

**SAVINGS AND LOAN
ANNALS 1973**

**United States League of Savings Associations
111 East Wacker Drive
Chicago, Illinois 60601**

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United States League of Savings Associations



Nick Gilbert

PRESIDENT

FOREWORD

For the savings and loan business, 1973 began with savings increasing but at a much slower rate than in 1972. Mortgage loan commitments were at record levels and continued to increase through the first half of the year. At the same time the economy was overheating and inflation accelerating. Market pressures were mounting for savings and loan associations. The Federal Reserve responded by tightening the money supply, and the administration permitted interest rates to increase at an accelerating pace. The Federal Reserve, fearing a repetition of the near disastrous disintermediation of 1969-'70, initiated a new set of higher savings deposit rate ceilings for banks and savings associations. Included was a new ceiling-free certificate quickly dubbed the "wild card."

For nearly three months, savings markets remained in near chaos. With the elimination of the wild card, by yearend savings flows to financial institutions had recovered to more satisfactory levels. However, commercial banks had substantially increased their share of the household savings market in 1973 while savings associations' share of the market fell. All of this was to the detriment of housing as housing starts plummeted at an unprecedented rate of decline. Increased competition was the name of the game.

A look at *1973 Savings and Loan Annals* will reveal the lessons relearned this year by the business: Growth in an increasingly competitive market cannot be taken for granted. The business cannot choose whether or not to stay abreast of developments. It must do so to survive. Association management must accept the challenges of both the regulatory and competitive environment in which the business exists.

The events of 1973 point up issues for the savings and loan business which are not necessarily new, but newly acute. These include developments in funds transfer systems and methods, conversion from mutual to stock associations, taxation and the powers and structure of financial institutions. Along with these problems and opportunities, there is an increasing awareness by savings association management of community and civic responsibilities. These responsibilities extend from equal employment opportunities in associations through mortgage lending policies to involvement with neighborhood and city projects. These subjects formed the discussions and deliberations at the U. S. League's annual convention in Dallas, Tex.

A glance at this volume's table of contents shows that the business does take its problems seriously. Funds transfer and EFTS matters pervaded general sessions, topical forums and committee meetings. An entire forum was devoted to the expanding of our Transmatic program. Emphasis was placed throughout the convention on making full use of current authorities including service corporations and the secondary market activities. Moreover, discussions included additional powers which must be secured through legislation including such competitive tools as inter-relationships with real estate investment trusts.

The unknown fate of the administration's proposals for housing and for financial institutions loomed over the discussions as a silent reminder of the challenges facing the business. Most agreed that the time has come for a resolution of the historically cyclical problems of which the business was once again the victim this year.

Members discussed these problems with experts outside the business and with the League staff. Their conclusions and resolutions, published in their respective committee reports, demonstrate the important role of membership in forming League policy. For example, resolutions were passed by the Board of Directors on League goals for more efficient use of energy, even as the energy shortage was first announced by the President. Emphasis was placed on the need for more home improvement loans. The administrative and committee reports taken together reflect the process through which the League develops policies and strategies to serve its members best.

Challenge is always exciting and there is vast potential for expansion. Resolution, persistence and continued study are called for to meet the changes that are now taking place.

RICHARD G. GILBERT

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GENERAL SESSIONS

PRESIDENT'S ADDRESS

by RICHARD G. GILBERT, *President*

United States League of Savings Associations

Canton, Ohio

If I were to give a title to this talk, it would be "A Business Under Attack." For our entire country—nationally and internationally, 1973 has been a year of stress, a year when our great institutions of government, education and business have had their foundations shaken. Our entire financial fabric is being torn at its very warp and woof. The great \$260 billion savings and loan business, the second largest system of financial institutions in this nation, is under attack. To borrow from Charles Dickens, "It was the best of times, and it was the worst of times"; 1973 is the epilogue and 1973 is the prologue.

Let us review this epilogue to determine if it will help us decide how we want the book written. Let us review the past to set the stage for our deliberations about the future. Housing shortages began to disappear in late 1972 and early 1973. The year opened with substantial although slowing savings growth. Early in the year the administration applied pressures to keep residential mortgage and other consumer interest rates low. Business and commercial interest rates were allowed to rise. Diversified lenders such as commercial and mutual savings banks moved away from residential mortgage lending to other investment outlets. This left savings associations doing a high volume of residential mortgage lending at rates lower than other credit market instruments and at rates lower than those subsequently available in residential mortgage markets. This hurt savings and loan earnings and concomitantly their ability to bid for limited funds in the ensuing tight money period.

While things looked good in the first quarter, storm clouds were beginning to gather. The largest and darkest cloud on the horizon was an almost uncontrollable inflation. Many solutions had been tried unsuccessfully—Phase I, II, III, III½ and IV, along with jawboning and political pressure. All failed for one reason or another. Then almost total reliance was placed on monetary policy to endeavor to stem this inflationary tide. Monetary policy was called on to correct the past mistakes in credit and fiscal policies. In my judgment, the greatest single threat to the efficient functioning of free financial institutions in the United States is inflation. We have to stop treating the cancer of irresponsible fiscal policy with the habit-forming drugs of monetary policy.

To return to noninflationary growth we must review our philosophy of full employment. Our present inflation is in large part a result of years of over stimu-

lative fiscal and monetary policy aimed at achieving full employment regardless of other costs. Sound credit and fiscal policy and a better coordinated monetary policy should be the number one legislative objective for the business.

The other clouds gathering on the horizon were numerous: the changing interest rate patterns and the impending expiration of deposit rate ceilings at mid-year; diminishing housing shortages; the desire by some in our business for conversions from mutual to stock associations; the call by many for a drastically changed financial structure; and the threat of changed taxation.

It is these challenges with which I would like to deal. Please note: I call them challenges because I think we should meet these problems as challenges and turn them into opportunities. As we view these opportunities, let us each remind himself that change is certain. Everything is in a state of change. Everything is in a state of change except the law of change itself. As we change, how do we want our book written?

First, let us talk about changing interest rate patterns. For the third time in eight years this nation has had to suffer the ravages of extremely high interest rates, rates high by all historic standards. In addition, during these few years, we have had to suffer yo-yoing interest rates. For example, as measured by changes in the rate on 90-day U.S. government bills, fluctuation over short periods of time ranged from 3% to 7% to 4% to 9%. In 1973 alone, the bill rate yo-yoed from 5% to 9% to 7%. If interest rates on consumer deposits at financial intermediaries fluctuated like this, the stability of the institution would be questioned. Three times in this eight-year period we have had an inverse or downward sloping interest rate curve. In other words, short-term money market rates were higher than long-term investment rates. These are devastating patterns for the buyer of short-term funds who sells them long-term, devastating for the thrift business.

There is little doubt that past mistakes and current events necessitated the present tight monetary policy. The method through which the limited money supply was made available to various borrowers was different in this period of monetary stringency than in either 1966 or 1969, and it is open to considerable question. During this period, shrinking monetary resources were made available to all comers to the highest bidder on the basis of price alone. The home buyer and the home builder and the savings and loan business are among the weakest bidders, home buyers because they cannot or do not want to afford high interest rates, savings and loans because in large part we have accepted the nation's mortgage interest rate risk. We are locked into long-term residential mortgages at relatively low rates yielding insufficient earnings to pay the price for funds when short-term interest rates exceed long-term rates. Better answers to the problems of inflation must be found than to curtail periodically the money supply, forcing interest rates to levels which knock the home buying public out of the market—rates which bring the real estate, home building and savings and loan business to a virtual standstill.

Next, as the year progressed, the question of conversions from mutual to stock associations became a burning issue. While this question has been temporarily laid to rest, we should not forget that a moratorium by definition is not permanent. Over time there have been conversions both from mutual to stock and also from stock to mutual. Proponents cite the advantages of conversions, opponents say the disadvantages outweigh them. There is generally great uneasiness and rightful concern over the fact that unless a conversion formula elimi-

nates windfalls, a domino effect would be created which would force conversions whether desired or desirable. But the problem will not go away. While Congress imposed a moratorium, it is only that—a temporary stay. So, soon again, this question will surface.

Now I would like to deal with housing. Today we have a type of housing shortage created by the absence of financing. In many areas it is impossible for an employee being transferred into the city to get a loan without a 30% to 40% down payment. Except for that market disallocation, we have made great progress in eliminating housing shortages today except for the low-income group. Housing for the low-income is a complex subject with many questions and few answers to date. It is a subject on which the U.S. League joined forces with the National Association of Home Builders and National Association of Mutual Savings Banks and had Real Estate Research Corporation do a study. This analysis developed some answers to the question of housing for the underprivileged. This is an area which should command more of the attention and resources of the savings and loan business. As housing markets change, we must ask ourselves some questions:

1. What will be the effect of diminishing housing shortages?
2. What will be the effect of smaller more mobile families?
3. What will be the effect on housing of overriding consideration being given to environmental protection?
4. How effective will be the movement for zero population growth?
5. We all know our heritage is in housing finance from Comly Rich to the returning veteran from World War II to suburban sprawl to the two-house family. Will housing provide the same opportunities in the future? Opportunities for service to our nation? For growth of the savings and loan business?

There will be new bidders for scarce dollars. Bidders with current, pressing political appeal. We have to have clean air to breathe and water to drink. We need energy to heat, cool and propel. Mass transit, urban blight and bankrupt American cities will also be high on the social priority list. All will cost money. All these politically appealing bidders will be seeking funds. Where will housing rank on the list of national priorities? What changes will savings associations need to effectively compete in complete real estate and housing markets? Shouldn't we be allowed to make unsecured loans to builders? To finance a builders' inventory? to own a mortgage banking firm? to manage real estate? to expand our service corporation opportunities? to group together to finance a new town? to advise, manage and sell loans to a real estate investment trust? We are the nation's housing financiers yet we are precluded from areas of real estate finance which would enable us to better serve the people of this nation. All of these things commercial banks can do, and we the nation's housing financiers can not. Why can't we? Do we want to? How do we want the book written?

Now, about taxation. With the possible changes of national priorities from housing to air or water or urban blight, tax subsidies will be studied. Perhaps subsidies will be adjusted to help meet newly established national priorities. We have already been signaled that our tax position and the other tax considerations given to real estate will be reviewed. I have three observations with respect to our current tax formula and the proposals for changes. First, the savings and loan business of this nation can be proud of the tax dollars it pays to support our national efforts. We have a tax formula which provides for an increasing amount of

our income to be paid in the form of taxes. And while our tax burden has been rising and is scheduled to increase further, taxes paid by commercial banks have been falling. In comparison, we pay more in taxes than our major competitor, the commercial banks, when measured against either dollars of assets or dollars of adjusted gross income. Further, I believe these new tax proposals need an in-depth study. As an example of one of the many flaws in the proposed tax formula, consider that the taxes would be less for an association with a high gross revenue and high expenses producing the same net income than for an organization with lower income and lower expenses. The high-gross-earning organization would pay less in federal income tax. The new formula penalizes efficiency and rewards high rates to borrowers. This is not in concert with American philosophy. Further, in my judgment, the proposed formula could lead to greater cyclical fluctuations in housing. This would result from diversified lenders leaving the relatively low-yielding home mortgage investment in times of high interest rates and then re-entering the market in periods of low rates to take advantage of an income tax credit. The U.S. League has the tax formula under thorough study. Substituting a very questionable tax program for a system which has helped America become the best housed nation in the world could be buying a bag of shells.

