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8. HOUSING

HOUSING

I. Proposals submitted by the National Association of Home Builders.

These proposals are discussed in a paper prepared by HUD included in this Tab.

Administrative Proposals

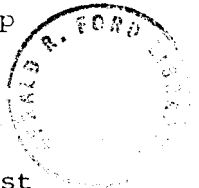
1. Set the interest rate and points charged under all programs, both GNMA and FHLMC, at the same level and reduce this uniform rate below the present 7 3/4 percent level. (NAHB)
2. Allow the interest rate on existing commitments to be converted to a lower rate in effect at the time of conversion upon payment of a 1/2 percent fee. (NAHB)
3. Release remaining \$1.75 billion (new commitments) under the Emergency Home Purchase Assistance Act, make available for re-commitment funds returned under all programs, and keep programs active until they are no longer needed. (NAHB)
4. Release and use immediately all frozen low and moderate income housing subsidy funds (section 235 and 236). (NAHB)
5. Simplify and expedite the Section 8 Program (modify administrative procedures) to make it more workable. (NAHB)
6. Initiate a positive program at HUD with adequate staffing to encourage production of housing and full use of FHA and other housing programs. (NAHB)
7. Lower FHA-VA interest rate substantially in order to lead all interest rates downward. (NAHB)



8. Reestablish the 1/2 percent differential on savings for thrift institutions over commercial banks (now 1/4 percent). (NAHB)
9. Substantially reduce the maximum allowable interest rate on certificates of deposit under \$100,000. (NAHB)
10. Have the Federal Reserve institute a special advance program for construction financing. (NAHB)
11. Have the Farmers Home Administration fully implement all provisions of the 1974 Housing Act, with staff and funds necessary to carry out administration and implementation. (NAHB)
12. Have FNMA initiate a program of construction loans for conventional and FHA-VA single family homes. (NAHB)
13. Have FNMA establish a program for purchase of conventionally financed multifamily mortgages. (NAHB)

Legislative Proposals

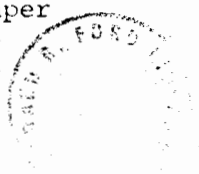
14. Expand Emergency Home Purchase Assistance Act to make conventionally financed condominium units and multifamily projects eligible, and support H.R. 2640 which would also extend the Act and increase funding. (NAHB)
15. Enact H.R. 29, or similar legislation, to provide homeownership mortgage loans at 6 percent. (NAHB)
16. Amend National Housing Act to permit no downpayment on the first \$25,000 of value under FHA to encourage construction of low-priced homes. (NAHB)



17. Provide for exemption from taxation of a portion of the interest earned on savings in thrift institutions, or alternatively accomplish the same purpose by means of a tax credit for the saver. (NAHB)
18. Provide an incentive for investment in residential mortgages through means of a variable tax credit. (NAHB)
19. Enact legislation requiring pension funds to invest a percentage of their assets in residential mortgages. (NAHB)
20. Enact legislation that would mandate the Federal Reserve Board to use its powers with respect to the growth of the money supply, the purchase of government securities, and credit allocation to assure that the general level of interest rates is brought down to the point that mortgage interest rates do not exceed 6 percent. (NAHB)

II. Other Proposals

21. Develop legislation to make interest income from thrift institutions tax deductible to increase the flow of savings for home mortgages. (Discussed in Treasury paper on tax policy)
22. Enact Temporary Tax credits for mortgage interest payments, designed to phase into tax deductions over time, to stabilize the housing sector. (Discussed in Treasury paper on tax policy)
23. Tax credit for new home purchases. (Discussed in Treasury paper on tax policy)



24. Provide incentives for rehabilitation of older homes. (HDL)
25. Provide short-term assistance to homeowners having difficulty making mortgage payments because of unemployment or sharp income drop. (HDL)
26. Establish a "lender of last resort" government agency to meet the construction needs of businesses and state and local government.
(AFL-CIO)



