

SAVINGS AND LOAN
ANNALS 1967

United States Savings and Loan League
221 North La Salle Street
Chicago, Illinois 60601

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United States Savings and Loan League



Otto Heisler

PRESIDENT

FOREWORD

DURING 1967 the savings and loan business experienced one of the most dramatic recoveries ever to be recorded in the American economy.

Following on the heels of the "tight money" year of 1966, most savings and loan managers faced the new year with a great deal of justified misgivings. Many of them, I think, felt that there was no light at the end of the tunnel.

But 1967 proved to be one of the finest years in savings and loan history from a growth standpoint. It is interesting to note, in this regard, that the traditional faith of our business in the American people was more than justified.

During 1966 I think that the American public became aroused at the trend the economy was taking. True, there were many adverse winds blowing across the nation's economy. The war in Vietnam, the civil disorders, the balance of payments problem and a host of other ills were plaguing us.

What did the American people do? They met the challenge in the best way they knew how. Almost overnight, they adopted a "recovery" philosophy and started to put away a greater portion of their spendable income, and they also went into the housing market with renewed vigor.

The result—a year of relative plenty.

The nation's savings associations reaped a growth harvest of \$10.7 billion in 1967—a growth which approached the record of \$11 billion recorded in 1963. Compare this with the dismal growth of \$3.7 billion in 1966, and you will get some idea of what the American public can do when motivated.

Mortgage lending made a remarkable comeback, too. Loans put on the books by savings and loan associations during 1967 amounted to \$19.9 billion, as compared to the \$16.7 billion on 1966. This growth of \$2.2 billion in mortgage lending again reflected the faith of the American people.

Borrowings from the Federal Home Loan Banks by our member institutions decreased by \$2.5 billion during the year, testimony that our associations do not relish debt any more than our citizens do.

Housing starts, always a good indicator of the economy, jumped from 1.3 million in 1966 to 1.5 million in 1967. In 1966 starts amounted to 1.2 billion. Admittedly, housing starts increased by no startling figure, but the increase certainly pointed out that 1967 was the year when the na-

tion's housing industry began to hit the comeback trail.

So in retrospect, 1967 has been a good year for our business.

The outlook for 1968, however, is somewhat cloudy. There is the question of continued inflation; the question of taxes and spending; and, most important, what will happen in Vietnam.

Some savings and loan executives feel that 1968—at least in the second half—might prove a repetition of 1966 insofar as tight money is concerned. All we can do is watch and wait to determine whether these predictions will become true.

One thing is certain: We are much better prepared for whatever 1968 may bring than we were for 1966.

In virtually all of our associations liquidity is up; the Federal Home Loan Bank system's liquidity is up; and the entire business, in effect, is ready for whatever the year may bring.

Come what may, our business has a challenge in 1968, a challenge which demands the utmost from all of us. I am sure we will meet this challenge and continue our role as the prime exponents in the promotion and development of thrift and home-ownership in this great country of ours.

OTTO L. PREISLER

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GENERAL SESSIONS

PRESIDENT'S ADDRESS

by OTTO L. PREISLER, *President*

United States Savings and Loan League

Chicago, Ill.

FIRST, I WANT TO THANK Hans Gehrke for his generous introduction and, at the same time, acknowledge his valuable support and contribution during the past year as League vice president. I am sure that Hans Gehrke will find his tour of duty as U.S. League president in the year ahead to be, as I have found, a most stimulating and interesting experience. Perhaps the greatest reward is the opportunity to meet so many of the fine savings and loan people in the country.

He will be reminded, as I have been reminded, that the savings and home financing services we provide are, in a very real sense, secondary to the building of greater security and financial independence for American families. Our primary effort, that of promoting and developing thrift and home ownership, provides an ever-broader base of stability at a time when there is unrest in some sections of the country.

It has been my good fortune to serve during a year which has been quite a favorable one for our business in most areas of our operations. Everyone remembers the difficult experience of the tight money year of 1966, but 1967 has been a different story. Savings balances in our institutions grew little in 1966, but they have advanced very rapidly so far in 1967. As we meet here in convention, it is now likely that the savings gains of our institutions nationally this year will exceed the record savings gains of \$11 billion recorded in 1963 by a comfortable margin, possibly by as much as a billion dollars.

TURNABOUT IN SAVINGS FLOWS

It is important to recognize, of course, that the savings flows into other financial institutions also have improved considerably over 1966. The savings departments of commercial banks, for example, have been able to obtain record amounts of so-called "household savings" during the year, and savings gains of mutual savings banks should certainly exceed the all-time record gains of 1964.

The key reason savings flows have been so good in 1967 is that money generally has been easy, and short-term rates have remained well below their peaks of last year. Some of the money we lost in 1966

to short-term investments and obligations has returned to our institutions this year. At the same time, there has been a normally favorable reaction to the higher passbook and certificate rates paid by many of our institutions as compared to 1966. Many American families are saving more, too; the ratio of savings to disposable personal income has run well above the level of recent years.

Finally, there has been less competition from the stock market because the market has been influenced by poor earnings reports and the poor outlook for profits on the part of many business firms.

At the same time, the mortgage side of the business has improved. The cutback in loan commitments in the last half of 1966 was reflected in the relatively small number of new houses coming on the market earlier this year and in the relatively small volume of loans in process. However, loan demand and loan volume have improved significantly as the year has gone on. The total loan volume of the year will be in excess of \$20 billion, well above last year's total of \$17 billion, and the trend curve is still upward.

MORTGAGE LENDING REDUCED

The available statistics, incidentally, make it clear that the insurance companies and, to a lesser extent, the mutual savings banks have reduced their mortgage lending this year in an attempt to take advantage of the high yield opportunities available in the corporate bond markets. It is of interest to note, however, that while life insurance companies have curtailed their home mortgage lending sharply, they have stayed heavily in the income-producing loan market where they can get rates of 7% or more and sometimes acquire an equity position.

In any event, the mortgage loan market has been served more and more by savings and loan associations. Over recent years, our institutions have been responsible for serving 43% to 45% of the residential mortgage market. This share of the market should be increased rather significantly this year when the final figures for 1967 are tabulated.

REALTY MARKETS STRENGTHEN

One of the most encouraging developments of the year has been the gradual buildup of strength in the real estate markets in most sections of the country. The recovery in housing starts has been impressive in many areas and would be even greater were it not for the acute shortage of building labor in some areas. Delinquencies generally are down, and foreclosures have leveled off. There are fewer vacancies in apartments and rental units than a year ago. The inventory of unsold new houses has shrunk to the point where there is now only about a three months' supply, and there are reports that there will be an actual scarcity of houses within the next year or two unless there is further improvement in home building.

The tight money pinch of 1966 camouflaged the fact that the United States has moved into the early stages of a housing boom that has long been anticipated. The World War II baby boom now is beginning to show up in household formation statistics, and these figures appear to

assure a strong and continuing demand for new apartments and single-family homes, especially apartment and townhouse accommodations.

Beyond the market provided by population growth, it is a foregone conclusion that there will be much more money spent in the demolition of and replacement of sub-standard housing in the years ahead, particularly when the conflict in Vietnam is concluded or settled. Within two or three years of the settlement of the Vietnam conflict, there appears to be a good chance that total housing starts will reach the annual rate of 2 million units.

1968 OUTLOOK UNCERTAIN

Thus, 1967 has been quite a good year for our business. There is, however, an undercurrent of concern that 1968 may not be as favorable.

We find the outlook for 1968 blurred by several questions that remain unanswered, including: Will the current threat of inflation result in a new siege of very tight money? How will the tug-of-war now going on between the Congress and the White House over taxes and spending be resolved? Third, and of paramount importance, what will happen in Vietnam?

There is some apprehension that 1968 might prove to be a repeat of 1966 when adequate fiscal action was not taken rapidly enough to combat inflation, and the Federal Reserve felt obliged to move in. All of us remember all too well what happened when the Federal Reserve really put on the brakes, halting the growth in the supply of money and credit, and the immense demands for credit of all kinds produced a rapid run-up in interest rates generally.

PRUDENT LOAN, LIQUIDITY POLICIES

As we approach 1968, prudent institutions are proceeding quite cautiously in their loan commitments, and the business also has used a substantial part of its savings gains this year to repay advances from the Federal Home Loan Banks and to build up its own liquidity.

In looking ahead to 1968, all of us should be encouraged, too, by the liquidity stockpiling that has taken place in the Federal Home Loan Bank System over the past year. The liquidity resources of the Federal Home Loan Banks are today much greater than two years ago. While the liquidity the Banks are maintaining is expensive, this appears to be a reasonable price to pay in light of the uncertainties in the money and capital markets.

In addition, our competitive position is substantially better than it was at the start of 1966. Many of our institutions have wisely launched investment savings certificate programs, and we are discovering that even though corporate bond yields are running a full percentage point and more higher than our savings certificates, most certificate holders are willing to settle for a lesser rate on a certificate that runs only six months or a year.

All of this supports the view that if another 1966 tight money squeeze takes place in 1968, both our institutions and the Federal Home Loan Banks are in a stronger position than we were at the start

of 1966. We have enough liquidity to assume a reasonable continuation of lending plans for next year and to enable us to avoid the radical curtailment in lending that occurred in 1966.

A few weeks ago, the Gallup Poll revealed the interesting fact that financial problems and the rising cost of living had become the "Number 1" problem with 80% of American families. Inflation is no longer just a subject of discussion in the financial pages of our newspapers; it is now a matter of deep concern for all American families. Certainly it is regrettable that the inflation spiral has proceeded as far as it has, and certainly it is equally regrettable that every responsible economist seems to be resigned to further inflation ahead.

MORE INFLATION, HIGHER RATES

Meanwhile, the unfortunate and unhappy impasse between the administration and the Congress on taxes and spending programs continues, and the country drifts along the road to more inflation and additional hardships and distortions in the economy.

It should be noted, of course, that despite the extraordinary expansion of money and credit by the Federal Reserve, interest rates on short-term Treasury obligations and other short-term securities have moved upward significantly since late last summer. This movement upward in short-term rates follows a sharp movement upward in corporate bond yields earlier in the year.

In the absence of some significant action by the Congress and the administration, or in the absence of the imposition of direct wartime controls, the most likely short-term prospect is for further inflation and higher interest rates.

Any preview of 1968 could not be complete without some substantial reference to a problem which clearly has emerged as the paramount operating problem of our business. Though growth in assets, mortgage loans and savings balances in 1967 has been most satisfactory, one vital statistic has not made happy reading: Our institutions simply are not producing net earnings available for reserves in the amount we should be producing.

As nearly as the United States League's research department can determine at this time, the allocations to reserves by our institutions in the first half of 1967 were about one-third less than they were in the first half of 1966, and the same general pattern will prevail in the second half of the year. There is, to be sure, a gradual improvement in earnings taking place, but it is a slow process.

It is a slow process, in part, because of inflation. The savings and loan business has made steady progress in reducing its operating costs in recent years, but further reduction in these costs is being impeded by salary increases for most of our employees to permit them to stay abreast of the rising cost of living. This is a problem, of course, that savings and loan institutions have in common with other employers.

The real significance of lower earnings is that it provides an effective brake on our rate of growth. The growth of our institutions, like every other financial business, is limited by the amount of earnings we can

retain to stabilize our capital cushion of reserves and surplus.

The earnings problem is not a new one for savings and loan associations. Even in our most prosperous years, some institutions have been unable to boost earnings on mortgage investments as rapidly as the cost of recruiting savings has increased.

In recent years, however, the problem has become businesswide in character, as the relative profitability of savings and loan associations to the total size of our business has been in a stage of slow, gradual but perceptible decline.

The spread between mortgage earnings and the cost of recruiting savings has declined. In 1962, the average yield on mortgage loan portfolios was approximately 1.75% greater than the average cost of savings accounts. This year, the "spread" has declined to about 1.25%, and in some institutions it is even lower.

There is an increasing problem in maintaining additions to reserves, surplus and undivided profits in a manner consistent with the growth in mortgage loans. In 1966, these ratios showed an improvement, in part, because of the slowdown in lending volume. This year, as lending volume has expanded, these ratios have edged downward.

INFLEXIBLE INVESTMENT POWERS

While more diversified financial institutions such as commercial banks have been able to maintain profit ratios in terms of net income after taxes in recent years, the declining after tax income ratios of our institutions suggest a reduced ability to retain earnings and build up our capital and surplus accounts, particularly in the face of rising interest rates.