Now, I would like to talk about the recommended changes in the structure of financial institutions. The Financial Institutions Act of 1973 which was just sent to Congress recommends changes which emanated from the Presidential Commission on Financial Structure and Regulation, commonly known as the Hunt Commission. First, let me deal with the Hunt Commission. To the dismay of many of the commissioners, we were precluded from analyzing, studying or making recommendations with respect to the causes or effects of inflation on the financial structure. This in itself made it a very questionable document, but even the Hunt Commission Report had several precepts which are not contained in the Financial Institutions Act of 1973 or which precepts have been negated in the interim by administration or congressional action. These precepts were that additional powers should be granted to the thrift business and time allowed to pass so that benefits could be derived from these powers before any costs were imposed. As an example, the Hunt Report called for two year phase-in period during which interest rate ceilings would provide substantial differentials between those institutions offering NOW accounts and commercial banks. The Financial Institutions Act of 1973 calls for uniform interest rate ceilings immediately for banks and thrift institutions issuing NOW accounts. It should further be noted that the Hunt Report called for a five year phase-out of interest rate ceilings and then recommended controls on a standby basis. The administration does not recommend standby controls. In the last four months 50% of the interest rate differential in the passbook area has been lost, 50% in the long-term certificate area without receiving one solitary offset. The price has already been paid and not any of the powers recommended have been received. Further, the few powers recommended will not make associations into commercial banks nor put them on an equal competitive footing with commercial banks—commercial banks with trust powers, the right to own and lease equipment ranging to 747s, the right to have international operations. A NOW account or limited consumer credit will not make a savings and loan association equal to a commercial bank.

There are those outside the savings and loan business who question whether

interest rate controls do more harm than good to the financial institution so controlled that it is precluded from bidding high enough to attract funds in certain phases of the market. Do they harm the savers who remain with low-paying financial institutions and thus do not earn as much as they could? Do they harm the borrowers who have found themselves at certain times without available funds at any price for the purchase or building of a home? A fact all must recognize is that the consumerism movement has great concern not only for rates charged to borrowers but rates paid to savers. Associations must maintain cognizance of the consumer's needs, desires and alternatives. Some say that savings interest rate ceilings are only to protect the thrift business. While this is partly true, I think there is a much greater, more pervasive need for interest rate controls. That is to preclude damaging rate wars which would weaken and perhaps destroy the entire financial fabric. This was the original reason for imposition of interest rate ceilings in 1933 and I believe it is still valid today. The events between July 5 and September 30 provide an interesting period to study when one wishes to consider this point. As these ceilings are studied to provide greater flexibility and profitability for the savers, associations must ask when does rate competition become a damaging rate war? When is the maintenance of status quo necessary for the financial stability of the nation, or when does it become the depositor subsidizing the borrower or the financial institution? Answers to these questions will require creative study and analysis. If associations opt only to consider status quo in this changing world and if their only concern is for the good of their own institutions, I doubt if the savings business will be consulted as new answers to these questions are sought.

KEEP PUBLIC IN MIND

As the business enters 1974, changes in the financial structure will be under consideration by the Congress of the United States. How do we want the book to be written? This is the prologue. The business has two broad options. One, we can ask to remain basically the same single-family lenders, borrowers of short funds which lend them on long-term inflexible contracts and seek government protection; or, we can seek and adapt to change which will let us better serve the American public as we have done so well in past years. Seek the flexibility so that our organizations can fulfill the changing financial needs and desires of our customers while still maintaining our housing and real estate finance specialty.

As we ponder our future, let me make two admonitions. Let us recall that the railroads failed to recognize what the public wanted was transportation, not necessarily railroads. Let us bear in mind that what the public wants today and in the future are safe, convenient and rewarding financial services. It is up to us to make certain that savings associations are that kind of a financial intermediary. It is the business' leaders who will decide where the savings and loan business is going. How do we want the book to be written? I think this great \$260 billion business wants the tools to compete, the tools to serve the financial needs of the American family. Knowing our abilities, knowing our competitive nature, knowing our desire to serve, I think we will seek the tools to serve. If the savings and loan business wants them, we will get these tools.

How do we want the book to be written? I think this business wants to serve this nation in the future as it has done so well in the past. That's the way I think the savings and loan business wants the book written.

THE PUBLIC INTEREST AND THE PAYMENTS MECHANISM

by the HON. GEORGE W. MITCHELL,

Vice Chairman, Board of Governors

Federal Reserve System, Washington, D.C.

In 1973 the opportunities for thrift institutions to play a role in the payments mechanism began to crystallize. Earlier the Hunt Commission hearings and report had stimulated study and analysis of various hypothetical possibilities. The actual inauguration of electronic payment which took place early this year in the California Automated Clearing House focused attention on a specific application—how to handle payroll credits to savings and loan associations' depositors. More recently the NOW account experiment in Massachusetts and New Hampshire, authorized by Congress, created an environment in which an early decision on participation is necessary, if it is to be timely. Thus, unless the business is prepared to accept a verdict by default, whether it participates or how it participates in money transfers is a decision for today.

Even if Congress does not, at this point, write specific rules for thrift institutional participation in the money transfer system beyond the two-state NOW experiment, technological change seems likely to force the issue in the near term. Electronic payment technology is versatile and can be adapted to a variety of institutional characteristics and objectives. Electronic payment systems operating with large volumes are extremely cost-effective as they displace labor intensive operations involving huge quantities of paper, but the technology is costly in dollars for equipment and in time for manpower training.

Experience thus far with electronic data processing suggests that it is a sufficiently different way of doing business to require its own generation of managers and operators to make best use of its capabilities. Needless to say, transition into the new way is a difficult adjustment for many organizations and institutions.

There are definite problems as well as opportunities in thrift institutions' participation in money payments. I approach the degree and character of their participation primarily from the standpoint of the impact such participation will be likely to have in terms of the public interest. Of course, if savings and loan associations participate individually or as a business, their institutional interest must also be served.

Going into the payments business, actively or passively, is not, in my opinion, a venture in which the prospects for risks are nil and the prospects for profits are

overwhelmingly favorable. Metaphorically speaking, any bovine impulse to leap the fence into a greener pasture should be resisted until it is fairly certain that the landing will not be in nettles and wild onions. On the other hand, there is no doubt, in my mind, that the money transfer needs of the public generally can be better and more widely served than they are now. For example, the efficiency of electronic transfer permits such services to be extended economically to a segment of the population that does not use checking accounts and is wholly dependent on currency, money orders and cash withdrawal from savings deposit accounts.

Over the past decade the use of checking and savings accounts has been becoming more pervasive among American families. Despite this trend, however, in 1973 approximately 25% of the 71.5 million American families and income recipients outside of families, still do not have checking accounts, and 16% have neither checking nor savings accounts. This potential market for improved payments service, in particular, should have the opportunity to benefit from the economies of electronic technology.

In what follows I will be dealing almost entirely with electronic money transfer because, in a word, I do not see how thrift institutions could derive any commensurate benefit from the effort required to offer paper check services in competition with commercial banks, particularly if they make use of the commercial bank payable-through draft. Check handling in any volume has become a highly mechanized operation, and relatively few banks or data processing service bureaus are in a position to perform this service efficiently.

So far as the general public is concerned, the electronic payments system now seems to be developing in the U. S. along two main lines. One is directed at meeting the needs of business organizations and governments that make income payments in large volume. These payments are usually to repetitive payees and are preponderantly for wages and salaries, dividends, interest, annuities, and retirement and welfare programs. Since the payment function is usually centralized in such organizations, conversion to an electronic system involves a minimum of disturbance to existing arrangements. Income crediting is operational today but in very small volumes. There are, however, active plans to dramatically increase the use of this technique in 1974.

POINT OF SALE SYSTEMS FEASIBLE

The other line of development serves the needs of the individual consumer whose payment volume is small, irregular in timing and does not originate at a single location, but, more often than not, occurs at the place of purchase of some good or service—thence, the designation, "point-of-sale." Point-of-sale transfer is not operational, except experimentally, in the United States, but there has been enough study and pilot experience to justify confidence in its operational feasibility.

These two emerging developments accommodate another payments arrangement in which consumers agree to permit their accounts to be electronically debited for contractual obligations, such as insurance premiums, rents, mortgage and installment credit payments, and for utility bills, credit card purchases and similar payments. The income crediting machinery is best adapted to these preauthorized payments, but point-of-sale mechanics could also be used.

An electronic system capable of accommodating both these paths of develop-

ment is visible today and is capable of displacing, at a substantial saving in overall costs, more checks and a substantial amount of currency. Based on the experience in other countries more advanced in electronic payments technology than is the United States, the conversion toward electronic settlement should be comparatively rapid unless, of course, additional technological changes or more ingenious application of existing technology bring into being superior data handling techniques, or unless commercial banks and the other depository institutions that may become involved abstain or delay offering such services because of consumer resistance or due to the lack of competitive incentives. The nature of the banking system has inhibited innovations of this kind because their introduction requires, at a minimum, the concurrence of groups of banks instead of action by a single institution.

There are, of course, many features and problems connected with these systems of electronic transfer of great interest and importance, but I will deal with them only as they affect public interest and acceptance of electronic payment.

PRESENT PAYMENTS EXPLAINED

Commercial banks now serve virtually all the money transfer needs of individuals, corporations and governments in the United States. They act as retailers of coin and currency, replenishing and returning excess supplies from stocks at the Federal Reserve Banks. Together with 43 Federal Reserve regional offices they operate a check accounting and sorting operation linking each of the 14,000 banks with every other and involving nearly 500 million items and \$350 billion in transfers per week.

An operation of this magnitude, given its predominantly repetitive features—the same banks, the same customers and even a frequent iteration of amounts—is a natural application of computer technology, and so the economics of money transfer has worked rapidly to bring “back room” money transfer operations into data handling factories where labor inputs are minimal. In the space of less than a decade, check accounting and transfer have become largely converted to electronic accounting and processing though still utilizing paper checks. For example, at present 84% of the transit items (those drawn on a bank other than the bank of first deposit) presented to the Federal Reserve check clearing centers have been processed on high speed electronic equipment.

As check handling has moved from a highly labor intensive activity into a machine tending and machine feeding operation, it has still involved considerable clerical support. As is often the case in innovation, this computer application too has initially failed to use the electronic technology to the best advantage because the functions to be performed are viewed in a context limited by the capabilities of the old technology. In consequence, documents, road and air couriers and hard copy survive even though electronic transmission, storage and reference are fully capable of displacing them. Thus, commercial banks have moved rapidly to make use of electronic data processing techniques but slowly to take advantage of a fully electronic system.

PUBLIC ACCEPTANCE NEGATIVE

One reason often given for stopping short of providing a fully electronic system is that bank customers—individuals and businesses—are not demanding such a change. There is evidence, but of a fragmentary type, which indicates that

many customers want the status quo.

This is hardly surprising in view of the public reception given to many innovations—such as the use of social security numbers when the social security system was introduced, or the abolition of counter checks when MICR-encoding was made universal for all checks. The lesson from such experiences, however, is that such opposition to change, regardless of its intensity at the time, is short-lived if the change has a sound economic and operational basis.

Several marketing studies, some self-serving to the status quo, have provided explanations of the public's coolness toward change in money transfer technology. Some go so far as to implicitly argue that people like to go to their bank to deposit their checks even though it may be an inconvenient, often delayed trip; that they like to stand in line waiting to make deposits; that they do not really mind if their checks are stolen from their mail box and cashed by some one else (they will get replacements); that if their checks are delayed in the mail or deposited late because they were away from the office on payday, they do not really mind overdraft charges because of the delayed credit, and so forth. Conversely, the implication is that the assurance pay checks will always be credited to their account on payday without any action on their part is a service of safety, certainty, and convenience they have long done without and can continue to do so. No doubt inertia, suspicion, secretiveness in managing receipts and disbursements, ostentation and hoarding evidence some of the habits and mores conditioning individuals' reaction to trusting their money transfers to an impersonal electronic system.

All of these explanations have relevance to the task of marketing electronic transfers, but I think that insufficient attention has been given to the rationalized advantages that have been attached to the present check system and which are incompatible with electronic transfer. Users' apathy toward electronic transfer is better understood if the advantages they exploit in the existing system are examined. For this examination, a distinction should be drawn between individuals and the professional money managers employed by corporations and some governments.

MONEY MANAGEMENT: CORPORATE TREASURERS

The professionals have adapted their payments practices to the existing technology in order to bolster corporate profits and corporate treasurers' prestige. They do so by managing their principals' bank balance and payments so as to achieve the highest possible total of debits to the lowest possible balance in the account—thus producing a ratio of debits to balance just short of infinity. How well they have succeeded is evidenced by the fact that in New York City all demand deposit balances now turn over 252 times per year or just about every banking day. It is said corporate treasurers can do this expertly because they have been well trained by their bankers. Numerous devices are used, some slyly, and others openly to take advantage of float whether it arises from the indifferent attitude of their payees toward depositing checks, vagaries in mail delivery, the willingness of their banks to credit uncollected items or to share with them the credit availability from Federal Reserve float.