HUD Paper





DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

ASSISTANT SECRETARY FOR
POLICY DEVELOPMENT AND RESEARCH

MAR 6 1975

IN REPLY REFER TO:

Dr. Marvin H. Kusters
Assistant to the Assistant to the
President for Economic Affairs
New Executive Office Building - Rm. 284
Washington, D. C. 20500

Dear Dr. Kusters:

We are enclosing our comments on the series of proposals intended to stimulate the housing industry which were submitted to Mr. Seidman by the National Association of Home Builders. I don't think I need to say that no one is more concerned with the troubles the housing industry has experienced during the past year than is HUD. However, we are equally concerned that the NAHB recommendations, if implemented, could have serious, adverse side-effects which would more than offset any positive contributions they might make to the housing market. Moreover, we feel many proposals have been put forth without any recognition of the strong evidence that a housing recovery is already well underway.

Although our detailed analysis of each proposal is attached, we have several general observations on the major issues the home builders seek to address.

First, we expect significant improvements in the housing sector during 1975. Savings inflows to thrift institutions were at near record levels in January, and preliminary figures for February support a prediction that the record for that month will be surpassed. Indicators for mortgage interest rates on new homes have been stable or falling over recent months, and further reductions are expected.



A casual reading of any newspaper shows that developers with completed, but unsold homes are now able to offer significantly better financing than was the case a short time ago. This type of evidence has lead forecasters to predict an annual rate of housing starts of 1.6 to 1.8 million by the fourth quarter of this year.

Additional Federal spending, whether for housing or any other activity, will only add to the already large anticipated deficit. Such expenditures would require even more Treasury borrowing which would, in turn, add to the serious risk that Federal borrowing will drive up market interest rates significantly. Should that happen, an entirely new round of disintermediation would begin, thereby reversing the favorable mortgage market trends which have been developing. It would be ironic, indeed, if a program designed to aid housing were to instead help choke off the recovery already underway.

The NAHB has also neglected to emphasize the unprecedented amount of Federal aid already extended to the housing industry over the past fourteen months. Since the beginning of 1974, over \$20 billion in subsidized credit has been made available to mortgage lenders. This compares with only \$3 billion of such support in 1966 and \$8 billion in the 1969 credit crunch. However, since more than \$14 billion of this \$20 billion in subsidized commitments still remains in the hands of lenders, we are understandably reluctant to make additional injections of funds at this time.

Finally, we have become increasingly concerned that the major obstacle to a full recovery of the housing industry will not be mortgage credit, but rather lack of consumer confidence in the economy and the concomitant unwillingness to make the new, long-term financial commitment required to purchase a home. This problem is, of course, far more difficult to deal with, and one which can certainly not be addressed by any "housing" program as such.

I trust the attached material will be helpful to you, and hope you will let me know if there is anything more we can do.

Sincerely,

William J. Kelley
for Michael H. Moskow

Enclosure



Administrative Actions1. Special Assistance Programsa. Uniform GNMA/FHLMC Interest Rate Below 7 3/4 Percent

This proposal would substantially increase Federal subsidies in order to sustain rates below market determined levels. The increased cost to the government would not appear to be justified given the marginal additional stimulus to demand provided. Available data suggest that a very high level of demand and production can be sustained with interest rates in the 7.5 percent to 8 percent range. For example, in the first quarter of 1973, when the average effective interest rate on conventional new homes was 7.69 percent, housing starts were at an annual rate of 2,392,000; in the second quarter, when rates were 7.74 percent, starts were at a 2,212,000 level. These interest rates are comparable to those already provided under the Emergency Home Purchase Assistance Act of 1974. The attractiveness of a 7 3/4 percent rate was demonstrated in January when the entire \$3 billion in commitments at that rate were sold by FNMA and FHLMC within the first two days it was made available.