The earning squeeze can be traced to the type of assets we hold. Long-term mortgages on owner-occupied homes do not turn over rapidly enough to improve our yields in a period of rising interest rates. When tight money retards our savings growth, we also lose the opportunity to invest new funds at higher rates.

Furthermore, there are some practical limitations in our ability to pass along the higher cost of savings to our mortgage loan customers. Everyone recognizes that it is easier for a major corporation or the United States Treasury to adjust to higher interest costs than it is for the typical American home buyer.

In addition, there is a traditional reluctance on the part of many savings institutions to charge unusually high interest rates on single-family home loans. Perhaps, however, we should be doing more to educate the American people that the low interest rate loans of two or three years ago are not likely to be available in the near-term foreseeable future and, quite possibly, for a long time to come.

FLEXIBILITY KEY TO PROFITABILITY

The problem of lagging earnings has been evident for some years, and it certainly was in the minds of the special committee that labored throughout 1966 to prepare the report on the future needs of the savings and loan business. The central theme of this report was that the

primary interest of the savings and loan business should continue to be the financing of loans on residential real estate. There was a companion theme as well—that our ability to serve the home mortgage market in a satisfactory manner would be facilitated if our institutions could secure a significant broadening in lending and investment powers, and if we could obtain some modernization and flexibility on the savings side of the business.

It should be emphasized that these two objectives are by no means contradictory. With greater flexibility in our lending and investment powers, we would be able to invest a portion of our funds in assets other than mortgage loans during a time when these other investments may be more attractive. Over the long-term, therefore, the enhanced earning ability of our institutions would permit a more consistent and constant service to home builders and home buyers of America. We would be more profitable, and this greater profitability would enable us more easily to adjust savings interest rates upward when necessary, thus serving home buyers with considerably less risk of interruption in the mortgage loan process.

There is another side to this coin which also deserves comment. All of you remember that in 1964 and 1965 savings flows into our institutions were impressive, but the mortgage loan demand was lukewarm in many areas until the big military buildup in Vietnam began in mid-1965. The result was substantial, sometimes excessive, competition for available mortgage loans and relatively low mortgage yields.

It is generally recognized, in retrospect, that if our institutions had had broader investment authority in this period of lagging mortgage demand, we could have acquired other higher yield assets, increased our earnings and placed our institutions in a better and stronger position as housing and mortgage needs increased in later years.

The argument that broader investment powers for the savings and loan business will mean that, over the long pull, our institutions will be better able to serve the mortgage market is not an easy one to make. The recent hearings on the Federal Savings Institutions bill certainly demonstrated that we have some distance to go in making this case before the members of Congress.

LEAGUE PROVIDES LEADERSHIP

Nevertheless, this is the argument which is at the heart of League support for legislation to improve and modernize the federal savings and loan statute. It is an argument, in the final analysis, for greater stability in savings and loan operations, and for additional safeguards against the kind of interest rate fluctuations and gyrations that have troubled this business in recent years.

If you will permit a personal reference, I have spent virtually my entire life connected in one way or another with the savings and loan business. My father was a secretary of four small building and loan associations in the Chicago area during the 1920s, the total assets of which were less than \$1 million. Certainly we have come a long distance since that time.

In the early 1930s, the United States Savings and Loan League developed and secured enactment of the three major legislative programs affecting the savings and loan business. These were the laws authorizing establishment of the Federal Home Loan Bank System, the Federal Savings and Loan Insurance Corporation and the Federal Savings and Loan System.

It was this legislative framework which not only enabled the savings and loan business to survive the depression years of the 1930s but also provided the basic legal structure on which the business has moved into national prominence and success since World War II. In this process, we have been successful beyond our fondest hopes, and many of us have been able to develop sizable institutions and share in the rewards of this progress.

No business deserves more credit than the savings and loan business for having stimulated the growth in home ownership. In terms, therefore, of meeting the great postwar real estate boom, the existing framework certainly has proved most effective. Now the question before us is whether or not what we have is adequate to meet the needs and demands of the future.

None can predict with certainty what the future will bring. Perhaps the end of the Vietnam conflict will usher in a boom in single-family housing of such proportions that any and all savings money can be invested in home mortgage loans at yields high enough to sustain a continuing growth of our business. On the other hand, perhaps a home ownership boom of this magnitude will not materialize, and the demands for mortgage money will take directions far different from those our institutions are equipped to meet. We should be prepared for either eventuality, and a broader investment authority serves both purposes by offering additional earnings and possibilities of service.

PREPARING NOW FOR CHANGE

The United States League has built an enviable reputation for foreseeing the needs of our business and then developing programs to meet these needs. While its status and future are quite uncertain at the moment, the Federal Savings Institutions bill, developed by the United States League and the National Association of Mutual Savings Banks, is in this tradition. Although a few key amendments have been sought—and will continue to be sought—the bill is, on the whole, a bold and progressive proposal toward asset diversification and strength building based upon the experience of recent years which has demonstrated that such diversification is essential.

The world in which we live is changing, and so is the American society we serve. The markets we have served in the past and serve in the present may not be the markets of the future. Surely the experience of commercial banks over the years has demonstrated that these financial institutions could broaden their horizons without impairing their traditional function of financing American commerce and industry.

The same broader horizons now beckon to our business. If we are wise, we will move toward them.

CURRENT ISSUES AND POLICIES

by the HON. JOHN E. HORNE, *Chairman*

Federal Home Loan Bank Board

Washington D. C.



SUSPECTING that your president, Otto Preisler, would speak in some depth about the savings flows of 1967 and the condition of the housing market generally, I decided to make only brief reference to those subjects. I do want to recall with you, though, that just a year ago, the business was still trying to recover from the severe conditions of 1966. At that time I hesitated to say that we thought the recovery in savings flow would be substantial. Perhaps you will forgive me if I now lay claim to some foresight since my colleagues and I did feel late last year and so stated, that the results of 1967 would be far more favorable than those of 1966.

HOUSING STARTS, LIQUIDITY POSITION IMPROVED

However, it is not enough to take pride in predictions no matter how closely they are realized. We have to look at what has been done with the opportunities that have resulted. In this connection, I should like to congratulate you on a number of grounds. First, the overwhelming majority of you have used the opportunities our regulations afford for attracting funds successfully and judiciously. This has meant learning to handle new instruments, avoiding the pitfalls of a too avid pursuit of one type of account as against another, and gauging the needs of your market. Second, you have contributed to an improvement in housing starts which, despite the severe pressures of recent months, has so far been well maintained. Yet, at the same time most of you have kept commitments in reasonable relationship to your flows. Third, most of you have improved your liquidity position. In doing so, you have not only improved your operating capability, but you are in a far better position to continue support of the mortgage market. For each of these steps the Board believes that you are to be commended.

Even more heavily than in 1967 and the immediately preceding years, in 1968 the savings and loan business may and most likely will

be called on to serve as the main supplier of mortgage funds. This will place on you a grave responsibility and likewise a wonderful opportunity to choose wisely the investment of funds you do have available.

As Otto pointed out, the Bank System is carrying more liquidity than at any time in the past—approximately \$2 billion of liquid funds—as a form of insurance in case you need to make use of these funds in 1968.

The major point, though, that I want to communicate to you today is the deep desire of the Board to help build a climate and condition under which your business can continue to grow in size, to improve in soundness of operations, and to become increasingly more capable of meeting the housing needs of the future and of serving the public.

We want this business ever to be proud of its service to the public; and we want the public to be proud of this business. It is easy to state this goal, but it is difficult to achieve. Already in very recent years some steps directed toward achieving this goal have been taken, both within the Board and through legislation. I want to mention briefly some of the things that have been done at the Board level.

SUBSTANTIAL PROGRESS BY FHLBB

Examinations and supervision have been consolidated in the Washington office and more closely coordinated in the districts. Discussions with the staff, improvements that I have noticed and letters from many of you convince me that substantial progress has been made. Larry Walters and his staff have indeed done a conscientious and good job and deserve your commendations.

Bob Rand is spending a great part of his time in examinations and supervision, and with his business experience and knowledge we all are acquiring, I am confident we can and will make further improvements. Just recently Bob discussed with Mike Greenebaum and me some good suggestions which I hope we can soon implement.

Another office that has been modernized in operations and is vital to the well-being of this business is the Federal Savings and Loan Insurance Corporation. Without the creativity and ingenuity shown by Jerry Worthy and his staff in arranging supervisory mergers and financial assistance for troubled associations, the Corporation would have paid out far more to savers and would be much more deeply involved in the liquidating of assets than is presently the case.

A similar compliment should be paid Clarence Smith and the Office of Applications for their streamlining improvements in the handling of applications for new charters, branches, insurance of accounts, mergers and myriad other requests. The number of items handled has grown far in excess of the increase in employees.

The Board could not function intelligently under today's conditions without the kind of information supplied by Harry Schwartz and his staff in the Office of Research and Home Finance.

In my opinion one of the greatest contributions made to enabling this business to serve the nation's needs is the clarification of what

accounts are insured, and the parity officially established between your insurance of accounts and that of commercial banks.

This accomplishment is a credit to Ken Scott. There are many other very meaningful ways in which Ken Scott and his staff have assisted the Board and the business, and I particularly want to stress this in Ken's case since he will be leaving the Board later on this year to join the law faculty of Stanford University. We shall hope to continue to utilize his services, especially with regard to projects undertaken when he was with us.

With the exception of the Office of Bank Operations, which is directed exceptionally well by Bob Day, I have mentioned only those offices of the Board in which the steps taken to strengthen your capacity to serve the public would be of direct concern to you. For the record, though, I want to emphasize that other offices of the Board have acted similarly. And I also stress that on the whole I do not believe any agency of government or any private company has a more dedicated group of employees than the Federal Home Loan Bank Board and the twelve district presidents and their staffs.

LEGISLATION ALSO REQUIRED

But much more than improvement of Board procedures is required "to help build a climate and conditions under which your business can continue to grow in size, to improve in soundness of operations, and to become increasingly more capable of meeting the housing needs of the future and of serving the public." Legislation was and is necessary.

The Supervisory Act of 1966 is a part of this legislative program. It was necessary to provide greater flexibility for the Board and also for the bank regulatory agencies to deal with problem institutions. With the new flexibility the act affords, we can often restrain or correct practices before they cause serious difficulties. We can cope with unsound practices before they proceed to the point where they damage the reputation of all institutions. It is only a very small segment of the business which engages in unsound practices, but there is necessity for this type of tool to protect the reputation of the vast majority which operates soundly. In fact, even the institution which needs to be corrected benefits from this procedure. Its problem is brought to its attention early, and the correction which results can prevent it from becoming a serious case.

In administering the Supervisory Act, three broad principles encompass almost all of the areas that give rise to supervisory concern about individual associations. These areas are the soundness of assets and their structure, satisfactory expense ratios and the reserve position of institutions.

In essence, these three characteristics paint a vivid picture of an institution's performance. They afford a guide to how well an association is complying with statutory provisions and intent. Initially, as I am sure you know, we try education and persuasion to obtain improved performance. Only if it is apparent that informative comments or persuasion will not do the job will a cease-and-desist order be issued. The

authority contained in the Supervisory Act of 1966 thus provides for reasonable procedures at a stage of development which permits correction of practices before they continue to damage an institution. The Supervisory Act protects the many against the few and indeed also serves to protect the few.

This vitally important legislative accomplishment could not have been achieved without the support of an enlightened organization such as yours, and I want to express the gratitude of the Board to the League and to the vast majority of its members whose support helped to make this possible.

CURRENT LEGISLATIVE PROGRAM

The most important parts of the Board's current legislative program are the Federal Savings Institutions bill and the Savings and Loan Holding Company bill.

The Federal Savings Institutions bill is designed primarily to comply with recommendations that have been made for many years that the investing and lending authority of savings and loan associations be broadened and that federal charters should be provided for mutual savings banks. That was the original recommendation.

The Commission on Money and Credit, a privately sponsored body, endorsed these proposals in 1961. Similar recommendations were made in 1963 by the Committee on Financial Institutions appointed by President Kennedy. And President Johnson, in my opinion the most informed and friendliest of presidents since the 1930s to this business, has recommended such a program to each Congress since he became President. These proposals are based on the recognition that there is a need for more diversification of lending and investing authority for your institutions. They are also based on the desirability of unifying thrift institutions, combining the best features of mutual savings banks and federal savings and loan associations. The broader lending and investing authority contained in the bill recognizes two basic needs.