This maneuvering is reversed, of course, when they are on the crediting end of transfers and seeking to convert payments into “good” money at the earliest possible time. In this they need as much vigilance as they can muster to block off the

very practices they pursue as payors. As a recent bank advertisement aimed at corporate treasurers put it, "Fast coming in—slow going out . . . that's what cash management is all about!" If a corporate treasurer can satisfy the company's creditors with money "futures" while getting paid by an electronic credit, he is getting the best out of both payment systems. He may also be retarding progress toward a fairer and more efficient money system.

The roots of aberration in present-day payment practices lie in pricing mores. If employees, stockholders, suppliers and others will accept payment in tomorrow's or next week's money, they do so because they are indifferent to that disadvantage or because the price of the product or service purchased includes all of the costs implicit in deferred payment. If settlement were in good money—i.e. currency, federal funds or in deposits in a commercial bank withdrawable on the day of deposit, as it would be with electronic transfers—money management would have a new set of rules. They might even include an explicit price for float or the converse, a discount for payment in good money.

In this situation, corporate treasurers would tend, I believe, to look favorably on the real efficiencies of electronic payment, which are substantial for a large percentage of corporate checks. That is, the savings from electronic delivery and verification over check preparation, delivery and reconciliation are, for most payments, greater than the interest earnings from deferral of payment by use of the check.

Most individuals are less sophisticated in their money management than corporate treasurers, but they, too, have noticed that retail establishments—except supermarkets—do not generally distinguish in their pricing between deferred payment and cash. Naturally, they take advantage of deferred payment and when they compare their checkbook balance with their bank statement, they have incontrovertible evidence that slow mail and delays in the handling of deposits by the retailer and the banking system further defer charges to their account. It seems like a fairly shrewd operation. Why should they trade it in for a system that hits their balance on the day of purchase? The answer, again, is they obviously should not if no distinction is to be made between cash and credit. Not until consumers are offered some incentive to pay in cash or good money, will they shed their reluctance to embrace a floatless system.

Individuals might show more enthusiasm for an electronic transfer system if they could visualize its operation resulting in some financial advantage for them. Strange as it may seem, the greater convenience, safety and certainty of payroll credits has not persuaded the majority of depositors who have been given a choice, to opt for them in preference to a check. An aggressive marketing program is needed to change this attitude.

The changeover from currency to the check was a long time in becoming the prevailing practice—it is not yet universal—and has probably achieved its dominance only by making available a job-site check cashing service.

ADVANTAGES OF ELECTRONIC TRANSFER

General reliance on electronic handling of payroll and other income credits awaits the opening of several million additional accounts in commercial banks or the use of accounts in other depository institutions such as credit unions, mutual savings banks and savings and loan associations. How this is to be done is a controversial issue in the United States at the moment. But there can be no doubt

that the public—as employer or other disburser of income payments, and individuals as recipients—would derive substantial benefits from such a system. The employer will reduce his costs—as will the participating financial institution—and the income recipient will realize convenience benefits: no trip to the bank is needed; certainty—the deposit is available for use on payday; safety—loss and theft of currency or the payroll check are obviated.

In recent years free check services for individuals have become common in many states and sections of the country. Such free services may be constrained by minimum or average balance requirements. The effect of this competitive development on the attitudes and psychology of many depositors is their belief that money transfer services have a nominal cost and are in the category of "throw-aways."

Of course, check payments are not a "free" good nor so cheap to handle that their cost can be ignored. Worse yet, the costs of free checking are not necessarily borne predominantly by the bank or other institution which offers the free service. Rather, the bank of first deposit usually stands the brunt of the cost. Many depositors have developed payment practices which waste checking services because they are free.

The recent introduction of the savings account with money transfer privileges in Massachusetts and New Hampshire has important implications for free checks. For one thing it has excited a great deal of depositor interest in an account that pays interest and permits transfers—a practice previously prohibited except to the extent payments may be in the form of services. Another result has been the stimulation of the efforts of mutual savings banks and savings and loan associations to become a part of our money transfer system.

The testing of the dual purpose account, used for savings and money transfer, is quite likely to eventuate in depositors making an economic choice between an interest yield and the number of debits to their accounts especially if check transfers are used. If this experiment succeeds and spreads, it will stimulate competitive rivalries and concentrate a good deal of institutional attention on the most efficient method of effecting money transfers.

In this connection, the cost advantage of electronic transfers over checks has an important bearing on the potential for extending more money transfer services to more people. From such evidence as I have examined, I think it clear that taking an inclusive view of costs—public and private, direct and indirect—beginning with those incurred once the capability to initiate the transfer has been reached and ending with reconciliation, the reduction in costs owing to electronic transfer is on the order of 80% to 90%. For this size saving to be realized, of course, the system needs to handle a substantial volume of transactions. At this level of cost, virtually all income recipients could enjoy the convenience, safety and certainty of electronic credits and debits.

EFTS COMING IN FUTURE

In summary, my views are that:

1. There are no technological barriers to achieving a rapid but orderly transition to a fully electronic system.
2. The ground rules for transfers in good money are different from those which involve or permit deferred credit. The new rules would not discriminate against payors or payees although the advantages some payors have been enjoy-

ing would probably disappear.

3. The major marketing task to gain public acceptance of electronic credits and debits to deposit accounts would need to be directed at individuals who have yet to experience or appreciate the superior convenience, safety and certainty of this method of paying and being paid.

4. The greatest sales appeal to individuals may turn out to be an account in a bank or thrift institution which pays interest and to which and from which transfers can be made.

5. Depository institutions other than banks are increasingly interested in providing a money transfer service. At present they lack requisite operating and technological skill and experience, but they have millions of loyal customers who constitute a ready market for such services.

6. Commercial banks do virtually all of the money transfer business in the U. S. today. They have been actively working to adapt electronic technology to money transfer, but they have been slow compared to banks in several other countries, including Japan, Great Britain, Sweden and France, to embrace a fully electronic system and to market it aggressively. The rising nonbank interest in entering and competing in this field may well stimulate them to move ahead far more aggressively.

THE UN-SAVERS

by ALBERT SEIBERT, Winner

Institute's 44th Annual Speech Contest

First Federal Savings, Delray Beach, Fla.

How many of you are familiar with this? It's a 1040 form. If you're honest, you send one to Uncle Sam every year along with Forms A B C D, or whatever you need to complete your return, telling him what your income was and how much you owe him in taxes. Now, if you are like me and probably many of the people in this room, you get down to the line which indicates all of the money you made the past year and you wonder "where did it all go!" All of my income is gone — I've saved nothing and have little or nothing to show for what I made.

It seems to get harder and harder to save money these days. We have turned into a generation of unsavers. I would like to speak with you about the unsavers, but first let's take a look at who is saving.

First we have the 65-and-over age group, who made heavy deposits and now are withdrawing the interest to supplement their social security, pension funds, etc.

Next we have the best savers, the 45- to 65-year age group. These people have seen a depression, have known despair, have depleted their savings while sending children to school and are looking forward to retirement. They will save something come rain or come shine.

Then there is the 30- to 45-year age group. This group saves when they can but they are now raising their families and their general living expenses usually keep savings at a minimum.

Now for the under-30-year-old group. They, ladies and gentlemen, are the *unsavers*. The dollar down and a dollar a week crowd. "Why should I save? I have good credit; why wait to get what I want?"

Now the *unsavers* are not limited to this age group. They may be found in any age group. The person beside you may be an *unsaver*. The person in front of, or behind, you may be on the brink of bankruptcy, and *they may not even know it*.

You see, the good credit that the unsaver speaks of is actually "reverse savings." The unsaver borrows \$3,000 to buy a car, pays 6% interest and then repays \$3,600 (rounded off for illustration). This is paid back at the rate of \$100 a month over the next 36 months.

The saver, on the other hand, anticipates this purchase and begins saving at his local savings and loan association 36 months in advance for the same car. He saves \$100 a month for 36 months and earns \$300 in interest, and again, that's

rounded. Accumulating \$3,900, he spends \$3,000 of the money he has saved instead of borrowing it, leaving \$900 in his account. Add to that the \$600 in interest he saves by not borrowing and you have \$1,500. Good reasons for being a saver rather than an unsaver!

Need more reasons? I've got them! How about these? (1) Education—for your children; (2) retirement—for yourselves; (3) accident or illness—for anyone in the family. But you say, "I can insure against these things."—surely you can but you're being foolish if you think your insurance, social security, pension, etc., is going to carry the full load. You need cash, my friends, to back up these insurance programs.

And how about these? (4) Unemployment—heaven forbid; (5) unknown—and who knows what it is or when it's coming, or how much it's going to cost? (6) wants and desires—there's no way to insure for these.

You need cash, my friends . . . and it's waiting for you in your savings account at your local savings and loan association.

THE SAVINGS AND LOAN BUSINESS— FACING BRIGHT PROSPECTS

by THOMAS R. BOMAR, *Chairman*

Federal Home Loan Bank Board

Washington, D.C.

Discussion of the problems confronting the savings and loan business during 1973 is worthwhile to the extent it helps determine how to overcome the factors limiting the accomplishments of the business.

The board believes there are two controlling objectives for this business which must dictate every action: (1) maximizing and stabilizing funds flows to housing; and (2) producing financial services in amounts, convenience and quality consistent with the needs and desires of the American people.

After 40 years of highly successful operations and an equally high level of contribution and accomplishment, it is clear that some fundamental changes are needed in order to assure even more effective performance.

I would like to discuss the Board's plan to help improve upon the business' level of involvement and accomplishment in reaching these two objectives. The plan has two major components: regulatory posture—doing the most within the framework of existing regulations; and business capacity—increasing competitive options.

This business is over-regulated, with entirely too many decisions being made by those outside the business. The Bank Board, in major proportion, is comprised of a group of outstanding people, but a central bureaucracy making operational decisions has to be inefficient. Therefore, the Board's plan calls for the elimination or simplification of regulations—taking operational matters from the Board and simplifying its organization so that it may properly function as a policy and control group.

Although during the last months the operating difficulties within the savings and loan business have had to take priority of the Board's time, significant progress has been made.

During this period, nearly 30 regulatory changes directed at eliminating the restraints on options and opportunities have been made. Some of these have considerable potential for helping to enhance the flow of housing credit and deliver financial services. Among the more significant:

1. The entire state may now be considered as normal lending territory. The

localized territory is gone. People in both large and small places will be provided greater housing finance options. Lending capacity can be expanded beyond a small geographic area.

2. Service corporations can operate nationwide. This shift performs the same function for borrowers and associations which the shift to statewide normal lending territory allows, but to a smaller percentage of asset totals. Ten percent of nearly \$300 billion, however, is a powerful volume.

3. The housing-related services which service corporations can engage in have also expanded. New capacities include: serving as agency for title insurance, serving as escrow agents and making loans other than first trust deed loans.

4. In making loans, the ability to tailor the loan to the borrower is greatly enhanced.

Construction lending is a natural for this business and can be a major factor in increasing income and shortening asset terms. Construction loans can now be made on multifamily projects up to 80% of loan-to-value ratio if the project warrants. Savings associations have a keen competitive stance in the construction loan area because they control the key element of the construction process, permanent loans. The Board continues to work in this area so that further adjustments can be made to assist associations.

The depression of the 1920s and 1930s taught a lesson about short-term mortgages and, in fact, was a major inducement for the creation of the federal savings and loan system. The straight-line amortized loan was a product of that period and has helped to make Americans the best housed people in the world. It would seem, however, that a little less rigidity would be helpful to both younger and older families. The Board has proposed that associations be allowed to tailor terms with a little more flexibility to help those getting started and those who may be looking forward to retirement years.

In the home improvement and equipment loan area, the terms allowable have been expanded. These loans, like construction loans, can help shorten an association portfolio's average asset life and increase income.

Central to these basic changes is more business opportunity for associations, more competitive financial services for families and a better balance in savings and loan operations.

