senate Committee on Banking and Currency were conducted on June 5, 6, and 7, 1967. Chairman John E. Horne appeared on behalf of the Federal Home Loan Bank Board and presented a comprehensive statement showing that although The Spence Act had been effective in achieving some of its objectives, the Board's experience had focused attention on certain problems that The Spence Act did not undertake to deal with at all. Among the major problems and abuses uncovered were the use of the holding company to evade the law governing the operations of savings and loan subsidiaries and thereby circumventing the safeguards designed to protect these associations; misuse of subsidiary associations to serve the needs of the holding company and other activities in which the holding company was engaged, particularly in the area of affiliated transactions; and heavy debt structures of holding companies causing undue pressure on subsidiary associations to generate income to service such debt in the form of dividends and

[1] (90th Congress, First Session)
[2] (90th Congress, First Session)

management fees to such holding companies. These problems were detailed and documented in Chairman Horne's statement and the tables, exhibits and schedules attached thereto.[1]

Public Law 90-225 amended section 408 of the National Housing Act to provide for the regulation of savings and loan holding companies by the FSLIC. The provisions of the amended section require savings and loan holding companies to register with the Insurance Corporation, file periodic reports as to their financial condition and operation, and submit to examination by the Insurance Corporation.

The act prevents a savings and loan holding company from engaging in certain transactions with its subsidiary associations and it prohibits any such company which controls more than one savings and loan association from commencing, or continuing for more than two years, certain activities unrelated to the savings and loan business. It requires prior written approval by the Insurance Corporation for any acquisition by a savings and loan holding company of an additional insured institution. Finally, it enables the Insurance Corporation to exercise control over the incurrence of debt in excess of 15 percent of consolidated net worth by holding companies engaged primarily in the savings and loan business. Although the legislation as enacted

[1] (Hearings before the Committee on Banking and Currency, U. S. Senate, 90th Congress on S.1542, pp. 24-68)

did not incorporate all the provisions which the Board and the Administration originally recommended, the Board believes that it will be effective for regulatory purposes.

Upon approval of the legislation, the Board adopted temporary implementing regulations, effective upon publication in the Federal Register on February 22, 1968.[1] The new Regulations for Savings and Loan Holding Companies are contained in a new Subchapter F of Chapter V of Title 12 of the Code of Federal Regulations.[2]

The next significant legislative action affecting the Board was the Bank Protection Act of 1968. The legislation was introduced in the House as H. R. 15345 and in the Senate as S.3001. H.R. 15345 passed the House on May 6, 1968, as an act "to provide security measures for banks and other financial institutions". The Senate Banking and Currency Committee considered H.R. 15345 and reported it out[3] with a committee amendment authorizing the Board to appoint the FSLIC as a receiver in the case of insured State-chartered savings and loan associations placed in custody or receivership or closed by State authorities. The amended version of H.R. 15345 passed the Senate on June 19, 1968, and the House concurred in the Senate amendments on June 24, 1968. The Act was approved on July 7, 1968, as Public Law 90-389.

[1] (33 F.R. 3322)
[2] (12 C.F.R. Parts 583, 584 and 585)
[3] (S. Rept. No. 1363, June 18, 1968)

Sections 2, 3, and 5 of the act are identical to the Administration bill for the "Bank Protection Act of 1968". Section 2 defines the term "Federal supervisory agency" as meaning the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board. Subsection (a) of section 3 directs those agencies, within 6 months from the date of enactment, to promulgate regulations establishing minimum standards for financial institutions subject to their jurisdiction with respect to the installation, maintenance and operation of security devices and procedures, reasonable in cost, to discourage robberies, burglaries and larcenies and to assist in the identification and apprehension of persons who commit such acts. Subsection (b) of section 3 of the act requires the establishment, by regulation, of time limits within which compliance would have to be effected and the submission of periodic reports with respect to the installation, maintenance and operation of the devices and procedures. Section 5 authorizes the imposition of civil penalties of up to $100 for each day of non-compliance upon financial institutions violating the regulations.