First, since this business has reached very substantial size, it is apparent that there are periods when the mortgage market, on which you depend almost entirely, does not absorb on a sound basis the funds you sometimes generate. Diversification would preclude the need for having to reach out for unsound assets or the equally unpalatable alternative of shrinking your operation. Second, it is apparent that a limited, narrow asset structure imposes more of an earnings restraint on your associations than is desirable. With a more diversified portfolio, including more short-term assets, you could adjust your earnings to market conditions more readily than is now possible. Properly utilized, diversification would improve your operations, your competitive position and, in particular, your ability to attract savings in a tight money period.

This last point, the ability to attract savings in a tight money period, can be crucial. While there is some merit to the point that, with diversification, you might be inclined to put a somewhat lower proportion of your funds into the mortgage market, it is clearly better to put 60% or more of a good flow into that market than 100% of a very poor flow.

Let me urge that you concentrate on the positive gains to be obtained rather than on some relatively insignificant supervisory feature. Without such a measure as I am talking about and as your president talked about, I frankly think it will require a decade or more to obtain the advantages that the measure introduced as H. R. 13118 would, if enacted, grant you overnight.

The last legislative proposal I want to mention today and one which in the Board's opinion is as important—perhaps even more so—as any measure proposed during this decade is the Savings and Loan Holding Company bill.

For several reasons, which will be obvious to you as I proceed, I hope you will listen carefully to what I have to say. The Board had hoped that the Holding Company Bill would be behind us before this convention but we concluded some time ago—months ago—that in fairness to all concerned, we should apprise the President, the Congress, and the business, if need be, of conditions that led the Board to make its recommendations. In fact Congress in 1959 requested the Board to make recommendations to it. Believe me, if this bill is not passed, you will be affected both directly and indirectly. The Senate passed an acceptable bill on June 26 of this year without a dissenting vote. But in the House no bill has been recommended as yet by the Banking and Currency Committee.

In discussing this bill, let me state that by no means are all holding company associations in difficulty, but taken as a group or in comparison with nonholding company associations there are enough in difficulty to cause the Board and the business grave concern. Let me explain also that there is nothing whatsoever personal involved in what I shall say. What I shall say is in no way intended to involve personalities, either in or outside holding companies.

In support of the need for the legislation, I want to quote from information placed in the November 2 issue of the *Congressional Record* by the Hon. Leonor K. Sullivan, a member of Congress from Missouri and a member of the committee handling the bill. She said:

Mr. Speaker, several large savings and loan holding companies in the Far West are in trouble. These companies overextended themselves by borrowing large sums of money with which to finance speculative real estate developments. As long as demand exceeded supply and ample mortgage funds were available at reasonable rates of interest, things looked good. However, subsequent events have demonstrated the speculative nature of these holding company operations, and today's high interest rates and tight money have made it exceedingly difficult—if not impossible—to develop and sell their properties.

As a result, these holding companies have been hard pressed to pay interest and principal required by their top-heavy debt structure, and they have exerted pressure upon their savings and loan subsidiary associations for funds.

The unfortunate result has been the milking of federally insured savings and loan associations to meet debt service demands made upon the parent holding company. Moreover, the holding companies have caused their subsidiary insured associations to make risky high-yield loans to generate maxi-

mum income. Now, many of these otherwise healthy savings and loan associations find themselves with substandard assets. This situation is detrimental to the entire savings and loan business as well as to the Federal Savings and Loan Insurance Corporation.

A letter I recently received from the Hon. John E. Horne, chairman of the Federal Home Loan Bank Board, spells out this situation with great clarity, and I strongly recommend that Mr. Horne's remarks be carefully considered by all members.

The public interest in a sound and solvent Insurance Corporation absolutely requires that the Congress enact a strong holding company bill in this session. Agency authorization to prevent excess holding company debt is a vital necessity.

Following this statement, Mrs. Sullivan put into the record a letter that I had written to each member of the House Banking and Currency Committee, and I want to quote a few parts of that letter.

This letter is intended to summarize for the committee some of the consequences and risks of savings and loan holding company operations that threaten both the public interest and the welfare of the \$140 billion savings and loan business.

Holding companies control one-eighth ($\frac{1}{8}$) of the savings and loan business but account for five-eighths ($\frac{5}{8}$) of the institutions in most serious financial jeopardy. (Both figures relate to total assets.)

The tendency toward higher risk operations of associations controlled by holding companies far exceeds that of the remainder of the business. For example, holding company associations have a foreclosure rate over three times as high as the rest of the business and they have a level of substandard assets almost three times as high as the rest of the business.

The result is a level of capitalization in relation to risk that is far below the rest of the business and that correspondingly increases the exposure of the Federal Savings and Loan Insurance Corporation (FSLIC).

In numbers, nearly 10% of holding company associations (and also 10% of holding company associations' assets) are in the most serious problem case category. But as regards mutual associations (which comprise about 78% of the savings and loan business), in numbers only 8/10 of 1% of associations (and only 6/10 of 1% of association assets) are in the serious problem book.

The assets of serious problem associations controlled by holding companies just about equal the liquid assets of the Insurance Corporation. (You do not have to use your imagination to realize the importance of this.)

It is argued that thus far there has been little loss incurred by the Insurance Corporation on holding company operations. The significant point to remember in this regard is the disturbing trends already shown by this relatively new development of holding companies in the savings and loan business and the precarious condition into which some holding company operations have gotten their savings and loan subsidiaries.

For every dollar of problem assets held by associations, the mutual association sector has contributed to the Insurance Corporation nearly \$3.00 in premiums and earnings thereon. But for every dollar of problem assets held by holding company associations, the corresponding contribution by the holding company sector has been less than 20 cents. In effect, the risks of holding company operations are presently being underwritten by mutual associations throughout the country and to a lesser but still significant

degree, by independent stock associations.

It is argued by opponents of the legislation that holding companies can provide financial strength to their associations. The contrary though has been true in nearly every instance. And in 1966, the worst year in two decades for the savings and loan business, holding companies put a mere \$1.8 million into subsidiary associations as capital contributions but took out \$17.7 million in dividends and fees.

Holding companies exist in 11 states, with 83% of the assets in California. I ask, why should the business in the nonholding company states, and indeed the nonholding company associations throughout the entire country, have to bear the burdens created by holding company operations?

The vast majority of the total business—the mutuals, most of the independent stock associations, and even two or three of the holding companies—have expressed support for a measure at least as strong as the Senate version. Moreover, the Board and its staff, the twelve District Bank presidents and their staffs, and the National Association of State Savings and Loan Supervisors—the authorities responsible for examining and supervising the savings and loan business at both state and federal levels—have strongly urged the passage of legislation at least as strong as the Senate version.

It seems illogical and unfair that the self-interest of a few should be served at the expense of many others who conduct their affairs in a sound and reasonable manner.

Let me stress for those who have savings accounts in a federally insured holding company that their money is just as safe as it is or would be in other insured associations. This safety, of course, is made possible by the Federal Savings and Loan Insurance Corporation through premiums from your associations. But the safety of savings in associations controlled by holding companies does not justify holding companies being free of supervisory authority and thus free to use an insured association in a manner that is detrimental to the association and to the business.

The Senate bill is itself a reduction in what the Board recommended as necessary to provide maximum protection to nonholding company associations—and indeed to the entire business. The Senate in good faith adopted what it thought was a reasonable compromise and one that would receive broad support. As I have indicated, it has received broad support.

The Board has made clear in public testimony and in letters to members of the committee that it considers the Senate bill to be adequate. Moreover, the Board agreed to support two amendments urged by the U.S. League, primarily to comply with requests of independent stock associations.

As I stated in my letter to Mrs. Sullivan and to other members of the House Banking and Currency Committee, and as I have said to you, the Senate bill has the overwhelming support of the business. In fact, with but scattered exceptions, the opposition stems from holding companies located primarily in California. I should add at this point that the Board does not regard this as a California problem but as a holding company problem. And I want to stress also that opposi-

tion to the bill does not come from all the California savings and loan business, but only from certain segments of it.

Even though the Senate bill is a compromise, 10 substantive changes were made by the Senate.

Holding company spokesmen continue to chip away at what remains. They have literally lived in Washington since the Senate began consideration of the bill last spring. Seemingly what they want—at least a great many of them—is what the Board warned against in testimony before both the Senate and House committees; that is, no bill at all or one that would grant them broad expansion rights but with few or no strings attached.

PROS, CONS OF HOLDING COMPANY BILL

Let me give you three or four arguments used against the bill, and tell you in a sentence or two the truth about each. Opponents say it is a case of the Board seeking too much authority. The truth is that the Board is asking for less authority over holding company operations than it has always had over federal associations and for less authority than it was granted last year, with your help, over state-chartered, federally insured independent associations.

Opponents say that the Supervisory Act last year gives the Board adequate authority to cope with holding company problems. The truth is that under existing law the Board cannot reach the source of the problem, the holding company itself; the Board has always explained that separate legislation is necessary. For example, present law does not give the Board any control over the debt structure of holding companies. Yet top-heavy debt is the primary cause for those in control of holding companies to direct their subsidiary associations into high-risk undertakings in an effort to support the debt of the parent company. In fact, as I have already stated, when the first holding company act (the Spence Act) was passed in 1959, Congress itself acknowledged that it was a stop gap; that further legislation would be required, and directed the Board to make a study and make recommendations. The Board has been doing so every year since 1961.

Opponents say that holding companies can be a source of strength to their subsidiary associations. I have already answered that by pointing out to you that the contrary has been true in fact. In 1966 they put in a mere \$1.8 million but took out \$17.7 million.

Spokesmen for holding companies, in an effort to gain support from independent stock associations, say that stock marketability would be adversely affected. The truth is that the marketability of independent associations would be enhanced, by virtue of the fact that the definition of holding company control would be increased from 10% to 25%. As to the Board having the right to screen a prospective buyer, it seems elementary that it is to the business' interest to prevent a company with incompetent or dishonest management or in a weak financial condition from buying an association. Moreover, the Board screens applicants for new charters or insurance of accounts, and the principle of protection for the public and the business is the same.

Let me assure all independent stock associations that the Board has worked with spokesmen of your sector of the business and with Senate leaders to assure you that marketability will not be lost in the event you want to sell. And let me urge that you not be drawn into opposing legislation imperative to your protection by those who would use your voice to obscure their own motives.

I would make the same plea to those holding companies whose associations are soundly managed.

The public is not sufficiently sophisticated to know the difference between holding company and nonholding company associations. And there is a limit to the risk that the Corporation should be required to take; a limit to the time the Board and staff should be required to devote; and a limit to the cost the rest of you should have to pay through potential loss of public confidence and premiums paid to the Insurance Corporation for unsound and unrestrained holding company operations. We could, if necessary, in fact we would be required to, continue beyond 1971 premium prepayments. Perhaps we could do other things but their cost would be carried by the rest of you.

I am pleased that your president, Otto Preisler, makes clear in his remarks that the U.S. League stands firm in support of this needed legislation. I am also gratified that President Johnson requested the legislation and that no Democrat or Republican voted against the Senate bill.

I am hopeful and—in spite of what has transpired so far—I remain confident that bipartisan action in the House committee and the House itself will result in legislation at least similar in strength to that passed in the Senate.

In conclusion, let me state the Board's pleasure that there have been other occasions since I have been on this Board that you and we have labored together in pursuit of the goal I expressed earlier, that is the building of a climate and conditions under which this (your) business can continue to grow in size, to improve in soundness of operations, and to become increasingly more capable of meeting the housing needs of the future and of serving the public.

The passage of strong and adequate holding company legislation would be one more essential rung on the way to the top of that important ladder.

75 YEARS OF SERVICE—A Presentation and Response

by DR. KENNETH D. WELLS, *President*

Freedoms Foundation, Valley Forge, Pa.

and NORMAN STRUNK, *Executive Vice President*

United States League, Chicago, Ill.



OUR BELOVED nation's tumultuous present and question-marked future are deep concerns in the minds of every living American. My remarks today are directed to the greatness of our origins and the difficulties of the present hours. I would like humbly to suggest a series of actions to be voluntarily taken to guarantee that the year 1976—our 200th anniversary—shall be proclaimed our nation's finest hour and the beginning of a century of the renaissance of the voluntary spirit which has made this republic for

193 years the hope of every informed, responsible person alive.

As we Americans look over our shoulder to the span of the centuries since the calendar year began, we find that the history of the human race has been a constant search by men and women on every continent for the fundamental high purposes and principles of human action that would provide an elevated, happy way of life with human fulfillment.

The ideals and high purposes found in the Ten Commandments received by Moses on Mt. Sinai have not been obscured, repealed, modified or improved upon in 20 centuries, except as the depth and magnificence of the expression in the Sermon on the Mount has expanded man's highest principles contained in the beloved rules given to Moses by God.