BRANCHING FACILITATED

Working on the operation of the regulatory agency itself, the Board believes the objectives for the business are facilitated by branching. Major changes have been made in this area.

In any state, federally chartered associations can now match the volume of branch applications allowed for state-chartered associations. The approval of unprotested branch applications has been delegated to FHLB presidents, as agents for the Board. Speed is critical to a business operation, and eliminating the Board from the operational decision process reduces approval time by several weeks. Additionally, protest procedures will be tightened. There is no lessening of interest in preventing undue injury; however, if a proposed branch will be delayed, the reason for such a delay must be substantial, the Board believes. The business and the public it serves are both benefited by more convenient locations of savings associations.

Along with these coordinated actions increasing association options, the

Board is building a larger and better tailored examinations and supervision staff to insure that mistakes by a few will not diminish the benefits important to so many.

The other half of the Board's plan for what it can do to assist the business deals with capacity—what the business is allowed to do. This area of concern is primarily with prospective changes in savings and loan legal empowerments. Needless to say, this is a more difficult part of the plan.

WIDENED AUTHORITIES PROPOSED

In talking about the regulatory area, I mentioned shortened asset life and better balance several times. It is the Board's contention that the business' primary limitation is the imbalance of its balance sheets—lending long and borrowing short. This is not much of a revelation; business leaders have been explaining that for years, but not nearly enough has been done about it. Countercyclical capacity has been enlarged, and it has performed well. In this immediate past period, the FHLB and FHLMC produced nearly \$8 billion in new advances and loan purchases, nearly twice the level of support produced in 1969. The FHLB System with FHLMC consolidated has assets of approximately \$20 billion.

In addition to this, the FHLB System has developed two significant additional capacities:

1. The use of long forward standby commitments for advances, in addition to FHLMC's forward commitments for loan purchases. The use of this procedure in the last 45 days alone has stimulated enough activity to provide 60,000 units that might not otherwise have been built. Sixty thousand houses are the equivalent of a city the size of 200,000 people.

2. A second new approach, just being introduced by FHLBs, is the special series program. This is a device to make an association's liquidity productive for housing. FHLBs can now offer savings associations a market rate, turn around and resell the money as an advance. This business has today approximately \$16 billion in liquid funds, and this special series program will make part of it housing productive and will give the FHLBs stabilizing capacity.

Certainly the Board is pleased that the Bank System could produce such a tremendous level of support and innovate these new stabilizing methods, but that begs the point. The point is that the business should not be subjected to such unstable periods in the first place. Further, it is unhealthy to place excessive reliance on federal support systems or anything else short of pure competitive business potential.

The Board believes it can make the changes needed to allow this business to operate in a purely competitive environment, without losing sight of its specialized nature. Fundamental to the Board's objective is the continued specialization of the savings and loan business as housing and family oriented institutions. There is no progress in returning to a type of uniform financial institution structure which existed before 1933 and failed.

FAMILY FINANCE CENTERS NEEDED

The vehicle which would allow the attainment of this objective is a concept long held by the business—the family finance center. The President has advanced a set of proposals dealing with the financial institutions structure. Much in the proposals is good—they move in the direction of this long-coveted family finan-

cial center concept.

These proposals would provide for consumer lending, elimination of the limiting percentage-of-assets categories for mortgage loans and unsecured loans to builders. Additionally, they provide access to the payments system.

The business, by and large, has expressed no great interest in checking accounts, but most leaders realize that with the coming of electronic funds transfers, access to this system is critical. Associations may never enter paper check processing, but the function it now performs is critical to the business' ability to continue to attract funds. It is a critical part of the family finance center operation. These factors all move savings associations in the direction of creating the better balance between assets and liabilities which is basic to operating in a competitive environment.

As long as savings and loan associations remain home mortgage specialists, however, the majority of their assets will continue to be longer maturities. This means that additional capabilities must be added to better match asset term. There are a number of ways to approach this problem. One is to make available long-term funds via Federal Home Loan Banks. Another is to make it possible for associations to sell mortgage-supported instruments which would find great attraction in the capital markets. The FHLMC is working with Treasury and the Internal Revenue Service to produce a means to do this. Yet another way would be for associations to pool mortgages and use them to support long-term bonds, using both their own credit and, as well, perhaps, the credit of large support sources such as insurance companies. Lastly, a variable mortgage rate should be available which works well and is also acceptable in the capital market, so that such mortgages are salable in a secondary market.

The Board does not want any one of these approaches, but rather it wants them all. It believes that all are well within the realm of the possible.

The Board proposes, and plans to help procure for associations, the ability to shorten assets, increase funds sources and lengthen liability maturities. When the business has this capacity, it will be able to operate as a specialist in a competitive environment.

Putting the two parts of the Board's plan together—regulatory posture and business capacity—will hopefully make possible the accomplishment of the objectives of stabilizing housing credit and maximizing convenient financial service to families.

These ideas and approaches are ambitious. A look at the Board's responsibilities, as established by Congress, emphasizes that the Board can best meet these responsibilities by taking positive and aggressive positions, and that is its tack.

The months and years ahead will not be easy. The promise they hold, however, is within the reach of the savings and loan business.

HOUSING POLICIES FOR THE '70s

by the HON. JAMES T. LYNN, Secretary

Department of Housing and Urban Development

Washington, D.C.

I want to talk to you today about the spirit behind a whole range of initiatives launched in this administration, directed at different and disparate aspects of the nation's life—economic, political and social—but united by a common philosophy. In business, as in government, policy-makers and administrators often immerse themselves so deeply in program requirements, procedural regulations and account books that they tend to forget what the activity is all about. Central to the success of any important new venture is some understanding of the philosophy behind it. People need to know the reasons for what they are supposed to do, the why as well as the what and how.

Members of the business and professional community have reacted promptly to the substance of individual proposals advanced by the administration but have been slow, on the whole, to respond to the spirit motivating them. Those of us who work daily with these matters value the expert feedback provided, for example, by savings and loan association spokesmen to federal housing proposals. In analyzing the ramifications of particular policy changes, however, it is easy to sacrifice the long-range perspective for a narrow focus on immediate effects. I am here today to share my view of this new spirit, how it will affect the housing industry, what it can do for savings associations, for their public and for the economic and social well-being of the country.

The heart of the President's policies is really an old idea rejuvenated. Call it free enterprise or individual initiative, call it the "new federalism"; its purpose is the same: to liberate all levels of government, society and the economy as much as possible from rigid, restrictive federal regulations. In terms of housing, this translates into goals that are compatible with those of associations. Basically, my job is to see that housing is built and communities rationally developed. All the policies of the Department of Housing and Urban Development aim to provide a framework where these essential activities can progress unimpeded by "big brother."

The department wants market forces to be able to operate as freely as possible. It wants people to be able to decide where they will live. It wants consumers to be able to choose from the widest range of investment, buying and borrowing options. It wants financial institutions to be able to compete vigorously and fairly for available resources.

To achieve this happy state of affairs, a stable and ample supply of housing credit is needed. A variety of financial institutions should exist among which buyers, sellers and builders can shop for money, no longer totally dependent on the cyclical swings of savings deposits or the changing tides of government policy. A climate must be fostered in which builders and developers can keep a force of skilled workers steadily employed, like any other businessmen. The financial structure should be flexible enough to respond to changes in demand; that is, America needs financial institutions with reliable sources of capital, diversified lending instruments and sufficiently broad authority to use them imaginatively and pragmatically.

This best of all possible worlds does not yet exist outside the dreams of HUD Secretaries and savings and loan executives.

ADMINISTRATION ATTACKS SPECIFICS

Signs of light are just now appearing at the end of the tunnel in this, the latest in a series of tight money situations. Interest rates have eased off a little; savings deposits are beginning to accumulate again in greater numbers and larger amounts. These encouraging signs of recovery must not, however, distract business or government from attacking the housing industry's problems.

Offering specific remedies addressed to particular aspects of the current tight credit picture will certainly help. The administration has taken a number of executive actions with which the savings and loan business is familiar. In addition to relaxing reserve requirements for lending and accelerating the advancement of funds, the FHLB Board has made \$2.5 billion available in forward commitments for new construction mortgages. HUD has reinstated the tandem plan in the amount of \$3 billion, encouraging new construction by giving these FHA-insured properties the benefit of interest charges below the going rate on a maximum principal of \$33,000.

All of these measures are designed to expand the primary and secondary sources of mortgage credit. None of them will succeed, however, without the cooperation of savings institutions. I realize that the drastic decline in savings deposits in recent months has made thrift institutions wary of making many new long-term commitments, but the drop in yields for other kinds of investment now beginning to show up should reverse or at least moderate this trend, so there is really no need for extreme pessimism. Besides, the solution does not lie in retreating cautiously into a bastion of inertia but in actively seeking and supporting policies that will obviate the need for such behavior in the years ahead.

There is an urgent need for more fundamental reforms to improve the availability of housing credit. The President has sent a group of legislative proposals to Capitol Hill, which are essentially short-range but vital to the overall improvement of housing credit. With the consent of Congress, the administration will:

1. Increase the permissible mortgage amount and adjust the loan-to-equity ratio for FHA-insured loans.
2. Authorize home buyers to pay market interest rates for FHA-insured and VA-guaranteed mortgages and eliminate the charging of "points" by mortgage lenders.
3. Provide for flexible interest rates, longer payment terms and higher amounts for home improvement and mobile home loans.
4. Authorize FHA to implement the technique of coinsurance, like VA.

5. Permit the experimental use of more flexible finance instruments and methods, allowing a graduated scale of mortgage payments, for example, to correspond to changes in family income.

REFORM NEEDED IN PRIVATE SECTOR

However, even removing the present statutory obstacles in such areas as FHA interest rate and mortgage amount ceilings still engages only the peripheries of the problem. Reform in the regulation of our financial institutions is the core issue. The nation's whole financial structure is the product of an earlier era with different conceptions about the requirements of housing credit. The hardships of the Depression awakened America's social conscience and pointed up the need for a concerted government policy to counteract the deficiencies of the private financial structure.

Overall, the housing industry and its financial allies have done a remarkable job under the old dispensation. America would not have the standard of living it does today without the efforts of the thrift institutions. HUD's housing study, though it focused by necessity on the deficiencies of the housing market, also pointed up the substantial achievements of this sector of the economy. Indeed, the current high demand for private housing is an index of how successful savings institutions have been in the past. Owning one's own home is such an essential part of the American dream that most of those war babies, married and settled down with their 2.4 children, are competing for the available mortgage money.

Unfortunately, when demand is high and money is tight, the old system breaks down. For every seven years of plenty, housing credit now seems to experience seven lean years—and the ratio may even shift against the business if the system is not reformed. In the old days, savings depositors had only limited choices, or at least were generally unaware of other options. Older citizens in particular saved money not to make money but to keep what they had secure. Today's depositor is a far more sophisticated breed. Savings associations themselves have contributed to his education by vigorously promoting interest rate differentials and seeking out time deposits. Naturally, the other side of the coin will show up when the yield on other potential investments tops that of savings.

This is the reason the federal government aims eventually to remove the interest ceilings on time and savings deposits.

After a generation of increasingly close direction, the government has come to the realization that the public interest is generally better served by the free play of competitive forces than by the imposition of rigid rules.

Some people would have us believe that the situation calls for more, not less, government regulation. The home builders, for instance, have suggested rationing credit. It is hard to believe that they really want such a regime with all that it implies. Cut back on consumer credit? How could one decide whether a family really needs a new home or new appliances? And who would make the decision? It would be bad for the consumer, bad for the economy, bad for savings and loan associations. Well then, how about cutting back on business borrowing for capital improvements? In some ways, this is even more frightening. Jobs—more jobs and better jobs—are the generators of those monthly home mortgage payments; and if my four years at the Department of Commerce taught me anything it was that in the competitive world of today and tomorrow those jobs are crucially dependent on new plants and equipment utilizing the latest and best technology.

Cutting off the flow of credit for such purposes most surely shrinks the effective demand for better housing.

I am aware that the savings and loan business has recommended another solution involving a tax credit for savings deposits. In general, however, I think it can be agreed that people—and institutions—respond better to the carrot than the stick. It is not just that positive incentives are more pleasant than negative ones; they also work more efficiently. As a social and economic catalyst, inducement beats coercion every time. If, with the best possible intentions, the federal government tries to dictate the terms on which it wants progress to advance, progress often obstinately refuses to budge.