Section 4 of P. L. 90-389 was added by the House Committee on Banking and Currency. That section directs the Federal supervisory agencies to consult with insurers furnishing insurance protection against losses from robberies, larcenies, and burglaries, and with

State supervisory insurance authorities, to determine the desirability of premium rate differentials based on the installation, maintenance, and operation of security devices and procedures. The Federal supervisory agencies are required to report to Congress the results of these consultations two years from the date of enactment.

Members of the Board's staff are presently working in conjunction with the banking agencies to develop appropriate regulatory standards for compliance by the institutions subject to these provisions of the act.

Section 6 of the act amends section 406(c) of the National Housing Act to authorize the Federal Home Loan Bank Board, under certain conditions, to appoint the FSLIC as receiver for insured State-chartered savings and loan associations placed in receivership (whether or not for the purpose of liquidation) or closed by State authorities. This new authority closely parallels the Board's existing authority to appoint the FSLIC as receiver for Federal savings and loan associations. Such appointment of the FSLIC would trigger the obligation of the FSLIC to make insurance payments to holders of savings accounts if such obligation had not already obtained as a result of State action.

The purpose of this feature of the legislation is twofold. First, it will enable the FSLIC to make prompt payment of insurance to holders of insured accounts in insured institutions when those holders might otherwise be unable to obtain withdrawal of their funds as a result of State action. Second, it will enable the FSLIC to effect an orderly liquidation of the assets of insured institutions in default. Since, after payment of the insurance to account holders the FSLIC would have a claim to most of the assets of an insured State-chartered institution in liquidation, the FSLIC has a vital interest in making sure that the liquidation proceeds in an efficient manner to protect, to the extent possible, the recovery of the funds expended by the FSLIC.

Regulations to implement section 6 of the act have been adopted, effective September 24, 1968.[1] These regulations are similar to the regulations currently in effect governing the conduct of receiverships for Federal associations and the powers of the FSLIC as receiver in such cases.

The Housing and Urban Development Act of 1968, approved August 1, 1968, as Public Law 90-448, contained a number of provisions enlarging the lending and investment authority of Federal associations and broadening their powers to borrow money and raise capital.

[1] (12 C.F.R. - Part 569a)

Subsection (b) of section 304 of the act would amend section 5(c) of the Home Owners' Loan Act of 1933 to authorize Federal savings and loan associations to invest in loans as to which they have the benefit of insurance (or of a commitment or agreement therefor) under new section 240 of the National Housing Act. That section authorizes the Secretary of the Department of Housing and Urban Development to insure loans to finance the purchase by homeowners of the fee simple title to property on which their homes are located. Such investments by Federal savings and loan associations are not subject to any percentage-of-assets limitation.

Subsection (c) of section 416 amended section 5(c) to permit Federal associations to invest in loans as to which they have the benefit of a guaranty (or of a commitment or agreement therefor) under title IV of the Housing and Urban Development Act of 1968. That title, known as the "New Communities Act of 1968", authorizes the Secretary of HUD to guarantee obligations issued by new community developers to help finance new community development projects. Such investments by Federal associations are not subject to any percentage-of-assets limitation.

Subsection (e) of section 804 amended section 5(c) to authorize Federal associations to issue and sell securities backed by pools of FHA-insured and VA-guaranteed mortgages and guaranteed by the Government National Mortgage Association pursuant to section 306(g) of the National Housing Act, as added by the act.

Subsection (a) of section 1716 amended section 5(b) of the Home Owners' Loan Act to authorize Federal associations to raise capital in the form of such savings deposits or other accounts (as well as shares) for fixed, minimum, or indefinite periods of time and to issue passbooks, time certificates of deposit, or other evidences of such deposits of accounts as permitted by their charters or by regulations of the Federal Home Loan Bank Board. All instruments issued pursuant to this provision would have the same priority in the event of liquidation. That subsection also permits such associations to borrow money and give security therefor and to issue notes, bonds, debentures, or other securities (except capital stock), subject to authorization by the Board.