Your search, my search, everyone's search for an improved way of living together harmoniously in perfect liberty and freedom in its total sense has been an ideal that has not yet had continual constructive progress. The entire world fell back in the centuries between the days of the Caesars and the foundations of English liberty in the Magna Charta.

Every judge, every legally trained man in the world knows and, I

believe, every person of high school training knows that the elementary principles of freedom, justice and liberty indivisible under the English law originated on June 15, 1215, when English barons took from King John at Runnymede the concepts of the Magna Charta. But again the ideals of personal liberty in those few short centuries suffered a setback. There was a lack of integrity on the part of rulers and individuals, a lack of strength in great voluntary organizations. Because of persecution and refusal to give religious liberty and liberty to engage in enterprise as one saw fit, the first English settlers were forced from their homeland to the shores of this continent.

The colonists engaged in more and greater trade, and learned better farming. The English government became deeply jealous of our prosperity and of our ability as individuals. They applied every form of tyranny. The young colonists' determination grew and they chose freedom. Mind by mind they decided to cast off the yoke of tyranny. We became free and independent states. The wholeness of the ideas of rights of men, as first stated in our Declaration of Independence, had as its natural parallel a fiery desire that the rights of the individual as a child of God should be at their zenith, and every citizen voluntarily accepted responsibility with every right for his own family and personal good conduct. Our desire for a free government that was our servant and not our master was our quest. Our federal Constitution was built. It has been proclaimed a thousand times as the greatest written document by any group of men of any nation, of any race, who desired the real blessings of personal freedom, religious, economic, and political.

From the Ten Commandments through centuries of the Sermon on the Mount to the struggle to build the Roman Code, to the forcing of King John to his knees to grant the Magna Charta at Runnymede, and to the time of our Declaration of Independence and our Constitution, man has struggled. These deep principles and positive truths—great in every sense—have been powerful and effective, and worthwhile, only as they have lived in the hearts and minds and daily lives of men and women.

CONSTITUTIONAL PRINCIPLES APPLIED

The United States is not the greatest nation on earth because Madison, Franklin, Jefferson, Washington and all the others framed the Declaration, Constitution and Bill of Rights directed at just and personal freedom. We have become the greatest nation on earth because we applied these principles of our Constitution in government without watering down their interpretation to satisfy individual and party political needs.

Our relations with other countries have been stable. They have known what we believed in. We have known what we have been committed to. They have been able to cooperate with us because we have been strong. They cannot cooperate with us when we are weak. There are serious people in our land who believe that the United States is in its last days of perfect liberty and individual freedom. They hon-

estly fear that our beloved country is flirting with unnecessary danger, indeed placing itself on the auction block because we are not standing fast with the faith that made us free. They say we are living in the last days of the American way of life, its liberty and freedom.

I do not share their view. If this were true, it would be solely because our people and our leaders have wandered away from the moral, religious, and free political and economic concepts of our land, from the basic purposes of the Ten Commandments and the Sermon on the Mount, for are these not the greatest human relation principles?

Our American way of life is endangered in every generation. We must be determined that intelligent, able and conscientious men and women of the arts, business, science, education and religion will dedicate themselves to the perpetuation of the great ideals, for without them this country is always in danger of dying. Historian Arnold Toynbee has told us that every civilization that has been overcome, and smashed, had been overcome by barbarians within before it was smashed by barbarians from without. There are barbarians within our country. There are many men and women right in this city of San Francisco, and all over this land, who hold no high standards for themselves, who take pride in being mediocre, who are unproductive, unwilling and deliberately unclean. We see complaint rather than protest. Honest protest, a peaceable assembly we admire, but mobs must be put down. No decent American will put up with fires set and rifles poked out windows to snipe the innocent. Why not be tough-minded like our forefathers? Where is our moral indignation? Why can't we again refuse to call wrong, right?

ASPIRATIONS NECESSARY FOR FREEDOM

There are certain aspirations we must adhere to. Simple things such as personal integrity, a good day's work, regular thrift, kindness to every man must prevail, or a free country cannot live. It is necessary to put our money into great things, whether it is Freedoms Foundation at Valley Forge in which many deeply believe, or other civic, patriotic endeavors.

Our patriotic societies are mostly languid. Our great youth movements are not growing rapidly enough to keep up with the population growth. Our fraternal bodies, and often our veterans' and civic bodies are largely bypassed in the most important affairs of the nation. Our service clubs are growing less rapidly than our population. We need to actively help the voluntary societies in every way. The leaders of our trusted and tested savings and loan associations have a duty to perform in assisting character-building agencies, youth groups, patriotic organizations, civic bodies, and above all, partisanship in the things which mean most to preserve our free economic and political system now heavily burdened with governmental preemption and control.

Open, moral support of law enforcement agencies, is always important. If civil order is to be preserved, it is essential that those who break the law be punished and that the innocent be protected. It is

critical and urgent that the law-abiding citizens receive protection of the law from the lawless.

We pray that our lives may be a tribute to our country's heritage. Let us stand with the American Credo: the right to worship God in one's own way, the right to free speech and press, the right to peaceably assemble, the right to petition for redress of grievances, the right to privacy in our homes, the right of habeas corpus—no excessive bail, the right to trial by jury—innocent until proved guilty, the right to move about freely at home and abroad, the right to own private property, the right to free elections and personal secret ballot, the right to work in callings and localities of our choice, the right to bargain with our employers and employees, the right to go into business, compete, make a profit, the right to bargain for goods and services in a free market, the right to contract about our affairs, the right to the service of government as a protector and referee, and the right to freedom from arbitrary government regulation and control.

Let us have unquenchable faith in this nation for every person, whether he is rich or poor, young or old, regardless of his race, regardless of his religion, regardless of the clothes he wears. Let us have unquestionable faith in our country and mankind. Let us put forth real enthusiasm to improve this nation so that it is perfect by 1976, our 200th anniversary. Let us have kind words, affection and esteem for all about us, regardless of rank or station.

CHALLENGE TO SAVINGS AND LOANS

Let us see if this massive financial instrument, called the savings and loan business in the United States of America, can have at an hour of challenge its proper, imperishable place in elevating the quality of life to strengthen family roots in this republic under God, and in addition, an elevated quality of loans and deposits to put roofs over families. The savings and loans of America are totally essential to every community in this nation. Let them be inspired, vital, knowing well that vigilant active work must come.

Liberty is freedom. Life without freedom is tragedy. Freedom is the most expensive thing in the world. Let us invest our money, our savings, our hearts and our souls in it now and forever.

[Dr. Wells then presented to Norman Strunk a plaque honoring the United States Savings and Loan League.]

Thank you very much, Dr. Wells.

On behalf of the officers and directors, the staff, and the membership of the United States Savings and Loan League, I wish to express our deep gratitude at being added to the impressive list of American organizations and individuals who have been granted recognition by the Freedoms Foundation for their contribution to the American way of life.

I also wish to take this opportunity to congratulate the Freedoms Foundation for the contribution it makes to this great nation. Since its

founding in Valley Forge in 1949, the Freedoms Foundation, probably more than any other single organization, has helped to create and build an understanding of the spirit and philosophy of the Constitution and Bill of Rights and all the indivisible, political and economic freedoms inherent in those two documents.

It is most fitting that this award should have been presented at the United States League's Diamond Jubilee Convention. It provides a forceful reminder of the profound wisdom incorporated in the memorable address of Judge Seymour Dexter, the first League president, at our first annual convention 75 years ago, when he suggested as a motto for the League the phrase: THE AMERICAN HOME—THE SAFEGUARD OF AMERICAN LIBERTIES.

This motto is just as meaningful today as it was 75 years ago. It is no accident, of course, that the banner with the words of this uplifting phrase should provide the background of the speakers' platform at every United States League convention.

U.S. LEAGUE HONORS SLOGAN

Surely it is evident that the League and the savings and loan business never have taken this slogan lightly. The United States League has sought always to couple the public interest with the aims, ideals and activities of the savings and loan business. The transition from what was primarily a highly individualistic, neighborhood-based business into the major financial system it is today has been caused by the fact that this business has been able to merge its interest with the public interest and with the personal advancement and security of millions of American families.

In his address earlier today, President Preisler indicated the United State League has won a reputation for anticipating the needs of the savings and loan business and then developing programs to meet these needs. It should also be emphasized that this would not have been possible if it had not been for the strong financial support given the League by its members and by the unselfish and tireless service provided by hundreds of savings and loan executives working on League committees, and by those who have served as League presidents. The Federal Home Loan Bank Act was the ultimate result of the work done a decade earlier by a special League committee. The development of a workable GI home loan program was an outgrowth of the League's Postwar Planning Committee.

The Federal Savings Institutions legislation now before Congress reflects many of the suggestions contained in the 1966 Report of the Special Committee on the future needs of the business.

CATALYST FOR COOPERATIVE EFFORT

With broad membership support and participation, therefore, the United States League has been the catalyst of cooperative effort in making our great business what it is today. But the road to continued business success is a long and unending road, and the road we travel is certainly no exception to that rule. Nevertheless, if we continue to

follow the philosophy of keeping our operations in tune with the public interest, we will continue to have public support of our endeavors, whatever they may be.

I think one of the encouraging developments in recent years has been the greater United States League participation in helping to establish thrift and home ownership programs in Latin America. Hopefully, before the end of this century this program will have borne fruit and will have introduced a measure of middle class stability in Latin America in much the same manner as the savings and loan home ownership movement has provided for the United States.

In recent years, the United States League has begun to work more actively and more vigorously in exporting the savings and loan idea and I think it is of interest to note that the educational program for the savings and loan business, carried on through the American Savings and Loan Institute, is being generally adopted by the savings and loan business in South America.

One of the people responsible for developing the educational movement in Latin America is now the head of the Institute. He is Mr. Dale Bottom. Dale is sitting here on the platform and I would like at this point to introduce him to this audience. Dale was elected executive vice president of the Institute by the Institute trustees last August. I am confident that he will provide new and vigorous leadership for the Institute in connection with the very vital education phase of the savings and loan business.

The Institute is the oldest of the League affiliate organizations. In the past it has performed an indispensable role in the development of the business. The Institute program is being modernized and changed in keeping with the changing character of our personnel and the new educational techniques that are available.

The United States League, as you know, has a number of affiliate organizations. Through them and the nine different League departments, we provide the business with a broad and comprehensive program which in its depth and professional character is unique in trade association operation. Like any business executive, I am extremely proud of the character and quality and depth of the League and affiliates, and particularly its experience and stability.

I am confident this savings and loan business of ours has a brilliant and successful future ahead of it, provided we do two things: First, we remember that businesses and businessmen succeed when they adapt to change and wither when they resist change and second, we re-dedicate these basic principles of public service which were laid down 75 years ago at our first convention.

Perhaps I can conclude in no better way than to quote from Judge Seymour Dexter's closing remarks: "Let us feel each moment that a solemn duty rests upon us to maintain this grand political heritage, and that the surest way is to make its people a nation of home owners. As we enter upon the deliberations of this convention, let it be with a united strength to magnify the movement we represent, not for our own welfare, save as citizens, but for the welfare of the Republic."

URBAN PROBLEMS AND THE SAVINGS AND LOAN BUSINESS

by ARTHUR M. WEIMER, *Special Assistant to the President, Indiana University*
Bloomington, Ind.



TODAY I WANT TO TALK with you about some of the problems of our urban areas. These are your problems because you are basically urban institutions. I believe your future is dependent to a considerable extent on how well you and your associations deal with urban problems in the years ahead.

Some of you may say that you have little to do with urban problems. You live in the suburbs. You lend money primarily in the suburbs. All those urban problems—the slums and the crime and the riots—affect you very little.

I think very brief reflection will indicate that this is not so. By living in the suburbs you escape to some degree the immediate impact of the broader problems of your urban areas, of course. To date at least the suburbs have been for the most part nice places to live. It seems as though all Americans want to live in the suburbs—including the farmers, slum dwellers and others in our central cities as well as people of all races, religions and nationalities. The American suburb has been and continues to be a part of the American dream, but it is also part of the urban complex. And ultimately I doubt that it can escape the types of problems that now plague the inner city. Unless these problems are moved toward solution—and soon—the suburbs will not continue as an attractive part of the American dream for very long.

Most of you represent urban institutions. You lend money throughout the breadth of your metropolitan areas. Some of you have managed to avoid lending money in the older parts of our cities, but most of you have some money there.