Take interest rate ceilings, for example, the government's primary tool for keeping mortgage costs down. Government restrictions notwithstanding, savers will manage to find higher yield investments, and lenders will find ways to charge higher prices when money is costly. Distortions in the shape of the financial structure and inequities in the distribution of financial gains are the only lasting results of artificial restrictions on credit flows. If, in order to keep the price of mortgages low, some savers turn to other investments and deprive those who remain of a fair return on their investment, a socially significant goal may have been served for those who managed to get the limited mortgage money available. But what has been done for all the rest, who cannot find mortgage financing at any price? And what has been accomplished by depriving depositors of earnings commensurate with the market?

Completely apart from questions of efficiency and equitability, thrift institutions will find themselves increasingly unable to attract the steady volume of deposits they could once command. As the events of the past decade have shown, the voice of the consumer, once heard in the land, is difficult to still. This healthy incentive to competition could not be eliminated, even if it were desirable to do so. People are simply too cost-conscious and investment-wise these days to be content with less than a competitive return on their money.

EXTERNAL STIMULATION GOOD

Nor is this really a bad thing. After they reach a certain age, institutions (like people) get set in their ways. Sometimes it takes irresistible external pressure to jolt them from the old, comfortable ways. Savings and loan associations as well as commercial banks have grown accustomed to conducting their business within the protective custody of the federal government. Dependency, with its attendant restrictions, is so familiar it no longer chafes. Indeed, some may find it hard to imagine the kind of free and open financial structure envisioned by the government—or hard to contemplate it with equanimity. Actually the proposed reforms offer far more opportunities than they threaten risks, and should substantially strengthen both the institutions and the markets they serve. If approved by Congress, such reforms will effect the following changes:

1. Interest ceilings in time and savings deposits will be removed over a five-and-one-half year period.
2. Expanded deposit services for consumers by federally chartered thrift institutions and banks will be allowed.
3. Investment and lending alternatives will be expanded.
4. The tax structure of banks and thrift institutions will undergo substantial modification.

5. Federal charters will be permitted for stock savings and loans and mutual savings banks.

6. Credit unions will enjoy free access to funds.

7. FHA and VA interest ceilings will be removed entirely.

Of those seven changes, the savings and loan business will be principally affected by, and probably has the most reservations about, the first four. They will alter relationships with customers as well as competitors. They will require a newly aggressive outlook on the part of thrift institutions. But along with the increased competition, they promise greater income potential.

By diversifying assets, and broadening deposit services, associations will be able to augment their reserves and raise the return on investments. Far from endangering the supply of mortgage credit, branching out into consumer loans, conducting credit card operations and offering checking account-type services among other things, should expand total reserves and provide a more stable base for mortgage lending. Thus even if the percentage of an overall portfolio invested in residential housing declines, the total volume should rise sufficiently to offset any reduction in absolute terms. Thrift institutions will still specialize in housing finance, probably routinely qualifying for the full mortgage income tax credit, but they will do so in a less rigid, more liquid manner than in the past.

EXPANDED CREDIT GOOD FOR BUSINESS

Changes in the tax structure, eliminating the present tax treatment of thrift institutions' bad debt reserves and substituting an income tax credit available to all investors holding a certain percentage of their portfolios in residential mortgages, will also expand housing credit. While this reform will entail keener competition with commercial banks and other sources of money within the traditionally exclusive field of real estate finance, it will also stabilize mortgage flows. This incidentally will enhance the efficiency and reliability of the builders and sponsors who rank among the most important clients of savings associations. If they prosper, associations do, too: a strong housing industry insures a steady demand for mortgage credit.

Combined with the middle-income housing proposals sketched earlier and with federal guarantees of private mortgage insurance, these measures should lay a firm foundation for the kind of ideal housing climate I described in the beginning. The administration cannot realize these objectives alone, however. It is counting on the past record of community service and invaluable store of expertise thrift institutions have to provide the wholehearted cooperation needed.

It will not be easy. The greatest single fear—and the hardest to fight—is fear of the unknown. Unsatisfactory as the present alternation of feast and famine may be, it does not require associations to take their chances in an open market, but the world changes and institutions must change with it to survive and prosper. Everyone is familiar with what happens to those who fail to adapt. The northeastern railroads are a very good example of "buggy whip" mentality.

It will take considerable courage and vision on the part of associations to trade privilege and protection for the as-yet-unfulfilled promise of greater rewards, but they will not regret it. Thrift institutions have been the backbone of America's housing credit. There is now the opportunity to add new flesh, muscle and life to their efforts—for their own advantage, for the benefit of communities, and for the economic and social health of the nation.

THE VOLUNTARY WARRANTY HOUSING PROGRAM

by GEORGE C. MARTIN, *President*

National Association of Home Builders

Washington, D. C.

Dick Gilbert and I surely picked a year for the presidency of our respective trade associations. The National Association of Home Builders finished last year with housing production of 2.4 million units, a new housing center in Washington being built and production at an all-time high; then I took office.

Since January, interest rates have reached a 200-year high in this country. There will be another record before the year is out. During previous housing dips housing starts had dropped 35% to 40% within a short period—from five to 10 months. During a 60-day period this year building permits went down 30%. When the October figures are in, the most precipitous decline of housing starts in the history of this country will have taken place. At least three major federal programs to aid low and moderate-income families have been eliminated.

But the entire year was not a failure. I decided early in the year to set up a voluntary home warranty program. This decision was made after a trip to Europe, where such a program is in effect. Ten-year warranties are issued for new homes. The builder is responsible for the first two years, while an insurance company insures the structural integrity of the house for the next eight years. I decided that the endeavor was worthwhile enough to try to accomplish during my year as president of NAHB. It was not simple to persuade the 72,000 builder members of NAHB that they ought to police themselves, issue 10-year warranties, form an insurance company if necessary or at least capitalize a corporation to insure themselves. At this point, the corporation has been authorized by the board of directors and formed.

Basically the program is this. A builder, at the time he starts a house, will guarantee to have the house covered under procedures which would assure a warranty on the house. He would guarantee normal maintenance callbacks for one year as he does now. The basic structure of the house would be guaranteed against major losses to the consumer for two years; the heating, cooling, plumbing and electrical systems would be guaranteed for two years exclusive of other warranties. Finally, the insurance company would guarantee the structural integrity for the last eight years. Insurance would also provide protection against the bankruptcy of builders or their inability to meet obligations the first two years.

The design of the program came directly from the National House Builders

Registration Council in London, then in the eighth year of its 10-year warranty. The program would not have been workable without the advice of their people and the actuarial data available from them. Also, the FHA and VA gave us data on failures due to structural defects in houses that they insured, covering the second through 10th year.

It is a voluntary program. Local associations around the country must ask to be chartered. Each will then be granted a Home Warranty Council charter and will be able to issue insurance. NAHB will set up procedures for standards of inspection. In addition, arbitration procedures will be set up with the American Arbitration Association for handling disputes between builders and customers. This will create a method by which a purchaser can be assured that he is buying a good house and that the builder will perform as agreed.

NAHB is hopeful that by January 1974 the first builders will have started or at least been assured that they can get warranty insurance on their houses. Organizations in 15 areas in the country have already asked to be chartered. If this program has the success here that it has had in England, 99% of the houses built for sale would be covered. I am not "cockeyed", I hope, but I am optimistic.

Secretary Lynn of the Department of Housing and Urban Development has pointed out what the administration's objectives are and detailed its housing proposals. For whatever reason, in the first 10 months of this year, housing starts have dipped from an annual rate of 2.4 million units in January, to a September rate of 1.76 million units—a drop of about 30%. Building permits, which precede starts, have dropped 32% in a period of 60 days. That building permit drop presages what will happen to starts in the last quarter of 1973. Sales of the units that are already available dropped 31% in the month of September.

This, I feel, is symptomatic of the public's unwillingness to pay 9% or 9¼% or an FHA rate of 8½% plus ½ of 1% plus 2 points to avail themselves of shelter in this country. This has happened in a country where interest rates until 1968 were 6% or below. The free marketplace concept of letting the interest rate seek its own level is not new to this country. We had it in the '20s and tried it again during the late '50s.

The cost of housing during the last 10 years has gone up 70%—before 1973. During the same decade wages went up 82%. On the surface, people have greater ability to buy housing now than they did 10 years ago. Real estate taxes, however, have gone up 124%. The debt service on housing has risen 109%. Other monthly payments such as state income tax and consumer credit are up 193%. Thus people's ability to buy and their ability to pay have been eroded.

I am frequently asked why builders must rely so heavily on government subsidies in order to produce housing now. The answer is simple. During the '50s the market interest rate was 4%, and it stayed there until the 1960s. During the '60s it rose to 5%. It was not until late 1967 that the rate rose from 5¾% to 6% for the first time. The FHA Sections 235 and 236 programs that produced a tremendous amount of housing in this country were overly complicated. They tried to place the entire population in an equally competitive stance with regard to housing. The 235 and 236 programs subsidized interest rates, and criticism directed at them should be aimed at their efficiency rather than blamed on the builders. The problems had nothing to do with construction quality. Any errors that occurred were administrative flaws, not defects in the concept.

In September the savings and loan business made an effort to patrol the Hill

and talk to senators and congressmen about the absolutely absurd move made by the Federal Reserve Board on July 5. The Fed implemented part of the Hunt Commission recommendations by administrative edict and set off the wildest rate wars this country has ever had.

The savings business was having the second best year in its history, with inflows of money every month until June. In June the commercial banks had an outflow of half a billion dollars, bringing on a liquidity problem. The Fed's action was without doubt an attempt to bail out the commercial banks. It took a few weeks for the construction industry and the savings business to organize and arrive in Washington to convince Congress that the Fed's action was in error. Congress then hurriedly passed a law directing the federal agencies to limit interest rates and amounts.

There were not enough specifics in that law. In my judgment, the latest action by the Federal Reserve Board and the other government agencies that were involved—the imposition of rate ceilings—creates not a wild card, but what I call the joker. The new rate ceilings are a travesty on Congress and a travesty on all people both in the thrift business and in the housing industry who worked so hard to have reasonable legislation passed.

Last week, when I pulled out all the full page ads advertising for funds in the *New York Times* I had nothing left but the front page and one page of the sports section. These were all full page ads by mutual savings banks. How, I ask, can a society continue to function when advertisements promise a moneyback guarantee at investment opportunity rates? Recent annualized rates being charged to the construction industry for loans average about 11%. Savings associations cannot afford to pay these new rates for government-guaranteed funds. The business has never had to give more than 4% or 5% for something that was guaranteed.

What will this do to our country from the standpoint of an inflationary spiral? Every corporation in the country, to meet this kind of return on borrowed money, must make at least 16% profit before taxes. That is where the risk is. There is no assurance that money invested in these corporations will be returned. America is about to have the wildest inflationary spiral that it has ever had.

Another inflationary recession is around the corner because the nation cannot exist on this kind of a paying binge. The wildest snare and delusion of all is that the regulation which came from the Federal Reserve Board proclaimed that for the first time the consumer, the saver, was getting a break. The consumer saver will receive high interest rates, just like those big investors who have \$100,000 CDs. Let us examine the effects of these interest rates on that little saver.

The average saver in a thrift institution has about \$3,200 in his account. When the interest rate goes up 1%, the average saver gets \$32 more that year; but when his son goes to buy a house, for that 1% increase he pays an additional \$6,000 over the life of the loan. If he is fortunate, Mr. Saver receives 2% more, and his son pays \$12,000 more over the life of the loan; for his automobile loan he pays \$376 more, ad infinitum. It is this simple. The average American only saves 6% of his income and spends 94%. For the benefit of higher interest rates on 6% saved, the consumer pays increasingly higher interest rates on 94% spent.

Most associations are already committed to high interest rates, in some cases for four years. As long as these four-to-seven-year certificates continue, the day in which interest rates can return to some degree of sanity will be further off.