Subsection (b) of section 1716 amends section 5(c) to authorize Federal associations to invest in time deposits, certificates, or accounts in banks insured by the Federal Deposit Insurance Corporation.

Subsection (c) of section 1716 amends section 5(c) to authorize Federal associations to invest in unsecured loans not exceeding $5,000 to finance the construction of new structures related to residential use (vacation homes). Such authority is in addition to the authority to make such loans for the repair, alteration of improvement of existing homes.

Subsection (d) of section 1716 amends section 5(c) by adding a new provision authorizing Federal associations to invest in loans for the purpose of mobile home financing, subject to such prohibitions, limitations and conditions as the Federal Home Loan Bank Board may prescribe by regulation. That provision also authorizes loans not exceeding $5,000 for the equipping of homes, as well as for their repair, alteration, or improvement, also subject to such prohibitions, limitations, and conditions.

Subsection (e) of section 1716 amends section 5(c) to authorize Federal associations to invest in loans, guaranteed by AID under section 221 of the Foreign Assistance Act of 1961, on housing projects located in developing countries outside of Latin America. Investment in such loans, together with investment in Latin American loans guaranteed under section 224 of that act, are subject to a 1%-of-assets limitation.

Subsection (f) of section 1716 amends section 5(c) by adding a new provision authorizing Federal associations to invest in loans to Federally supervised financial institutions or to brokers or dealers registered with the Securities and Exchange Commission, if such loans are secured by loans, obligations, or investments in which the Federal association has statutory authority to invest directly.

Section 1717 amends section 12 of the Federal Home Loan Bank Act to authorize the Federal Home Loan Banks to acquire housing project loans guaranteed by AID under section 224 of that act and to facilitate the acquisition, holding, or disposition of such loans by savings and loan associations which are members of the Federal Home Loan Bank System. Regulations for the implementation of much of this new statutory authority are already in effect; the rest of the implementing regulations should be adopted by the end of 1968.

Public Law 90-505, approved September 21, 1968, extends the rate control authority of the Board and the Federal banking agencies until September 21, 1969, and broadens such authority to permit the financial agencies to issue rules and regulations prohibiting misleading or deceptive advertising concerning rates paid on time and savings deposits.[1] The legislation also contains a provision authorizing the Federal Reserve Board to purchase securities issued by the Federal home loan banks and other Federal agencies directly from the agencies as well as in the open market. This provision is intended to provide a means of mitigating the impact of a tight money policy on the homebuilding industry by supplying liquidity to the mortgage market.

[1] See discussion of Public Law 89-597 at pp. 44-45, supra

When the Senate considered and passed this legislation on July 24, 1968, it added two floor amendments of importance to the Board. The first of these provisions (sections 4 and 5 of the act) achieved another of the Board's legislative goals by amending section 5A of the Federal Home Loan Bank Act to strengthen the Board's authority over the liquidity required to be held by members of the Bank System and widen the choice of liquidity instruments which members could use for such purposes. It also amended section 5(c) of the Home Owners' Loan Act of 1933 to authorize Federal associations to invest in instruments which are made eligible for use in meeting liquidity requirements.

The second provision (section 6 of the act) amended section 404(d) of the National Housing Act to eliminate certain inequities suffered by insured institutions with respect to prepayment of insurance premiums.