If you think about it, you must conclude that you simply cannot escape being involved in the problems of your urban areas. Even if you live in the suburbs, even if you lend the bulk of your money there, you

are still a part of the urban complex. Unlike a manufacturing company you cannot move to another town or invest much money abroad—in short you are literally a prisoner of your urban area.

What can you do about the problems of our central cities? About the older areas of our cities? About slums? About rising crime rates? And how can you help to avoid riots in the future?

I wish I could give you some direct and simple answers to these questions. Unfortunately, I cannot—and at this stage I do not believe anyone else can. But I think you will agree that answers have to be found. And I believe you will agree, also, that you should help find them.

WORK AT SOLUTIONS TO CITY PROBLEMS

I believe that you should help to work at solutions to these problems in part for practical reasons of self interest. A number of business opportunities may open for you in the inner city. These will be different types of opportunities than those most of you have been familiar with up to now.

Some opportunities are open right now. For example, you can help with the 221(d) (3) programs; you may be able to help form the non-profit corporations that are required; perhaps the service corporations you have the authority to organize may be used in connection with programs of this type; you can help with guidance and know-how.

Federal associations now have authority to invest 5% of assets in loans in urban renewal areas. This authority is in addition to that involved in investments and loans on income properties. Within this 5%, federals may invest up to 2% of assets in equities in urban renewal areas. Guarantees may be worked out with the FHA, for example.

There would appear to be some good opportunities now for interim construction financing for housing projects in the inner city. The billion dollar program recently announced by the life insurance industry essentially provides for take-out financing. Through local know-how in construction financing you may be able to develop some profitable programs; an 8% return is entirely possible.

This is not solely a matter of seeking profitable programs, however. This business cannot afford to let the life insurance industry and the commercial banks steal the spotlight in the housing field. We cannot stick our heads in the sand and hope the problems of the inner city will go away. If we do not help come to grips with them, the people and Congress will find others who will help even if new financial intermediaries have to be developed.

But as of now people think that you have a lot of know-how and expertise in this field. They expect you to help find sensible and hard-headed solutions to some of the problems of the inner city, especially the housing problems. They believe in you and in my opinion will give you whatever authority you may need to function effectively either through the Federal Savings Institutions bill or in other legislation. They are not satisfied with the answers to the problems of the city that have come along so far. They think there are more sensible answers

and they believe you can find them.

One of our problems is that many of us need to reorient our general thinking about housing. After World War II we moved in the main stream of the political and social as well as the economic needs of our people. For example, we moved rapidly via the GI program to help correct the great housing shortage of the time largely through expansion of our supply of single-family homes. We continue to work largely in the single-family field, often in suburban locations. But now the big housing problems, especially those with political and social implications, are in the inner city. Some of them are in the slums; some involve housing for minority groups; in addition, there are rapidly growing numbers of young people who are frustrated by rapidly rising building and housing costs. They may not be able to aspire to single-family homes in the suburbs. We have to help develop some alternate solutions for them, I believe.

Phil Brownstein, assistant secretary of the Department of Housing and Urban Development and FHA commissioner said recently: “. . . it is our job to enlist and encourage private enterprise to play a leading role in providing decent housing for families of low and moderate income, and in improving housing and related human conditions in the inner city—especially in the slums and blighted portions of the inner city. . . . Every organization must change as the needs of the country change.”

I should like to underline the statement that every organization must change as the needs of the country change. Every industry—including this one—must change as the needs of the country change. Think, for example, of what will happen when the Vietnam War ends. Billions of dollars are likely to be spent to improve our cities and especially the central cities. Much effort will go into improved programs in education, in housing and in broadened economic opportunities.

The problems of the city may well be the center of a broad range of political, social and economic interests in the decade ahead. Many of the government's efforts in this area are likely to be of a bipartisan type; for example, we have seen already Senator Percy's program for subsidized interest rates to make possible home ownership by low income families and Senator Kennedy's program for tax credits for improvements in the central city. Many of you know that Senator Dirksen recently endorsed the rent supplement program.

CONSIDER SPECIFIC URBAN SITUATIONS

In efforts of this type I would hope that greater attention would be paid to the differences between cities, rather than trying to treat them as being essentially alike. Federal programs should provide for more experimentation and individuality so that the specific needs of specific urban situations would be met. You could contribute a lot to programs of this type.

Let me invite your attention to a few additional observations:

All of us have been expecting some major technological breakthroughs that would help to reduce greatly the cost of housing, both

in the single-family and multi-family areas. Let me suggest that if a big discovery were to be made tonight—a major technological advance in this field—it probably could not be put to use in very many of our cities tomorrow, if at all. The fact is that the building codes in most of our cities are such that they would not allow the introduction of a major technological advance. Many months and years of effort would be required.

The conglomerate organization and virtual bankruptcy of many of our local governments is widely recognized. They do not have the taxing powers to support the program that people are demanding of them. They exist to a considerable degree today through handouts from state and federal governments. Is not this a set of problems in which you can work to advantage?

BIG STAKE IN LOCAL GOVERNMENT

Last year the Committee for Economic Development brought out a study entitled "Modernizing Local Government." It created a good deal of controversy. But it started a lot of thinking and may bring some action in this difficult area. Should you not be involved in efforts of this kind? Who has a bigger stake in local government than you? We need some new ways of financing local government, some new types of municipal securities, some new sources of funds and a host of other new things in the field of municipal finance. If local governments are not rescued from the increasing control of the federal government and of many state governments, those who like yourselves believe in the importance of local government will be the losers.

We need improved social engineering to deal with many of our urban problems, which is another way of saying that we need better management. We need a lot of economic and social inventions to make our urban areas work more effectively.

Allen M. Weinberg, director of the Oak Ridge National Laboratory, said recently in an article entitled "Can Technology Replace Social Engineering?" (*University of Chicago Magazine*, October 1966) "During the war, and immediately afterward, our federal government mobilized its scientific and technical resources, such as the Oak Ridge National Laboratory, around great technological problems. Nuclear reactors, nuclear weapons, radar and space [exploration] are some of the miraculous new technologies that have been created by this mobilization of federal effort.

"In the past few years there has been a major change in focus of much of our federal research. Instead of being preoccupied with technology, our government is now mobilizing around problems that are largely social. We are beginning to ask what we can do about world population, about the deterioration of our environment, about our educational system, our decaying cities, race relations, poverty . . .

"The technologist is appalled by the difficulties faced by the social engineer; to engineer even a small social change in inducing individuals to behave differently is always hard even when the change is rather neutral or even beneficial."

Weinberg suggests that to some extent technology has provided solutions for a number of social problems. For example, the hydrogen bomb may have solved the problem of major war, the birth control pill and related developments have helped reduce problems of overpopulation, and safer cars have proved to be easier to create than safer drivers.

NEED BETTER SOCIAL ENGINEERING

So far technology has not given us a very broad range of choices in approaching many of our urban problems. If we assume that such choices will be forthcoming, we need better social engineering and management to use our growing technology effectively. And we need many more new social inventions, especially those that will lead to a more efficient use of our resources.

One of the best recent illustrations of such a social invention is the condominium. This form of ownership may represent a significant approach to the organizational problems of some of our urban neighborhoods. At the present time, for example, those who occupy public housing have to move when their incomes rise beyond a stated level. Thus such neighborhoods lose their leaders as fast as they emerge. Some sort of ownership arrangement such as the condominium would help to create neighborhoods of greater stability. Incidentally, those of you who object to subsidizing home ownership in the older parts of our cities should think about the extent to which suburban housing is subsidized through the tax break given to home owners in upper income brackets.

We need better incentives for our slum dwellers and others who are on welfare or in very low income groups. They need the incentive to move ahead, to improve their situations and thus reduce the burdens on the rest of us. We need to devise incentives that will lead to growth and progress rather than arrangements that put road blocks in the way of our slum dwellers and doom us to heavy charges to support continued squalor and incompetence. I believe you can help to design the types of incentives that are needed.

Widespread opportunities for slum dwellers are likely to develop more rapidly in cities that are enjoying good rates of economic growth. Your institutions grow faster in areas that enjoy economic growth and thus your interests here coincide with those who need enlarged economic opportunities.

I have tried to state a few propositions that will be of major concern to you as we move ahead into the last third of this century. In summary these are:

1. You represent urban institutions. You cannot escape from your urban environment. Your institutions are prisoners of the modern city.

2. The political future of your institutions and their standing in our society and our economy depend in part on applying your special ability to the housing problems of the inner city along with various related problems such as employment opportunities, education and others. We need a better system of incentives for the many of those who live in the inner city. They must have "a chance to rise on inde-

pendent terms"—the same chance the American economy has tried to provide for all of its citizens throughout its history. The American frontier has moved to the city. We need new approaches oriented toward the private sector largely on a local basis to take full advantage of the opportunities offered by this new frontier.

3. Technology may help us. But if it is to help we must open opportunities for it as in the case of many of our building codes. We need improved management and social engineering. We need many new economic and social inventions.

4. We need to recognize the individuality of our urban areas. We have tried to treat all of them too much alike. True, there are similarities, but by concentrating on the differences we may now make more rapid progress. And who can help more in understanding the problems of a specific urban area than the manager of a localized financial institution?

Finally, let us suggest that all of us need to study and learn more about our urban problems. Much information is already available. Indiana's Graduate School of Savings and Loan through its "Economics for Savings and Loan Executives" service under Ed Edwards' direction has made available to many of you such materials as the CED study to which I referred and more recently the Brookings Study on *The Economics of Urban Renewal* as well as others. Perhaps the U.S. League should sponsor special sessions on how this business can move in on the major housing problems of our urban areas. Perhaps you should sponsor some study and planning groups in your local communities. I believe we are ready for some grass roots approaches: They may lead us to some new and exciting alternatives.

In closing may I wish you well in 1968 and the years ahead. I think 1968 will be a good year for you even though it will be beset with many difficulties. And I think that the rest of the century can be a great period for you, especially if you learn not only how to cope with some of the problems we have been discussing this morning but how to turn them into opportunities for this great business.

PROTECTING AGAINST RISKS AS INTEREST RATES SHIFT

by SHERMAN J. MAISEL, *Member*

Board of Governors, Federal Reserve System

Washington, D. C.



THE FEDERAL RESERVE SYSTEM and the savings and loan business have many common goals and objectives. We all want the U.S. to have the best possible savings and credit system. We want to see our economy increase its output of useful goods as rapidly as possible with a minimum waste of productive resources. Like most of you, I am particularly concerned with the problem of building a better urban environment and am mindful that it will require a vast amount of physical capital investment made possible by

mortgage and bond financing based on a rising flow of savings.

At the same time, we all are troubled by the threat of inflation. A long period of relatively stable prices did much to stimulate the great expansion of your business. In the United States, in contrast to many countries, thrift institutions have flourished because depositors have known that they would get their money back and that when returned it would be worth as much as when deposited. Any threat to price stability is a threat to your industry.

While we have had to wage repeated battles with inflationary pressures, recently this fight has turned more critical. Halting inflation will require a great effort on the part of the whole country. Either the burden of this battle will be shared evenly by all, or it will be paid for by disproportionate sacrifices on the part of individual industries and specific sectors of the economy.

Because of the strong forces at work in the economy, no matter which method of fighting inflation is adopted, you, as savings and loan executives, will not find your tasks simple. Today, therefore, I want to discuss one approach to your possible dilemma, that is speeding up innovations and improving the management of the relationships between assets and liabilities, or more simply your portfolio policies.

Over the past two-and-a-half years, interest rates have risen to record levels. The entire postwar period has witnessed increased fluctuations in interest rates. How can your associations meet the problems raised by these fluctuations?

Before discussing this major question, let me answer briefly a separate question often asked. Since monetary changes have frequently produced sharp shifts in interest rates, why cannot the Federal Reserve keep interest rates down and stop these fluctuations?

In asking this question, some—I hope a small minority—probably will think that the answer is simply the Federal Reserve. Fortunately, or unfortunately, the answer is not that simple. When I meet such a viewpoint, I must admit I am torn. I am never quite certain whether I ought to wish that the Federal Reserve could control interest rates, or whether I should be happy that Federal Reserve action is only one of the many factors that determine the level of interest rates.

The reasons behind interest rate shifts are both simpler and far more complex than the incorrect answer—the Fed. It is true that changes in the flow of Federal Reserve funds can cause considerable shifts in interest rates in an immediate period primarily because they are often at the margin and they seem to tip the scale at critical times. On the other hand, changes in one or all of the underlying forces which determine interest rates may be either exaggerated or offset for short periods by shifts in expectations. Sharp short-run changes in interest rates come primarily from speculation (more politely, changes in expectations). Such expectational shifts, however, cannot continue independently to dominate interest rates. If not validated by events, sooner or later they fade away. The degree to which interest rates over a longer period can be held down by bank creation of more money is limited. It may also be very expensive to the fabric of our economy.