I adjure you, I implore you to go back to your local communities and talk to

business leaders, bankers, commercial bankers and builders. Try to reason together to get some sense of sanity back into the interest rate structure. The concept of a free marketplace and of an unrestricted, unregulated interest rate is like saying, "Let's do away with all the speed signs on the freeway." This is one item we cannot live with in a permissive society.

In England and Ireland 11% interest rates and 60-year mortgages are now being advertised. When payments are spread out over 60 years, people do not own their housing, but rather the association is leasing it to them. Also, for as much money as must be tied up in four-year certificates at high interest rates, associations will be impelled to ask for new ways to put out money at higher rates because home buyers cannot afford it. It is not a question of their being willing to pay 8% or 10%. They simply cannot afford it. In January of 1973 the interest rates were 7%. Only 38% of the people in this country can afford, at today's salaries, the houses that are being built today.

Without some sanity, an interest rate drop or a federal philosophy of no production, the United States will attempt to solve its housing problems as no other nation in the world is now solving them. Anyone who cannot afford a house will be given a housing allowance. The charge was made earlier in the year that the nation could not afford the money spent to provide 2.5 million housing units for low income families. Although the program was well on its way to meeting the goal of 6 million units for low-income families, the program was cut off with the charge that it would cost money. It may cost as much as \$80 billion dollars over a period of 40 years—\$2 billion a year. Two billion dollars per year is less than 1% of our federal budget. The program that has been suggested will cost us \$11 million per year, because it has been set up to take care of everyone in that price range. What good will come of handing somebody in the Delta region of Mississippi an \$80 check, and telling him to go out and find housing? What will a resident of the Bedford Stuyvesant area, Harlem, or rural Maine do with a check for \$100 in his pocket, looking for housing?

The housing demands of this nation for the next 10 years call annually for 2.2 million units of construction, 600,000 units of mobile homes plus some rehabilitation. By comparison, during the '40s and '50s, the biggest 10-year period ever, the construction industry built 1.5 million units per year for that 10 years. That was 15 million units. During the '60s, 14.5 million units were built. During the '70s, the nation needs 2.2 million units each year. The building industry cannot produce that housing for the American people by producing only 1.7 million units in 1974 and 2.7 million units in 1976, an election year.

Some stability of production must emerge. Builders, suppliers, subcontractors and plumbers cannot continue to go out of business every other year. The new booklet, *Housing in the '70s*, states that the building industry has proved that it is very flexible. It can come in and out of the market to meet housing production demands in various years when money is available, but the firms that go are not the ones which come back in.

The thrift business and the housing industry must work together to assure that there will be money available at reasonable rates for a stable housing production of 2.2 million units for the next 10 years in this country. I pledge myself to work with you for those goals. I hope that you will go back into your own communities to work toward them. If we address ourselves to the problem, I believe that together we can solve it.

THE SAVINGS AND LOAN BUSINESS IN 1978

Participants: YAN ROSS, Washington, D. C.;

DR. CHARLS E. WALKER, Washington, D. C.;

GORDON LUCE, San Diego, Calif.;

GREGOR F. MEYER, Pittsburgh, Pa.

YAN ROSS: What I will not do this morning is to review for one more time either the Hunt Commission proposals or the proposals of the Domestic Finance Subcommittee of the House Banking and Currency Committee. The administration's package has been reviewed most impressively several times during the week, and I do not believe that I can do much to improve upon what you have already been told about the substantive nature of these proposals. What I should like to do is to interpret what I have heard and learned and to characterize my five-year view as being one of guarded optimism.

This will undoubtedly be a time of substantial changes just as the last five years have been a watershed period. A look back may be helpful in looking forward. Not too far back was the 1966-67 credit crunch, followed by the 1970 credit crunch. I am not suggesting that there will be a 1976 credit crunch, or a 1979 credit crunch, by the way. During the past five-year period savings and loan aggregates have continued to grow. In 1966 Regulation Q was offered as a solution to the problems of the business in attracting money. The differential provided seemed to work quite well over a period of time.

In 1968 the Housing Act was passed with its commitment for 26 million new units of housing during a 10-year period. This commitment included financing those homes and added great impetus to a business which by its very nature, that of borrowing short and lending long, needs assistance and support. The answer in 1970 was the Emergency Housing Act which relied largely upon enticing money into the housing finance area through secondary mortgage marketing.

The proposed 1973 Emergency Housing Act would include raising FHA ceilings for insured mortgages as well as the ceilings on the amounts of mortgages which FNMA and FHLMC could purchase. There would be greater flexibility achieved by loosening the restrictions on associations' Class I loans over \$45,000. There would be some purely institutional changes as pointed out by Congressman St Germain to increase deposit insurance to 100% for public units and to cover \$50,000 for individual accounts.

Whether any of the suggested tax changes are incentives for financial institu-

tions or individual savers, they are outside the jurisdiction of the banking committees. A difficulty in committee coordination could very well impede any sort of reform and serve to maintain the institutional status quo. This is to say that I do not think that either banking committee, House or Senate, would be willing to legislate to standardize financial institutions with the hope or expectation that tax provisions would be enacted later to encourage investment in housing.

Likewise, I doubt very much that the Ways and Means Committee on the House side or the Finance Committee on the Senate side would enact tax changes applying to financial institutions which do not yet exist.

GUARDED OPTIMISM FOR FUTURE

As Dick Gilbert pointed out, the future means change. Great forces are brought to bear from all quarters to solve the chronic problems of housing and home finance and the interrelationships of financial institutions—forces which pull in many different directions.

One common theme is the dilemma we face between competition and protection. Savings and loan associations, as well as everyone else, live by the rule of survival, that is—adapt or perish.

There are certain more stable aspects on which you can rely. Although the past five years have seen a commitment to a provision for housing, perhaps it is something of a sacred cow. If so, that cow has suffered indigestion in recent months. I recognize that the proposals sent to Congress have not been satisfactory to you or others in housing and home finance, but I believe that the next five years will witness neither the death of the housing cow nor the demise of those responsible for keeping that cow nourished. I believe that savings associations will be preserved for performing this and other functions—that you will survive.

There are certain attitudes in three important and relevant areas which assure this survival—that of the regulators, the legislators and those in your own business. With regard to the regulators, the Federal Home Loan Bank Board has been working overtime to preserve and protect the business. The Board posture on the cyclical problems and structural weaknesses is to consider the savings and loan association as a family financial center. Expansion of services to households, such as demand deposit accounts, would make savings associations competitive in drawing funds.

In addition, they might have authority to issue mortgage-backed bonds to supplement present secondary market operations. Harris Friedman mentioned also the possibility of a mini-Fed-funds arrangement to be based upon the reserves which are held by the Home Loan Bank System.

Further flexibility on both asset and liability sides of savings and loan operations is also possible. With a strengthening of institutions and an increase in their ability to attract funds with services, the temporary interest rate controls of 1966 could well be removed by 1978. Regulation Q has been recognized as being a liability as well as an asset restricting inflows as well as holding down costs.

On the other side, variable interest mortgage rates may win support as a way of loosening the squeeze of short borrowing and long lending. The ratchet effects of the present 7½%, four-year certificates of deposit will be felt for at least four years with no way of lowering mortgage rates when the money has been brought in at that high price.

While the legislature is dedicated to the same ultimate goals as yours, any in-

novations proposed by the administration, by agencies or by the business will not be undertaken lightly. This does not mean, however, that actions taken elsewhere will go unchallenged because of any congressional disposition to act only where comprehensive solutions can be made. Legislative action can be looked for in two time frames: the relatively immediate to meet the present acute squeeze, and the long range to strengthen thrift institution structures.

This preservation and strengthening will be dependent in no small way upon the business itself. Savings associations and their representatives have the will to compete and survive. If my impression of this convention's attitude and of the testimony before the Banking and Currency Committee is correct, savings and loan associations do not wish to become banks. You do not want to compete effectively for those dollars in the market place and to put them to work in home finance.

ORDERING OF PRIORITIES NECESSARY

It is not a question of "good guys versus bad guys" but an ordering of priorities to reach mutually agreed upon or mutually desired economic ends. You have taken an active interest in providing those services necessary to the maintenance of home financing activities, for example, by providing family banking services. You have considered the dual consumer nature of your depositors and your borrowers. You have certainly shown a forward-looking attitude toward efficiency and economy, even where capital expenditures have been necessary and the development of sophistication, such as in the provision for electronic funds transfers. You have been responsive to suggested innovations in structure through ownership or conversion, and with regard to your relationships with other financial institutions in general. To mention one particularly important attribute, you have proved yourselves on the legislative field of battle.

What will savings and loan associations be doing in 1978? You will be borrowing short and lending long—and rolling over wild cards. You will be taking in more deposits in more types of accounts as well as providing more convenient means of withdrawal and transfer. If you are not on a fully electronic basis, you will be well on the way to a fully integrated system with that of the commercial banking community. Money is a fungible commodity and has to be treated as such, whatever the EFT system looks like by the time it gets instituted. I cannot believe you will be left out of it. You will be providing broader, better loan services to your customers.

It is the vitality of the savings and loan business as associations and as individuals that leads me to these conclusions. Without question, it is a rough time right now. That is the reason my optimism is guarded. You have survived the struggle before and I know you will again.

I will not presume to speak for the 40 members of the Banking and Currency Committee, or for even a majority of them, but I know they are not going to let you go down the drain. With your efforts and with those of the regulators and legislators, you will be here and you will be stronger than ever.

CHARLES E. WALKER: I wish the subject were "What the Business Would Be in 27 Years" so I could talk with much more certainty—knowing you would not remember in the year 2000 what I had said here today. In fact, I would feel a little more certain talking about the savings and loan business in 27 weeks because I think you are coming out of the "disintermediation woods" where you have

been in 1973. But five years is my subject.

It seems to me that the savings business has three alternatives. Which alternative you take depends basically upon your assumptions. Alternative number one would be a return to what might be referred to as your "golden days," those that existed between World War II and 1965.

GOLDEN DAYS ARE GONE

To do that, you would have to make at least four rather heroic assumptions. As I state these assumptions, I am sure you will all agree that they are somewhat on the ludicrous side. You have to assume, first of all, that the new generation of aggressive, competitive-minded commercial bankers that came down the pike in the '50s and '60s will drop dead. You may wish it but don't you believe it.

Second, you would have to assume that the regulatory climate in Washington is going to become very "pro-savings and loan" and very "anti-commercial bank," particularly with respect to administration of Regulation Q. Maybe you wish it, but don't you believe it.

Assumption number three for a return of the "golden days" would have to be that stabilization policy—overall monetary, fiscal and government policy in general—will have to be so perfect and so good that we will be able to avoid the extremes of tight money and disintermediation that have clobbered the business three times in less than a decade. Moreover, you had better think through last summer very carefully as to cause and effect between the wild cards, high short-term interest rates, and the overheated economy. The basic factor again for the third time since 1966 is an economy that tended to outrun itself—bolstered by strong inflationary expectations—and interest rates reflecting that situation.

Finally, to return to the Golden Days, I think you would have to assume that the interest rate yield curve would return to the positive slope that we all grew up with. In other words, short-term rates would be low, and long-term rates would be high. This would mean that commercial bank earnings, which are geared more to the short-term sector, would tend to be lower, relatively speaking, and that your earnings would tend to be higher. Thus, you would be able—as from World War II on into the 1960s—to compete very easily, not only with commercial banks but also with the open market, in that you would not have to worry so much about disintermediation. That is another very heroic assumption. I think that we are going to have a full employment policy, that we are going to see interest rate structures that are as often negative as they are positive, or at the least, short-term rates not far from long-term rates.

I have given you four heroic assumptions necessary for a return to the old days. If they come true—then, as all fairy tales end, "you will live happily ever after." Don't you believe it. As Thomas Wolfe said, "You can't go home again."

What about the business' second alternative? Alternative number two is to relax and let nature take its course. Let the U. S. League's highly capable Washington relations effort—members and staff—continue to take care of you. In other words, applying this approach to the President's adaptation of the Hunt Commission proposals, try through the legislative and regulatory process to take the "goodies" without the "baddies."