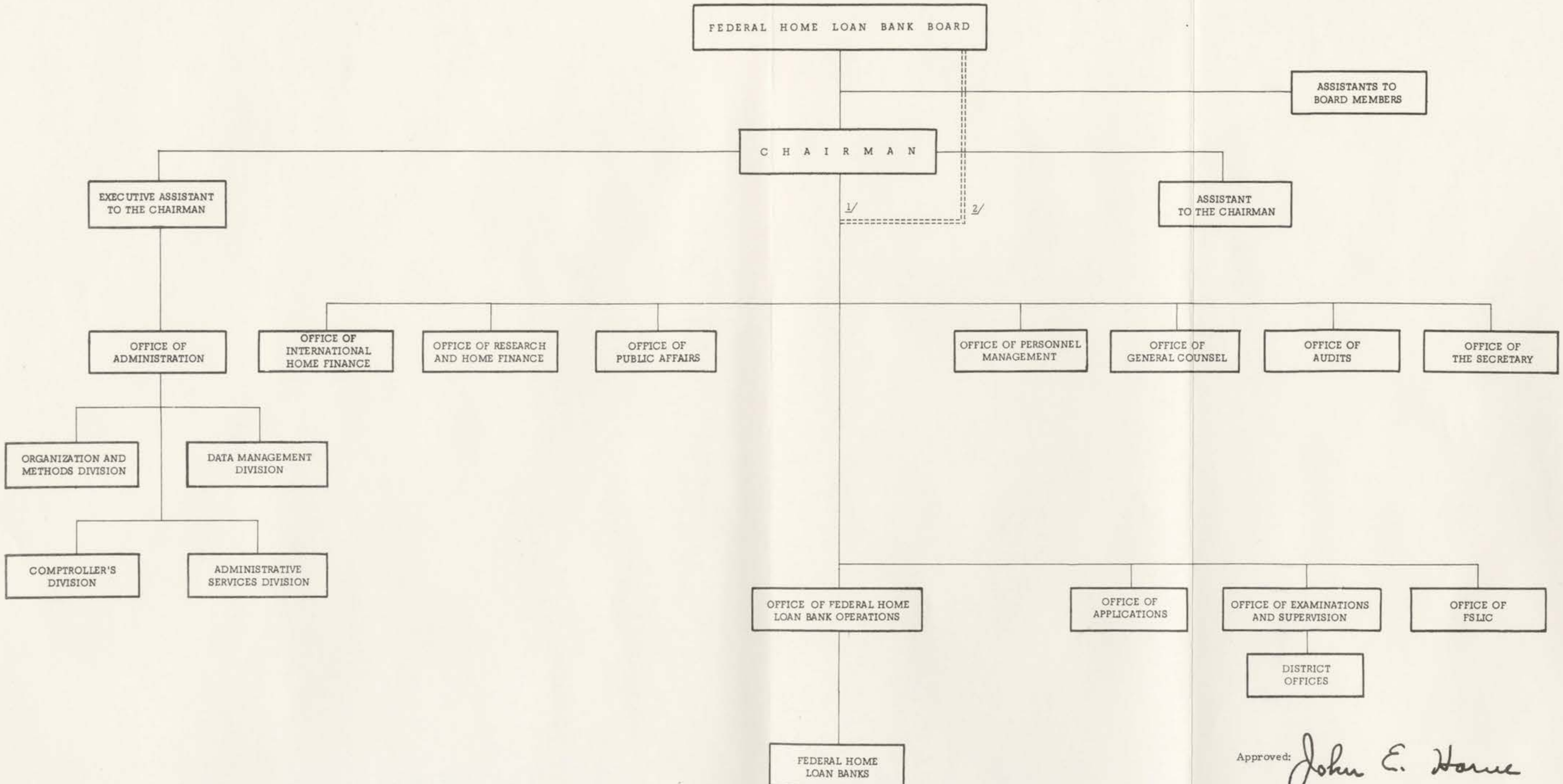
Finally, the Higher Education Amendments of 1968, approved on October 16, 1968 as Public Law 90-575, contained a provision (section 118(b)) amending section 5(c) of the Home Owners' Loan Act of 1933 to permit Federal associations to make loans for expenses of vocational education, as well as college or university education.

EXPLANATORY STATEMENT RE
OMISSION OF VOLUME II

A "Vol. II Documentary Supplement" is not being supplied because all of the Board's practices, procedures, regulations, policy papers, as well as the legislation affecting its operations, are cited fully in this Vol. I. The citations and references to source material were made with a view to facilitating the work of scholars or historians, and are designed to indicate where in the Board's records or in published documents, material underlying the action reported may be found.

Exhibit - Organization Chart

ORGANIZATIONAL CHART



1/ ———— Administrative Direction and Coordination

2/ ============== Substantive Responsibilities

Approved: John E. Horne

John E. Horne
Chairman

June 6, 1967