MORE MONEY INCREASES DEMAND

People rarely hold money for itself, but rather for what it can buy. What money will purchase depends on how rapidly it is spent compared to the amount of goods that can be produced. More money increases demand. It can bring about lower interest rates only if the economy has sufficient resources to turn out enough goods to more than satisfy this increased demand. If the ability to expand supply is limited, newly created money merely raises demand faster than output. Prices rise in consequence. Such rising prices for goods and services can themselves stimulate new desires for credit.

At the same time, if prices are rising, this means the value of money is falling. People will be less interested in holding cash and some will be willing to retain deposits or savings and loan shares only at the higher interest rates that will compensate them for the loss in purchasing power of such assets. Thus, while the demand for credit spirals upward, the willingness of savers to supply funds at the old interest rates diminishes. Interest rates rise. Experience in many countries has been that the faster money was created the faster interest rates rose.

An examination of the supply and demand for funds leads me to an

optimistic view of the intermediate and long-run future for low interest rates. While people's saving and spending desires change sharply for short spells, they have been stable over longer periods. Unless these desires shift radically, the government's budget and monetary policy—the so-called fiscal/monetary mix—should be the primary determinate of interest rates in the next several years. Firmer tax and spending policies together with easier monetary policies can give lower interest rates.

ANTICIPATE LOWER INTEREST RATES

Most projections of the economy show that with normal growth and a more balanced fiscal policy, in 1970 interest rates should be far lower than in the past two years. Because of their basic value to the economy, I hope we have the political courage to vote for the mix that will bring lower interest rates. With government saving up, lower interest rates can make it easier to mount a vigorous attack on some of our most critical problems—the need for better housing, better cities and a more rapid capital expansion.

Some people worry about a shortage of mortgage money over the long run, but I do not. A mortgage shortage can be caused only by a failure to live up to our fiscal responsibilities. I do not think we will fail now or in the future. When the war in Vietnam ends, we are more likely to find the situation similar to '63 and '64 when mortgage money was in surplus than we are to suffer through shortage of mortgage money.

This optimistic view of the longer run future need not, of course, apply to any specific shorter period. Interest rates will continue to move up and down as businesses, individuals and the government demand or offer more funds to the savings market. In fact the postwar period has witnessed a more stable economy accompanied by more frequent shifts in interest rates—almost certainly not unrelated phenomena.

The knowledge that interest rates will fluctuate is one of the most valuable pieces of knowledge available to a savings and loan executive. Yet use of this knowledge has frequently been neglected. Recent history shows far too few savings and loans developing strategies or portfolio policies aimed at reducing the costs and offsetting the risks of fluctuating interest rates.

PREPARE STRATEGY FOR FLUCTUATION

This neglect has been expensive. It may grow still more costly if it continues. To make certain that it does not, thrift institutions individually and as a business need to reexamine their strategy of meeting interest rate fluctuations. The reason a strategy is needed should be clear. When interest rates rise, long-term assets carrying rates fixed previously become worth less. To the extent associations' income is limited to prior interest rates on outstanding mortgage contracts, they have no earnings gains out of which to increase their payments to shareholders. Funds withdrawable on demand can and may be trans-

ferred to the bond markets or the money market when higher rates become available there.

In other words, the securities markets offer higher rates than the associations because the income of the associations is relatively frozen by existing contracts with borrowers. Savings are withdrawn to move into market assets. If the associations have to sell long-term assets their problem is compounded. They will sell on the basis of current market interest rates. This may mean having to show sizable capital losses on balance sheets.

I have never understood why this point—that fixed long-term assets carry a risk of losses caused by interest rate shifts—has been neglected by so many institutions. It may be because past interest rate fluctuations came when the margins between mortgage and share rates were much larger and thus pressures were less. It also may be because under our accounting conventions, we do not show the loss in capital values which occur with rising interest rates. It is assumed that with sufficient liquidity long-term assets will not have to be sold. The fact that interest is lost compared to current reinvestments is neglected.

By failing to recognize this risk that capital values and relative income will fall as rates fluctuate, institutions make incorrect decisions. They fail to consider all the costs of long-term loans in comparison to maintaining greater liquidity.

INCLUDE ALLOWANCE FOR ILLIQUIDITY COST

This confusion is clearest in some recent debates. When long-term rates were much higher than short-term rates, managers thought it was too expensive to maintain liquidity. They invested too much in long-term mortgages or bonds. They made wrong decisions because they failed to include an allowance for the cost of illiquidity in their calculations. Our accounting conventions allow us to show higher income by neglecting these risks. They force us to report lower incomes if we take the safer steps which probably increase long-run profits.

Since interest rates will fluctuate, an interest rate risk exists. Failing to insure against this risk is like failing to insure against other risks. For a period, anyone may save money by not carrying fire or car insurance. When the insurance is not needed he has a higher income and lower expenses. We frown on such an understatement of expenses because we know that in most cases it pays to insure. In case of fire, the house or business will be lost.

The same is true of interest rate risk. We are not forced to carry insurance against this risk. If we do not adopt a safe policy our income looks higher. If interest rates change, however, we suffer from a lack of protection. The losses can be severe enough to threaten the entire institution. In most cases, insurance against these risks as against others is worthwhile.

Tremendous strides have been made in recognizing how these risks can be insured against. Most of the ideas put forth still require a good deal of work and analysis. Some have been adopted, some not. The three which I feel have shown greatest promise are maintaining greater

liquidity, obtaining variable interest rates on mortgages, and offering a greater variety of intermediate-term certificates and long-term bonds. Let me discuss each briefly.

The advantages of liquidity are manifold. Short-term assets do not fluctuate in value as interest rates shift. If cash is needed, they can be liquidated without capital losses. If rates change, liquid assets are re-invested at the higher rates. Banks have traditionally held far more liquidity than savings and loans because of their different historical backgrounds. Do such large differences still make sense if an association is buying its funds in a broad or national savings market?

The advantages to lending institutions of variable mortgage interest rates are also clear. If carefully drawn and explained, the variable rates are fair to borrowers also. They enable the borrower and the lender to share gains and losses as interest rates shift. Thus, they reduce the need for insurance against the risks which arise if one or the other is not protected in the mortgage contract. Doing away with a risk is a real saving. Everyone is better off.

Most discussion has been concerned with variable rates on the single-family mortgage. Winning acceptance for a new idea is hard. It takes work and understanding. Progress will be made, but it may be slow. Meanwhile, let me suggest an innovation which might be simpler to adopt.

Why should not interest rates on mortgages on income properties vary with the income from those properties? On the surface, such an idea does not seem difficult to implement. Such mortgages could require that higher interest rates be paid when the income of the property rises. They might also have a prepayment penalty which increases with the amount of capital gain made when the property is sold or refinanced.

Variable income provisions are, of course, the basis of most current agreements between landlords and tenants in shopping centers. Various forms of so-called "sweeteners" are becoming more common in the lending agreements between income property owners and insurance companies, pension funds and endowment funds. It might make a great deal of sense if they became part of lending practice on all types of income properties. It seems proper that there be a sharing of risks between borrower and lender.

CREATE VARIETY OF LIABILITY INSTRUMENTS

While changing assets and the return to assets can give some protection against interest rate risks, programs to create different types of liabilities seem more hopeful and immediate. Your associations have been experimenting with different types of certificates in the past several years. These programs should be expanded and shaped to meet your problems head on.

Sometimes I feel that not enough emphasis has been given these programs because their logic has not been fully explained. All deposit institutions should understand completely the purpose and potential gains from offering different maturities of shares, certificates and

debentures at varying interest rates. Only with such knowledge can they formulate a logical strategy for their use.

Because of interest rate risks, the value of shares or deposits to an institution varies with the length of time they are certain to remain. Longer term certificates may also create significant savings in marketing and other costs. Savers have differing needs for rate of return, liquidity and convenience. A program to shape an association's liabilities to its customers' needs makes all better off. It may be fairer and cheaper to pay savers for giving up liquidity than to insure against their withdrawals on demand deposits. Associations compete in many different markets. Some competition comes from other associations, some from banks, some from Treasury bills, some from corporate bonds, some from tax-exempt bonds. The best way to compete is to tailor a different instrument to compete with each of these markets, insofar as it is possible to do so. If this is possible, each instrument may have to carry a separate rate.

You are all familiar with the differences among savers. Some are primarily concerned with liquidity and convenience. They are willing to sacrifice interest for these advantages. A passbook normally payable on demand meets their need. Others are more interested in yields. With larger sums to invest and more sophistication, they can search for higher rates.

When market rates rise, an association's attempt to hold the money of rate sensitive savers by increasing the rate paid on all shares is both expensive and inefficient. Losing their funds, particularly if it means taking capital losses, may be expensive also.

As a result, recent trends in differentiating savings instruments ought to be pushed further. They should lead to a variety of different instruments, but also to greater penalties than now exist for liquidating longer term contracts. We might expect to see passbooks, six-month to three-year certificates, and 10- to 15-year debentures all being used side by side. Rates would vary with maturity. Penalties for obtaining cash prior to maturity would also vary depending upon the length of the initial contract.

I recognize that these are proposals involving not only changes in management policy, but also to some extent in supervisory attitudes, regulations and in some cases even in applicable statutes. But the first step toward all these changes is insuring a clear understanding of how and why these changes can benefit the association, its savers and its community. That is a job I would urge you to undertake now.

THE NEED FOR UNITY IN THE THRIFT BUSINESS

by HARLAN J. SWIFT, *President*

National Association of Mutual Savings Banks

New York, N. Y.



I GREATLY APPRECIATE this opportunity to address your Diamond Jubilee Convention about a subject that could represent the most significant public interest advance in our financial system in more than a generation. I refer to the Federal Savings Institutions bill and to the long-term end result of its enactment—the unification of mutual savings banks and savings associations into one strengthened, modernized thrift and home-financing system capable of serving the changing family financial needs of Americans.

A unified thrift business would not only answer the massive competitive challenge that both savings banks and savings and loans face from commercial banking. It would also represent the logical culmination of the converging paths our institutions have traveled over the years. The first mutual savings banks were organized in Boston and Philadelphia in 1816 to give the working man for the first time a safe, profitable place to save. The first savings and loan association was organized in what is now part of Philadelphia in 1831: Its objective was to help its members, who were also working people, attain home ownership.

Savings banks since the end of World War II have channeled the bulk of their funds into mortgage loans, and the savings and loan business long has vigorously promoted savings to obtain funds for home financing. Thus, while starting from opposite sides of the balance sheet, savings banks and savings and loan associations have both evolved into mortgage-oriented savings institutions currently holding a combined total of more than \$180 billion in savings and more than \$150 billion in residential mortgage loans.

The convergence of our two businesses has been accelerated and given new urgency by the emergence of commercial banks as powerful competitors, and by the rapidly changing financial needs of Americans.

It was the restoration of a flexible monetary policy back in the early 1950s, and the subsequent rise in open market interest rates, that set the stage for revolutionary savings market developments in the 1960s and turned commercial banks into the vigorous, no-holds-barred competitors for time and savings deposits that they are today.

As long as commercial banks pretty much left savings promotion to us, we felt that our institutions could continue to serve the public well—and thrive in doing so—while operating as “specialty stores” of finance, providing the best possible thrift and home-financing services.

MUST CONVERT FROM ‘SPECIALTY STORES’

But a sleeping giant in the form of retail “one-stop” commercial banking has awakened with a vengeance. This, plus a growing financial sophistication on the part of the very Americans we serve, makes it apparent that if our institutions are to survive as thrift and home financing specialists we must convert our “specialty stores” into “shopping centers of family finance.”

If there is any doubt that commercial banks have moved into the savings business to stay in a full-scale competitive way, a statement made last March by the executive vice president of the American Bankers Association should erase that doubt once and for all.

“Commercial banks, as major suppliers of the nation’s means of payment, are not usually thought of as thrift institutions. But the fact is that we are; we are firmly ensconced in the savings business and we intend not only to stay, but greatly to expand our activities.”

And the figures bear him out. Commercial banks increased their share of total savings account flows from less than 25% in the decade ending in 1956 to 40% in the 1957-1966 period. Even more revealing is the record of the past few years. In 1965, commercial banks attracted fully 50% of the total increase in household savings accounts. During 1966, a disturbing year for thrift institutions, their share rose to more than 60% of the total savings account increase. And this year, even with record inflows at savings institutions, commercial banks will attract about half of total savings account growth.