Again, I caution you not to believe this route to be feasible for at least three reasons. First, there will be difficulties in getting the annual or biennial omnibus housing legislation which has been so important to your business in the past. Sec-

ond, the opposition with respect to letting you have the "goodies" without the "baddies" is much better organized now than it was in the past. Third, the consumer, when it comes to savings rates, is no longer the forgotten man in Washington. Quite the contrary, if you can tell a story in terms of consumer benefit, you are off to a fast start on the Washington scene.

MANAGE CHANGE YOURSELVES

So I would hope that the savings and loan business would go to the third alternative. Alternative number three is not so much where you want to be, or where you want to end up. Alternative number three has to do with how you get there. The real question is: Are you going to manage change, or are you going to let change manage you? What your institutions need to be in five years are not second-class commercial banks, but full, first-class, one-stop family financial centers. What you need to get there is not necessarily demand accounts, but a third-party payment transfer mechanism—a NOW account mechanism—or something similar. You need credit cards—those little plastic widgets that are going to be so vitally important for transfers of funds and credit transactions in the future. Associations need a pretty broad range of consumer lending powers. You need to provide trust services for individuals. You need a full range of consumer savings powers, including some opportunity to offer hedge instruments against inflation if able to do so. You need access to electronic funds transfer systems very badly. You need plenty of branches. You need the management savvy for this mode of operation, and I think you have it.

Most important of all, you need legislation.

You can get the legislation, it seems to me, by one of two routes: Over a long period of time by working with 50 state legislatures, or in a short period of time through the United States Congress. But if you get it through Congress, you are going to have to work out a strategy that involves some compromise—some pluses and some minusses—in order to end up with a truly first-class one-stop family financial service five years from now.

This is the direction that I am convinced that economic and technological forces are moving the entire depository financial business. Whether you will continue to stay in the sun—or whether you will be the lamb that is not only shorn but that plays a diminishing role in the family financial picture depends on you.

Either you can manage change or you can let change manage you.

GORDON LUCE: I entered the savings and loan business in 1955. You remember those days of Sputnik I, Elvis, cruisin' down main street, *From Here to Eternity*, and a 5% interest rate.

You could say we've matured since then. Certainly we're more sophisticated. I'm sure you'll agree that, although the fifties were unusual in some respects, nothing can equal our present savings and loan era that offers a Transmatic; or a Sallie Mae who is hung up on truth-in-lending; or a disintermediated inner city office with free services and wild card accounts; or an interest rate of 10%!

The point is — the times have changed, the business has changed, the public has changed. We've grown up and we're on the threshold of some very important times. Our experience and accomplishments in providing over 50% of America's housing; our expertise in encouraging thrift and our size of \$260 billion, have made us one of the nation's major financial forces with the capability of providing vital services to the consumer.

Our record shows that we can provide the best housing in the world when regulations and authorities are innovative enough to allow us the proper climate to accomplish our tasks. History reveals the fact that our major problems occur when our delicate financial balance is disturbed, when government takes over our functions, or when government manipulates the financial market rates, or when governmental action places one financial group at a disadvantage. I need cite only one example:

We would still be providing adequate housing funds and at equitable rates today if government in the form of the Federal Reserve had not intruded last July 5 to increase interest rates, confuse the public, and trigger a savings outflow from associations of massive proportions.

It would seem to me our best future lies in the field of what we do best. Many of our customers perceive us as banks—so be it. Whether we are called banks or become banks is not the main issue. The specialized services we provide and the savings we accumulate qualify us to be first class financial institutions. We should provide all of the services the average family requires or expects and yet still be a specialist in home loans and savings accounts.

If government really believes in encouraging the American family toward thrift and home ownership then so called reforms of the financial structure should first liberalize association asset and liability freedom and then, if these changes are successful, consider ceiling removals. The responsible course would first equalize thrift institutions with the present preferred borrowing position of competing agencies, and continue Regulation Q until enough time has been allowed to restructure portfolios.

In order to do what we do best we must broaden the scope of the business and at the same time keep stability. I think there is a strong possibility that thrift institutions will have Regulation Q or something similar for the next 10 years.

If common sense becomes the order of the day then I can optimistically see our business in a favorable condition in 1978.

What should be our future?

1. We must become "family financial centers." The family bank concept means we provide the consumer most of the services he expects from a financial institution. In other words we should be full service.

2. We must also provide a "full house" of credit possibilities, e.g., a line of credit should be established at the association for each customer so when he needs additional consumer goods he can borrow easily without rewriting his real estate loan.

3. Variable interest rates on loans and savings accounts are essential in these coming years. Variable interest rates, when required by law, will reduce the cost of home financing and minimize the effect of wide swings in the market. A savings account automatically should receive escalating savings interest rates when it reaches higher plateaus. We must assure the public of this kind of service in a dynamic society.

4. Financing low income families, one of the biggest problems facing America today, will be one of our highest priorities. We offer the best mechanism to accomplish home ownership and both government and the public should recognize this.

5. We will continue to introduce the most modern thrift services: e.g. a special phone number and numbered messages on magnetic tape to answer the most

frequently asked questions about financial services; sophisticated electronic funds transfer systems; fully automated remote savings outlets which permit handwriting analysis by colored television and check writing by teletype; customer profiles to provide free budget analysis and to encourage the customer adoption of payroll savings plans; advertising that takes a new direction toward making our product "unique"; and both customized saver and credit cards to improve convenience and establish our own individual identity in the market place.

6. Public funds should finally receive both federal and state sanction to be invested in thrift institutions.

7. Broader consumer lending powers and a relaxation of artificial loan limits and other barriers will allow thrift institutions to perform their family full service function. The artificial \$45,000 loan limit on single family dwellings will either be increased or only the excess amount will be counted in the commercial category. Hopefully the limit will be eliminated entirely.

8. Insurance of savings accounts at a \$50,000 level and a tax exemption on interest paid on consumer savings accounts will both be utilized to stimulate consumer saving in our economy.

9. Association tax status should be recognized for what it is—a stimulus to housing. It should and must continue.

10. There certainly will be a place for the small local associations and banks in the future. Small savings and loans will continue to thrive and provide excellent service to the consumer thereby forcing the larger institutions to be on their toes and responsive to the needs of the American public.

If some of these necessary changes are realized we may be able to reverse the present savings and loan trend of diminishing profitability. If so, then, we can provide the housing needs of this country.

But, whatever our future, we should tailor our business to a changing environment and the differing life styles of the American people. The public expects the broadest of services, the ultimate in convenience, and maximum incentives for saving. They want to be the best housed nation in the world. We can be the first class financial institution they expect if government provides us with the encouragement and assistance to provide the best of financial services.

GREGOR F. MEYER: The great amount of eloquence from the podium in the last few days puts in question the ability of one to offer truly new thoughts. With assurance I can venture that these remarks are original as a production from Western Pennsylvania—the home, incidentally, of the Pittsburgh Steelers who have made it well known that the best offense is a good defense. Such, indeed, may be the appropriate strategy for our business. Intensification of competition between savings associations and commercial banks is the most certain observation one can make of that relationship in the coming five years.

To make these remarks more meaningful, let's explore who will be holding what cards and how the cards are likely to be played in the coming years. A few words need to be offered on the fantastic expansion of influence within the commercial banking system as in the last 10 years with the blossoming of the holding company system it has forged into finance companies, leasing, factoring, credit card companies, mortgage banking firms, credit life insurance, new forms of investment management and other numerous activities.

During this period the slumbering giants awakened with intensified marketing operations. Indeed, our savings business was carefully studied as the resource

to enhance the effectiveness of consumer banking activities. Full service banking has produced time and savings deposits 25% in excess of savings deposits of savings and loan associations. Of the funds on deposit in banks, the portion which is free—checking account balances—has shrunk while the portion which is paid for—time and savings deposits—has increased so the banking system has been fully able to respond to the marked increases in the cost of funds while yet maintaining a steady earnings growth. The savings and loan business has expanded at favorable rates and until the current dilemma maintained satisfactory earnings from operations.

The future prospects for adequate earnings are in doubt. The Hunt Commission report and the President's recommendations for change in the United States' financial system focus one's attention in the foreseeable future. You have by now formed definite opinions on these reports so I will not directly comment on their details. How is the savings and loan business going to fare under these proposals? I am confident that the business will come out well and continue as a major financial intermediary as it is today. There is no realism in any expectation that Congress will materially alter or suffer the dismantling of the savings associations of the United States. The system has produced the most remarkable and reasonably priced amount of consumer credit extensions found anywhere in the world. To injure the opportunity for the system to continue to carry out its role in consumer credit extension is unthinkable. Is it probable that Congress would take on the risk of uncertainty which attends the adoption of the principal recommendations for change? There will be inevitable uneasiness in Congress as to whether the flow of needed housing credit would be preserved.

Will the alleged trade for additional asset authority, modest consumer lending and slightly expanded investment authority, coupled with NOW account authority and alleged improvements in federal taxation, actually result in more or less housing credit? If the assessment is on the side of any serious doubts over the maintenance of adequate levels of housing credit, the major proposals will fall. I submit Congress will not be willing to bear the risk attendant upon material structural alteration of a major financial intermediary such as the savings and loan business.

CONSUMER RELATIONSHIP ALL-IMPORTANT

Let us return for a moment to the issue of who holds the cards in this matter. The cardholders in fact are the constituents of the members of Congress. These constituents are indeed your customers. To the extent this business maintains a viable relationship with its customers—the consumers of the U. S. A.—then you in the audience truly are the holders of the cards necessary to favorable decisions in the congressional arena. Achieving the viable relationship with the consumers is a formidable task. The recent achievement of a joint resolution in Congress mandating a rate limitation on the four-year certificate was far more important to me as the showing of an acceptance of the vital role of the savings and loan business than the particular result of the achievement of rate limitations.

That exceptional result is not, however, a laurel we can rest on. As our fortunes are interwoven with legislative authority and taxation, it is a certainty that the verdict rendered by consumers on our activities and services will be the dominant factor in our future. Maintenance of good accountability with our customers will demand zealous efforts to see that all transactions are carried forth with

the prime attention to fair play and complete understanding. Preservation of hard-earned goodwill is mandatory. Such attention to customer needs will call into play the full utilization of authorized services. How can we expect to blossom into the aspired-to family financial center unless we make use of all authority presently granted? Credibility with Congress in seeking other legitimate extensions of authority will be impaired without use of programs already permitted.

Meeting the competitive challenge will necessitate some restructuring of both the asset and the liability sides of the balance sheet. To be able to respond more effectively to the cyclical credit crunch conditions, market orientation must be continually strengthened to assure preservation of responsiveness to customer needs.

IMPROVED EARNINGS ESSENTIAL

Other future essentials to the savings business are continuing attention to improved earnings with which to sustain the ability to attract capital. This should include the extension of service corporation activities so that material earnings would begin to derive from other than capital employment. The trend line on consumer account rates brought on by what I refer to as permissive inflation corroborates the necessity for improved earnings. The only alternative is to join with the many others visibly shaken by the detrimental effects of persistent inflation in seeing that the political process responds more faithfully in mandating government action such as will abate inflation.

All the options under the technology accompanying electronic funds transfer systems, including third-party transfers, must be employed. This leads directly to one of the hazard areas—NOW accounts. Conceptually, there is much to commend it. The fit between this business and the commercial banking business raises the strain. Already regulators for the commercial banking system and the bank business have made it plain that when NOW accounts surface, there will be only one way—equality to all financial institutions in structural dimensions and interest rate authority. I ask you to assess the real potential for the savings and loan business to compete on these terms, keeping in mind the four-to-one office location ratio in favor of commercial banks over savings associations and the scope of services to the public under full service banking in the commercial banking area.

I am extremely apprehensive of the ability of this business to provide the bulk of housing credit, should it be faced with the launching of NOW accounts on equal parameters with commercial banks. The flow of funds into NOW accounts at savings associations will tend to have differing material results from the flow of funds into NOW accounts at commercial banks. Perhaps this differential might be ameliorated through the installation at the time of establishing the parallel NOW account authority of the long-sought-after \$750 exemption from income tax in the thrift business savings accounts.

How is our place in the sun to be assured? The most powerful component will be forward planning assuring a leadership role in extending association activity where it counts. To wrap up, the ability to grapple with the intense competition imposed by commercial banking can be adequately met and favorably reckoned with if we are willing to shoulder the burden of managing our associations in such a way as to be sure that we are wanted so that something would truly be missing in our communities if we were not there.