Moreover, as commercial banks have increased the competition for liquid savings on one flank, savings institutions have become increasingly vulnerable to competition from high-yielding open market investments on the other. I need hardly dwell upon the unpleasant results experienced by our institutions last year when individuals acquired a record volume of open market investments while reducing their net savings inflow 29% at savings banks and by 57% at savings and loan associations.

By 1966, the traditional savings and loan interest rate advantage over other types of institutions had largely evaporated and in many cases had been reversed. Your institutions have thus lost much of the protective insulation from the shock of high and rising open market rates that your favorable share account rates formerly provided.

This year savings have been flowing over the counters of our institutions in record volume. But we all know that the possibility of an-

other 1966-type financial squeeze remains. In this regard, concern is already widespread over the possibility of a sharp upward spiral of open market interest rates and of a renewed wave of investment switching.

Unfortunately, savings institutions and home building will remain vulnerable to this chronic danger in a relatively full-employment economy until basic changes are made in the nature and structure of our thrift and home-financing system—changes that will enable us to compete effectively for savings against “one-stop” commercial banks in this new market environment. Indeed, it is the growing recognition of the serious mortgage and housing implications of a progressive diversion of savings to non-mortgage-oriented commercial banks that has accelerated the movement toward a strengthened, unified thrift and home financing system.

Our institutions are by far the nation’s leading suppliers of home mortgage credit. Together, during the postwar period, we have supplied almost three-fifths of the total residential mortgage flow. You dominate the conventional home financing market; we are the nation’s leading lenders on federally underwritten loans. We both channel almost all of our savings growth into mortgage loans, while business-oriented commercial banks channel substantially less than half of their savings growth into mortgages.

Recognition of these basic differences in investment orientation between mortgage-oriented savings institutions and non-mortgage-oriented commercial banks—and of the strong inroads being made by commercial banks on the nation’s most important source of mortgage funds—has raised widespread concern over the future cost and adequacy of mortgage credit. It will take a massive volume of funds to finance the housing needed by the sharply rising number of new families projected for the coming decade and to finance the urgent task of building and rebuilding our nation’s urban complex. The supply of mortgage funds will fall far short of these mammoth demands if the nation’s leading mortgage lenders are not able to compete for savings.

MUST BECOME ‘ONE-STOP’ CENTERS

The solution, of course, is obvious. Mortgage-oriented thrift institutions must be given the powers needed to generate an increasing volume of savings for mortgage investment. This will require increased flexibility in the type of accounts we are allowed to offer. It will require broadened and more modern branching powers, so that we will be able to serve a maximum number of people with the maximum degree of convenience. And it will require significantly broadened loan and investment powers, so that we will be able to provide the full range of thrift and financial services demanded by today’s sophisticated and convenience-minded customers. In short, we must become “one-stop” family banking centers, if we are to counteract the growing “one-stop” appeal of retail commercial banking.

These considerations in particular highlight the importance of trying to serve the needs of the youth market. We all know that young people

tend to save relatively little and that one of their first major financial requirements is for consumer credit. Commercial banks have capitalized strongly on this need and, as a result, are in a strategic position to gain the thrift accounts of these young people as they mature and begin to increase their savings. To meet this threat, we too must be able to offer consumer credit and other youth-oriented services as a means of generating long-run savings growth. This will be particularly crucial in the period ahead, moreover, since the number of young adults is due to rise sharply as the postwar baby boom continues to come of age.

With the broader powers available through the Federal Savings Institutions bill—particularly the power to make consumer loans—our institutions would be able to increase long-run earning power and, as a result, our ability to pay competitive rates to savers. We would be able to adjust earnings more rapidly in periods of rapid financial change such as occurred last year and would be better able to minimize liquidity pressures and maintain savings and mortgage lending volume.

In short, with broadened powers we would be able to compete for savings against both non-mortgage-oriented commercial banks and high-yield direct investments. And this would mean an increased long-run flow of home mortgage credit—given our traditional and unchanging basic orientation to residential mortgage lending and the specific requirements of the Federal Savings Institutions bill.

MORE STABLE FLOW OF MORTGAGE CREDIT

Moreover, broader and more flexible powers for our institutions would also promote a more stable flow of mortgage credit over the entire business cycle. We would be better able to maintain savings growth and mortgage flows at different stages of the cycle. We would be able to avoid excessive mortgage credit expansion in periods of rapid savings growth and relatively low housing demand by acquiring nonmortgage assets. We would be able to cushion reduced mortgage credit availability during periods of relatively slow savings growth and strong housing demand by converting non-mortgage assets into mortgage loans.

Providing broadened and more flexible powers for savings institutions, therefore, would moderate the tendency of the residential mortgage market to swing rapidly between periods of feast and famine, while increasing the total flow of mortgage credit over the long run.

Some will still ask what assurance there is that mortgage lending will remain the staple investment of the more flexible association. To answer this, we can look at the experience of the savings bank industry itself. Our state-chartered banks have, in the aggregate, under all of their various state charters, all of the so-called broader powers contained in the Federal Savings Institutions bill and some that are not granted in the bill. Yet over the years and particularly since World War II, they have steadily increased their mortgage lending until it approaches 80% of assets. Last year they liquidated other investments

in order to help meet the demand for mortgage credit so that in effect they made mortgage loans equal to 180% of new savings taken in, and the record for this is the same in states that grant consumer credit powers. So long as home ownership remains a highly prized aim of Americans, an institution that exists to serve the American family will have to include the mortgage loan among its most needed services under any and all economic circumstances.

The legislation on which hearings will be held—H.R. 13718—is the kind of bill that will give our institutions improved ability to serve the nation's savings, home financing and other important family financial needs. In legislation as important as this, amendments and changes are to be expected. We should not be dismayed by this. In fact, the process of compromise will be vital to achieving a bill that will provide our institutions with needed flexibility to serve the public interest well. By working together in this legislative process, we can do much to assure that this goal will be achieved.

Predictably, the commercial banks have mounted strong opposition to the proposed bill. In fact, a top American Bankers Association official has labeled the bill "the greatest legislative challenge commercial banking has faced since the 1930s."

MAINTAIN UNIFIED THRIFT FRONT

Given our institutions' strategic role in housing and real estate markets throughout the nation, and the widespread recognition of the need to strengthen our thrift and home-financing system, there is good reason to believe that we will see passage of this legislation in suitable form, notwithstanding the forces of self-interest-motivated commercial bank obstructionism. To succeed, however, we must maintain the unified thrift business front that has been forged in recent months. Nothing would serve the interests of commercial banks more than to succeed in their efforts to destroy thrift business unity.

I believe, however, that the process of unification of the mutual savings bank and savings and loan businesses is too far along to be reversed now by commercial bank interests. There are many examples of what I mean. We worked together on tax legislation early in this decade. In 1965, savings bankers readily joined with your business to form the new Savings Institutions Marketing Society of America, after commercial banks closed the door on your membership in the Bank Marketing and Public Relations Association.

More recently, unification of the thrift business has taken another important turn at the state level. In New Jersey, a group representing each state trade association is exploring unification. In the states of Washington and Pennsylvania, your state associations have announced plans to consider inviting savings banks to become members. And in several states legislation has been introduced, is pending or has passed that would permit the consolidation or merger of savings and loan associations and savings banks.

A successful campaign to secure enactment of the Federal Savings Institutions bill would be the capstone to this arch of unity that has

been building on the foundations of our two businesses. Enactment of this legislation would open broad new potentials for our institutions as the nation's urban family banking centers. It would open the way to a broader specialization based on the fundamental core of thrift and home financing, but encompassing the wide range of financial services demanded by individuals and their families in our modern, complex society. It would permit our institutions to play a more significant role in helping to solve the growing environmental problems of our urban centers. It would help maintain needed variety and choice in our financial system by providing a strong consumer-oriented counterpart to the business-oriented commercial banking system. Most important of all, enactment of this legislation would assure an adequate and sustained flow of home mortgage credit over the years ahead.

As modern people or family-oriented institutions we seek not only to be true to our traditions but relevant to our times. The Federal Savings Institutions bill can make this possible.

THE HOUSING AND MORTGAGE MARKET

by the HON. JOHN J. SPARKMAN

United States Senator

Huntsville, Ala.



THREE YEARS AGO when I last addressed your convention, we had just passed a huge housing bill; the presidential elections were over; Vietnam was not yet a serious war; and the savings and loan associations were riding high on a wave of prosperity, the best in their history.

Much has happened since then. Our war, our city riots, our student demonstrations and the militant resistance to authority by much of society have raised questions about many facets of our government and private institutions.

The riot problems and problems of law and order, are being studied by several presidential commissions and committees of Congress. Perhaps next year we may begin to see more affirmative and more effective action taken to help solve some of these problems. The Vietnam story is a separate issue. I wish we might be more helpful through a presidential commission or committee of Congress in solving that. I have high confidence that we are going to win the victory out there. In fact I am confident that we are winning it, and this time next year we shall be able to see and tell an entirely different story, a more hopeful story. I hope that it will be finished by then and, if not, that we will be able to see daylight, but I want that daylight when it comes to come so we can say that in honor, dignity and in courage we have upheld and maintained our position as leader of the free world.

The current winds of change in our economy have not left untouched the savings and loan business. In fact, the change in the traditional relationship among the nation's financial institutions was the primary cause of the deep difficulty faced by savings and loan associations during last year's tight money period.

I can well understand why this money crisis, referred to by some writers as the 1966 money "crunch," was a frightening experience to many of you. And I can understand why you are so anxious to make

changes in the structure of financial institutions to prevent this from happening again. And when I refer to it or accept the reference that has been made to it as the 1966 money "crunch," I mean just that. I know something of the difficulty and hardship of the savings and loan business suffered during that year. I remember when the Federal Reserve Board put out its famous order back in December of 1965. The Joint Economic Committee of the Congress immediately called hearings—I mean we called them within the next day or two—and we held three days of hearings with the members of the Federal Reserve Board testifying fully. I remember at the time saying to that Board, and particularly to Chairman Martin, that I was fearful of what was going to happen to the savings and loan associations and to smaller commercial banks throughout the country. We received assurance that this would be watched carefully and that every effort would be made to prevent hardship from occurring. But 1966 is behind us. We know what did occur. We hope that we are in the clear and that it will not happen again.

Our Housing Subcommittee conducted a study of mortgage credit early this year to determine the causes of the 1966 credit crisis and what recommendations could be made to insure an adequate flow of mortgage funds for the future. As part of this study, strong opinions were expressed by several participants that the thrift institutions, with limited investment and borrowing powers, could not survive in today's competitive financial world.

We heard statements to the effect that the day of the specialized industry is gone and that without diversification and more flexibility, the specialized thrift institutions would eventually be forced out of business by the strong commercial banks with their one-stop service. We heard a great deal about the hazards of borrowing short and lending long, which is what a savings and loan association does when it uses demand deposits to make 30-year loans.

The basis for much of the concern about the future of the thrift institutions is the upsurge of interest in recent years by the commercial banks in the thrift and mortgage lending fields. Historically, the commercial banks were not interested in savings. They made their profits out of short-term loans to finance commercial and industrial expansion. When the mutual savings banks and the savings and loan associations demonstrated the great profit opportunity in thrift and home financing, the commercial banks became aggressive proponents for changes in federal laws to permit them to participate.

CHANGES FAVOR COMMERCIAL BANKS

Let me say that we made those changes as time went along until now the commercial banks do have more privileges than they formerly had. Of course you have heard the statement made many times. You know that Governor Robertson of the Federal Reserve Board has said that perhaps the time will come when all of these financial institutions will merge, or at least have common supervision to narrow the gap that separates the institutions at the present time. I am not predicting this.

I would have to be sold on this before I would be willing to advocate it, but nevertheless we do see that they have been moving closer.

It is hard to believe that for over 20 years, from 1935 to 1957, the commercial banks were limited by Regulation Q to a maximum of 2½% on pass-book savings and only 1% on 90-day time deposits. The ceilings have been raised gradually, up to the current 4% on pass-book savings and 5½% on large time deposits.

A dramatic change in the pattern of savings flows has taken place in the last five years. As recently as 1961, the net savings deposits in savings and loan associations were far in excess of time and savings deposits going into commercial banks.