THE FUTURE OF HOME FINANCING: THE ROLE OF AMERICA'S HOME FINANCING INSTITUTIONS

by the HON. WRIGHT PATMAN, *Chairman*

House Banking and Currency Committee

Texarkana, Tex.

Today, there are many in Washington who seem unconcerned about housing problems, particularly as they relate to low and moderate income families. This has been the year of the freeze, the impoundment and the veto, and it is quickly becoming the year that a new depression started in the housing industry.

It is also the year that the administration trotted out its long-awaited, much-publicized and well-thumbed recommendations to reshape the financial industry—the dregs of the so-called Hunt Commission appointed by President Nixon.

It is also the year that the Federal Reserve System forgot some of its reserve and started to openly sharpen the knives for the savings and loan business. The Federal Reserve threw in its new Regulation Q rules and created the wild card savings certificate on July 5, 1973. That day marked the beginning of a new era in which the Federal Reserve plans to use its vast powers to narrow the differences between thrift institutions and banks to the detriment of the entire mortgage market.

It is also the year in which the Federal Reserve—admittedly with some timidity—started eyeing the possibility of using its regulatory powers to let bank holding companies literally take over savings and loan associations around the country. That proposal is being actively considered right now in the Federal Reserve Board and the decision will have tremendous ramifications for this entire business.

As if all these problems were not enough, the savings and loan business—like the rest of the nation—is forced to operate in an economic and political climate of great uncertainties.

Despite all of the heralded plans announced by the administration at the beginning of the year, the economy has not improved and inflation is not licked. Interest rates rose to the highest levels in history this year, and the recent easing at the upper levels of the money markets is temporary.

There will be some fluctuations, but interest rates are going to remain high—and, in fact, will climb through much of 1974. The Federal Reserve remains confused and continues to wallow in its mistakes, mistakes in the management of

the money supply that have fueled much of our current inflation. The popular myth too often repeated on the financial pages that the Federal Reserve is a bulwark against inflation is hogwash. It simply has no basis in fact. In the current situation the Federal Reserve has been the engine of inflation and it is still making enormous mistakes behind the locked doors of its marble palace down on Constitution Avenue.

FED NEEDS CONTROL

Events of just the past two years will illustrate the absurdity visited on the country by the Federal Reserve's wise men. From January 1972 to July 1973, the money managers let the money supply expand rapidly and in fact the figures average out to an unbelievable 8% per year expansion for this 18-month period. When the Federal Reserve saw what it had done, it panicked and slammed on the brakes. The growth in the money supply has been screwed down to an effective zero. Now imagine the Burns team panicking again and erring in the other direction. It's up and down the Burns roller coaster, and it is the American people who are being taken for a ride on this rickety, rusty old machine.

The current mistakes are just part of a long list, much too long to repeat in this forum, including three Federal Reserve recessions in the Eisenhower Administration and unbelievable mistakes during this period. It is not necessary, though, to look back even that far. The past seven years have seen three sizable credit crunches brought on by misguided policies in the Federal Reserve and each of these crunches has been aimed squarely at housing and the savings and loan business.

In a democracy, where the public controls policy through its elected representatives, one would think there might be some limits to an agency's license to tear up the economy. One would think there might be some limit to the powers of an agency to take over the regulatory structure of financial institutions and dictate overnight new ground rules which leave the mortgage and homebuilding industries prostrate. At least one would think that America would have the machinery to take a look at such an agency and to determine how faithfully it was carrying out the laws passed by the Congress. One would think that the great American press would be right up there at the forefront supporting the people's right to know about this agency.

This is not the case, however. The Federal Reserve, with surprising support from the free press, operates totally in secret; the Congress has only the most limited means of determining what, if any, laws the Federal Reserve System might be following at any given moment. There is absolutely no machinery in this great democratic government to find out how this agency is spending the people's money.

This is a shame and a disgrace. Moreover, the failure of the Congress to stand up with the necessary backbone to correct this situation is a sad commentary. It does nothing to enhance the people's confidence in their government when their representatives will not even agree to an independent audit of a federal agency which operates on the public's money and which has such tremendous power over the people and their hopes.

When I came to Congress 45 years ago I was warned by some of the senior members to stay away from money matters and to just tell my constituents that interest rates were under the Federal Reserve and Congress did not really have

anything to do with the issue. In other words, I was being told to dodge the issue and let the people stew about the fact that monetary questions were in a mysterious realm controlled by a mysterious agency populated by wise men who were not to be questioned. Apparently this same kind of advice is still current on Capitol Hill because some members seem very nervous when anyone suggests that the Congress exercise its constitutional responsibilities in the monetary field.

Certainly this nervousness—jumpiness—has been evident ever since the Banking and Currency Committee adopted a bill last month to require the Federal Reserve System to submit to an audit by the General Accounting Office. It is being treated as a hot potato that no one seems to want to pick up, and the lobbying efforts being orchestrated by the Federal Reserve are increasing the temperature. That potato now looks red hot to many people.

All this shows how far the propaganda can spread, particularly when one is able to spread it with the unlimited funds of the Federal Reserve System.

AUDIT BY GAO PROPOSED

The legislation—contrary to this massive campaign of distortions—is not radical, unusual or strange in any manner. It simply says that the Federal Reserve System, after 60 years of operation, shall be subjected to an audit by the General Accounting Office, a watchdog agency set up by the Congress to help protect the public. It is the same kind of audit that other government agencies undergo all the time. This includes the very sensitive areas of the Defense Department, the Federal Power Commission, the Agriculture Department, Health, Education and Welfare, the Interstate Commerce Commission—every major agency in the federal government. What is wrong, then, with a piece of legislation that extends this audit to the mammoth Federal Reserve System?

There are many emotional cries that the GAO would become a "Monday morning quarterback" and second-guess everything the Federal Reserve does. This is hogwash; pure propaganda; scare talk. The GAO has been operating since 1921 as a watchdog for the Congress and the people, and they have never harmed the legitimate operations of any agency or department. I do not know of a single instance where the GAO auditors suggested, pressured, or did anything else to cause an agency head to do anything but follow the law.

In fact, some of this Federal Reserve scare talk has been highly unfair and damaging to the General Accounting Office. This is an agency with a high degree of integrity, and I do not feel it is in the public interest for people to suggest, falsely, that somehow politics would enter the picture if the GAO audited the Federal Reserve. The GAO is nonpolitical and its comptroller, Elmer Staats, would resign before he would allow his agency to be pressured into issuing a false or improper report. The Federal Reserve owes the GAO and Mr. Staats an apology for the false implications of this scare talk.

The General Accounting Office looks into sensitive areas of the government all the time—top secret areas of the Pentagon and highly confidential materials in various regulatory agencies. It has been able to do this with skill and discretion without harming the agencies or their work. It is outlandish to suggest that they could not handle an audit of the Federal Reserve in a like manner.

Despite this, Dr. Arthur Burns is still singing his doomsday song to anyone who will listen, and unfortunately a great number have been listening. He stands around the halls of the congressional office buildings wearing the saddest look

with all the appearance of those fellows who stand on the street corners on Saturday night with a sign reading "The world's coming to an end tomorrow."

It will be interesting to see just how long Doomsday Burns can keep making people—and especially congressmen—believe the world will come to an end if the General Accounting Office audits the Federal Reserve System.

All of this does have its comical side. The emotional tear-jerking appeals are unbelievable. At the same time, however, the effort does have its questionable aspects.

FED LOBBIES FORCEFULLY

Not content with presenting his views before the committee in open session, Dr. Burns and his people at the Federal Reserve have been trying to enlist all kinds of support from the big business and big banking communities to block the audit. These have been secretive behind-the-scenes efforts to mount a big telephone, telegram, mail and personal contact lobbying campaign to bottle up the legislation. These are areas of the economy most dependent on the actions of the Federal Reserve Board and the Federal Reserve Open Market Committee. I am not sure that this Federal Reserve-banking-business-private foundation "block the audit" collusion is healthy.

Dr. Burns has personally contacted a bank lobbying organization to enlist its aid in the campaign. He has traveled down to the Business Council meetings and has urged the business leaders to join the efforts. The work is and has been extensive. We have even had a former member of Congress, who is now a leading banker, appear on the floor of the House of Representatives to lobby members against the audit bill. The White House has moved into the campaign, and it has put pressure on other departments to fight the bill. Newspapers have been contacted to generate, where possible, editorial comment against the legislation.

I do not object in any way to public appearances by anyone against the audit bill. This is any person's right; it is Dr. Burns' right, but I do object to these secretive campaigns and to efforts to make the lobbying appear spontaneous when it is being orchestrated by the Federal Reserve itself. I object especially to the severe distortions which have been spread in these secret sessions about the nature and effect of the legislation. These are claims which would be challenged quickly and revealed as empty scare talk if they were made in broad daylight.

No one knows the full extent of this anti-audit lobbying, and we will never know how much of the unaudited monies of the Federal Reserve will go into this campaign directly and indirectly. The auditors are shut out even from exploring this aspect of expenditures.

Of course, the Federal Reserve has unlimited funds—money they draw in interest from the Treasury—interest on the \$76 billion in the Federal Open Market Committee's portfolio in the New York Federal Reserve Bank. These are bonds that have been paid for once, with the credit of the United States government, yet the Federal Reserve continues to demand interest payments totalling nearly \$4 billion annually.

Out of this slush fund, the \$4 billion in interest on paid-up bonds, the Federal Reserve spends whatever it wants on anything anywhere without even an audit by the General Accounting Office. It is a sad situation when this kind of thing is allowed to go on openly, and no one does anything about it.

For a number of years, I have been appearing before groups of savings and

loan officials, and invariably I have brought up questions about the Federal Reserve System. I have tried to convince business leaders that the Federal Reserve had life and death control over the welfare of the business and that some serious attention should be paid to seeking reform of monetary policy.

ASSOCIATIONS MUST HELP

Usually my comments and urgings have been greeted politely by savings and loan audiences. I never see any action, however. I really have the feeling that you have looked on the Federal Reserve issues as someone else's bailiwick—not that of the savings and loan associations.

Some surprising things have been happening lately. I have been reading many letters on savings and loan association letterhead demanding that something be done about the Federal Reserve and its arbitrary actions. Someone, somewhere, has apparently, at long last, learned that the Federal Reserve in the end decides the fate of the savings business.

No sooner had the Congress passed the wild card bill last month than congressmen started hearing from savings and loan people urging that Congress ride herd on the Federal Reserve and see that it followed congressional intent. I am glad to get this support, belated though it is, and despite the fact that it had to take the absurdity of the wild card regulations to stir the savings and loan business, and to let associations know just how destructive that crew at the Fed can be.

So long as the Federal Reserve is able to thumb its nose at Congress, at the public, at the needs of the nation, there will be problems. It is against the interests of savings and loan businessmen—and obviously against the public interest—to allow the Federal Reserve to operate outside of the purview of the people or their elected representatives.

If the business were really serious about those requests for the Congress to ride herd over the wild card regulations, then it must lend support for proposals to make the Federal Reserve a more responsive agency. The savings and loan business cannot ignore this issue and then expect Congress to bail out the business on issues like these wild cards. One must see that tools like a GAO audit are available. Otherwise, effective action on these issues will not be taken.

I realize that the audit bill, although reported out of committee by more than a two-to-one margin, is stalled in the Rules Committee, and the way has not yet been cleared for the 435 members of the House to work their will on the legislation. Many are interpreting this as a fatal defeat, and the bank lobbyists and Dr. Burns are congratulating each other over the fact that they have taken the public once again, but they may be gloating a little too early.

A full-scale audit bill will eventually clear both the Senate and the House. The Federal Reserve System, for the first time in its history, will be audited by the General Accounting Office. The people will not tolerate this foolishness of allowing the public to be locked out of its own public buildings and institutions. The people, once aroused, as some people in government are learning the hard way, cannot be put off, and when the true facts get out on this audit legislation, there will be action. I am convinced of this, and I plan to use every device possible within the rules of the House of Representatives to get action.