Since that time, the banks have moved ahead fast. In 1965, more than twice as much savings and time deposits flowed into commercial banks as into savings and loan associations. In 1966 and in early 1967, the comparison became more lopsided with three times as much flowing into the banks. If the regulatory differential in interest rate ceilings between the two types of institutions were removed, there is no telling how much further the scale would be tipped in favor of the commercial banks.

Several mortgage credit study witnesses viewed this development with alarm and urged drastic steps to put the institutions back into their traditional relationships. The U.S. League participated in the subcommittee's mortgage credit study and made a number of recommendations to strengthen the business and the Federal Home Loan Bank System. One of the League's recommendations—that there be a greater availability of funds in the Federal Home Loan Bank System during periods of tight money—is now being followed by John Horne and the Board. I understand the System now has over \$2 billion of extra liquidity as a buffer against a 1966-type liquidity crisis.

The Board also has pressed the individual associations to build up their liquidity position to prepare for any further emergency, which has resulted in another increase of \$2 billion of liquid funds since last year. In fact, the Board seemed to consider the liquidity squeeze in 1966 as the most serious item requiring correction and is working on several proposals involving liquidity management which it believes will forestall any future emergency.

Other recommendations of the U.S. League included the widely supported request for broader borrowing and lending authority. The justification referred again to your competitors, the commercial banks, which can outbid you for savings because of the higher yields realized from short-term loans rolled over rapidly at higher interest rates. The Bank Board did not respond directly to this particular issue but, in previous hearings before our committee, the Board supported wider lending authority confined to a specialized category related to the home, including household durable goods or furnishings.

As far as the Congress is concerned, I believe it is appropriate to review these issues and reconsider the relationship among the financial institutions and the philosophy under which they operate. Last year, after a lot of tugging and pulling, the Congress passed the rate control

bill, which many of your members originally opposed, but which turned out to be your salvation in last year's hot pursuit for the savers' dollar. I think you can read into that decision by Congress strong support for continuing the present relative positions among the financial institutions.

This does not mean that some wider investment flexibility should not be permitted if the need can be demonstrated consistent with the basic purposes for which the associations were created. However, the type of lending should be carefully screened. Empowering associations to become involved in consumer lending would raise serious questions. My concern is that the more lucrative short-term investments will attract the lion's share of the funds and the housing market will become the stepchild again as it turned out to be last year.

Testimony has been submitted to our committee to disprove this possibility based on experiences of mutual savings banks in states where they have the wider investment powers. We need to analyze these data and see to what extent they could be considered representative of the national picture.

The Federal Savings Institutions bill, now pending before the House of Representatives, brings to a head many of the issues that I have been discussing. It has gone through many changes, both in name and in substance, since I introduced the first bill about eight years ago, but there is one good thing about it. It has brought together more supporting groups and people than has ever been the case heretofore.

BILL OFFERS LATITUDE IN BORROWING, LENDING

This bill, which started out as a federal chartering bill for mutual savings banks, has been redrafted several times and, as I understand it, the current version would authorize savings and loan associations to convert to federally chartered mutual savings banks with wide latitude in borrowing and lending. A minimum of 60% of assets of an association would be required to be invested in residential mortgages, but the other 40% could be invested in a variety of activities unrelated to home mortgage financing. Savings and loan association mortgage holdings are now about 85% of total assets.

Once the House of Representatives completes action on this bill, it will be referred to the Senate and I expect full and extensive hearings by the Senate Banking and Currency Committee. I have alerted the proponents of the bill that we were pretty well jammed on our side and this would be one bill the House would be expected to act on and have sent over to the Senate before we took action. We have to work out an arrangement like that. Just as in the present situation, there are several bills pending before the House Committee that we have already passed through the Senate. I know that some of those bills will not be financed before the end of this session. But everything stays alive and when we move into a new session in the beginning of January, we can catch up. I have said that the committee ought to study the bill carefully and make certain of the impact of such legislation on the future of the savings and loan business.

Let me say that I have kept up with what has been occurring here during this convention and I am pleased to note the interest that has been taken in this particular legislation. There is much more to getting legislation passed than just introducing the bill. What gets legislation through Congress is the desire of the people back home to see that legislation enacted. You have to build up steam among the people who normally are interested in this type of legislation. It seems to me that is exactly what has been done this year on this bill that has been languishing in Congress for eight years. I am delighted to see the interest that has been taken by this convention and by other groups in support of this legislation.

As specialists in the mortgage credit field, the savings and loan business has done an outstanding job of helping to make the United States the best housed nation in the world, and I would not want to see this changed. It seems to me that more proof is needed that the future of the savings and loan business is dependent upon changing to a diversified business rather than remaining a specialized business, and I am certain when that proof is submitted to the two committees in Congress, those committees will respond with legislation that will assure a continuing place for the savings and loan business in making this nation, regardless of its growth in population, the best-housed nation in the world.

The mortgage credit needs of our nation in the years ahead are enormous. To meet these needs, the resources of our existing institutions will be stretched to the limit.

The traditional concept of a savings and loan association, going back to the earliest days, is that it receives the savings from the people in the community and uses those savings for investment to build homes for those people and their neighbors. Of course this has been radically changed over the years but that feeling still lingers, and it is on that the present favorable tax treatment is given to savings and loan associations.

CONCEPT OF HOUSING CHANGED

In today's technology, housing is not just limited to a house, but it covers the necessary environmental facilities that make the house a genuine home. This goes back to the Housing Act of 1949 when the national housing policy enumerated the goal of a decent home and a suitable living environment for every American family.

We have been working toward that over the years and with considerable degree of success, but we have a long way to go to keep up with the needs of the American people, particularly in view of the expanding population. In the last few days I read an article in the paper to the effect that next Monday—I believe at two o'clock in the morning—the clock that indicates the population of this country will cross the 200 million mark. According to the timekeeper in the Bureau of the Census, we become a 200 million nation next Monday.

When I came into existence back in the 19th century, the population of this country was about 75 million. We became a 100 million nation about 1915. Now in 52 years we have added another 100 million. I be-

lieve that clock will cross over the 300 million mark in 2016. That is how fast we are growing. I mention this just to indicate how fast the demand for homes is growing and how tremendous becomes the problem of supply—materials, labor and, probably most critical of all, financing. For those homes must be built if we are to achieve the goal of a home that is safe and sanitary—a decent home in a good neighborhood for every American family. Our recent housing legislation has been away from a narrow brick and mortar approach and toward the consideration of the house and its environmental amenities as a package. Some of you have advocated that savings and loan associations move in a parallel direction to finance this type of package, and I think this should be considered.

I assume that matters of this sort are being considered by Dr. Friend's University of Pennsylvania study. As you know, the Congress appropriated \$500,000 to have this study made in depth of the Federal Home Loan Bank System. The appropriations were made last year and I understood that a preliminary report would be ready early next year. But John Horne now tells me that Dr. Friend is keeping the Board informed on his study but will not have a report until the end of next year.

In the last two years the Bank Board seems to have concentrated on putting its supervisory house in order. Last year the Congress went along with the Board's recommendations and enacted the Financial Institutions Supervisory Act. This year the Board is fighting hard to have its Savings and Loan Holding Company bill approved by Congress. Our Senate committee agreed with the Board that greater problems in this segment of the savings and loan system warranted tighter supervisory controls.

The present law, the Spence Act, was passed in 1959. It imposed a freeze. It was a stopgap measure until Congress could enact a comprehensive bill. The act provided that the Federal Home Loan Bank Board undertake a thorough study of holding company activities and report to Congress within a year with its recommendations. The study was completed in 1960 and implementing legislation was offered in each succeeding Congress.

SENATE SUPPORTS BILL

This year we received the Board's recommendations in April, hearings were held and the bill was approved by the committee and adopted by the Senate in June with almost unanimous support. The bill passed the Senate on a voice vote without any outspoken opposition. Some significant changes were made by the committee from the bill proposed by the Board. While the Senate bill would require registration of and reporting by the holding companies and give the Board power to examine them, it would permit, subject to Board approval, orderly growth in the business. We tried to protect the marketability of savings and loan stocks, and we made a number of other changes requested by the business to assure that the bill, while adequate to protect the public would not work an undue hardship on anyone.

I notice that in the House Committee there has been rather strong opposition. Frankly, I was disappointed to see that opposition because I felt we had worked out a very good compromise bill in the Senate. We want a bill that is fair to existing holding companies; we also want a bill that is fair to the rest of the business as well and to the public at large whose savings we insure. Once the Board gets this matter out of the way, I hope it will concentrate its entire resources on a matter of utmost importance, that is, how to involve more deeply the savings and loan associations in financing lower cost housing and in participating in the rebuilding of the run-down and blighted areas of our cities.

Our subcommittee had three sets of hearings this year and the subject of credit shortages for lower income families was raised time and again in all three hearings. We heard about the red-crayon areas in our cities within which no legitimate lender would venture on a conventional or a government-assisted basis. We learned that absentee landlordism, overcrowded tenements and indifference toward property are the common denominators in these areas, all of which contribute to the rapid deterioration which, in the long run, leads to government intervention at an extremely high cost.

NEW HOME OWNERSHIP PROVISION

In recognition of these problems, I developed a new home ownership provision to make it possible for lower income families to buy a home. The principal feature of my proposal which, by the way, has been agreed to by the Housing Subcommittee and I hope will be ready to send to the Senate floor immediately following Thanksgiving, is an interest rate subsidy to be paid by the federal government. The buyer would pay an interest charge based on a 3% mortgage, and the government would subsidize all interest charges above 3%. This would be only for those who are in the lower income bracket. We think we can get it down to as low as \$3,000 family income and certainly it would range between that and \$4,500 or possibly \$5,000 income. The loan would be made on the basis of whatever the going interest rate is; the buyer would pay 3% and the government would pay the interest charges above the 3%.

We have had this in effect in housing for the elderly, for college housing and perhaps in one or two other fields, and it is working very nicely. It does not have a great impact on the budget because it is only the interest rate the government puts in instead of the millions required for floating public housing.

To make sure that the subsidy would go only to the neediest, each family would be required to pay at least 20% of its income for principal, interest, insurance and taxes. Authorization for appropriations would be requested adequate enough to finance 200,000 units over a three-year period. Certainly this should show us just how well this would work. Then we can determine whether we want to continue it.

The Senate Housing Subcommittee has approved this proposal as part of its omnibus housing bill for 1967. It has worked hard on the bill and we are pleased with the various provisions to provide better

housing and an improved living environment for all of our people.

The subcommittee also approved several interesting amendments affecting the FHA program. One amendment would authorize the FHA to qualify for insurance an applicant who heretofore would have been turned down because of flaws in his past credit history. Studies have shown that many of these families make good credit risks for mortgage loans if they are assisted with budgeting and related matters. A high risk fund would be established within the FHA which would separate it from the regular FHA insurance as far as the reserve for losses is concerned. Another amendment would authorize the FHA to take risks in blighted areas of our cities which heretofore have been no-man's land for government-assisted or conventional mortgage lending.

These provisions have a common theme that the federal government must take the risk involved in housing the poor and in rebuilding our run-down cities. The risk would be evaluated and a reserve fund established to take care of any losses. FHA would not have to pay it out of its regular reserve fund, or if it did it would be reimbursed. The Congress would be expected to back up the FHA with the necessary appropriations to take care of the cost involved.

Several other provisions were approved which would shore up existing urban renewal and rehabilitation programs, to speed up the public housing program, particularly the new "turnkey" type of public housing, the 701 planning program and others.

We also agreed to a provision which would remove the statutory 6% interest rate ceiling on FHA and VA mortgages and adopted a flexible rate subject to the discretion of the Secretary of the Department of Housing and Urban Development. We first voted on the question of removing the interest rate entirely, coupled with a provision prohibiting discounts but this was lost on a tie vote in the subcommittee. Then we voted for the flexible rate. We did this regretfully but felt we had no choice in light of today's high interest rates for which I must say in all honesty, I see no early relief.

INVOLVE YOURSELVES IN REBUILDING CITIES

You have no doubt been reading about the necessity of involving private enterprise in the rebuilding of our cities. This involves both those industries which do the construction and those which do the financing. One is worthless without the other. Home financing is your business and I am hopeful that your energies will be extended in this direction.

I am confident that the U. S. League will play its part in the compelling responsibility which our nation has in making decent, safe and sanitary housing available to low-income families, particularly in the central city. I shall welcome at any time your comments and your constructive suggestions. In turn, you may be assured of my full cooperation and I look forward to sponsoring any legislative proposals to carry out the purpose of this tremendous undertaking. Perhaps by this time next year, we shall see some effective action taken on some of these ideas.