b. Interest Rate Conversion on Existing Commitments

HUD is currently considering proposals to permit lenders to convert their existing commitments to lower interest rates. This would have the advantage of insuring that more commitments would be utilized rather than having some go unused due to the fact lower rates are available in the market. However, there are drawbacks to this approach, especially with those commitments made under the Emergency Home Purchase Assistance Act since the rate must



be adjusted monthly to reflect recent yields in the Treasury bond market. As a result, if we were to allow the commitments now outstanding at rates above 7 3/4 percent to be converted, the March rate would probably be below 7 3/4 percent, thereby starting a new clamor from mortgagees holding commitments at that rate to allow them to convert to the lower March rate. However, until this legislative requirement is changed, there is no way to avoid the rush to swap commitments every month the rate goes lower.

c. Release \$1.75 Billion in Emergency Home Purchase Act Funds

At present there are \$14 billion in commitments and in unused authorizations in the hands of potential lenders out of the \$20 billion in subsidized credit that has been made available during the past eleven months (including \$5.9 billion of the \$6 billion made available under EHPA). Since there is significant subsidized credit still available for lending, consideration of the utilization of the additional subsidized credit authority should be deferred until currently available sources have been exhausted.

2. Use Housing Subsidy Funds

Apart from the fact that the Administration has released the great percentage of funds that were frozen in early 1973, we feel that the old subsidized housing programs were inequitable and inefficient as well as incapable of accomplishing the objectives for which they were designed. Accordingly, Congress and the Administration collaborated to draft a new program, Section 8, which now is being implemented. This NAHB proposal conveniently neglects the fact that HUD has released \$900 million for Section 8 which, when added to the funds previously allocated, will be sufficient to provide housing assistance to approximately 385,000 lower income families. In short, the Administration has not frozen subsidized housing but instead has made a massive commitment to it over the next year.



3. Simplify Section 8

The Department is devoting maximum resources to make Section 8 a simple and direct means for providing decent housing, and the Department is committed to making the program work as efficiently as possible. The Department welcomes any specific recommendations for simplification and improvement which developers and builders may suggest as they gain experience with the program.

4. Encourage Housing Production and Increase FHA Staff and Use of FHA Programs

We are confident the Section 8 program will encourage the production of housing, as will the recently-announced Section 202 construction loan program for non-profit sponsors of elderly and handicapped housing. We have also reorganized our field structure so these programs, as well as the unsubsidized insured programs, can be administered effectively, and we have taken significant steps to streamline FHA processing. Utilization of all FHA programs is on the rise, and we will continue to improve our implementation of these programs. In addition, we are planning to begin a mortgage co-insurance program in the near future which should speed up processing, reduce FHA manhours needed on a case-by-case basis, yet not diminish the quality of the underwriting.

5. Lower FHA/VA Interest Rates Substantially to Lead Interest Rates Down

The Department has recently announced a reduction in the FHA/VA interest rate to 8 percent. This is the third 1/2 point reduction in this rate in the last four months. We intend to monitor the impact of this move closely, since artificially adjusting the interest rate substantially below market rates could result in the charging of excessive points. Since points tend to increase the asking prices of sellers, and discourage the use of the FHA and VA programs, the result of such artificial actions could hurt rather than help homebuyers. However, the Department will flexibly tune the FHA/VA rates in a way that will encourage the purchase of housing.



6. Financial Regulatory Agenciesa. Require 1/2 Percent Differential Between Thrift Institutions and Commercial Banks

Since January showed considerable strengthening in the flow of funds into thrift institutions, and because we feel that February may be a record month for inflows, the Department feels that it would not be necessary to re-establish a half percent spread to make more credit available to potential homebuyers.

The Department feels that, where specific regulatory issues are involved, the views of the responsible agencies should be solicited. In addition, such issues should be addressed as part of the fundamental institutional reforms proposed in the Financial Institutions Act.

b. Reduce Maximum Allowable Interest Rate on Certificates of Deposit Under \$100,000

Such an action might dry up a major source of funds for the home building industry. Yields on alternative investments would be unaffected and savings and loan associations could once again face a serious outflow of funds.

c. The FRB Should Institute a Special Advance Program for Construction Financing

As noted above, the Department recommends that the view of the affected agency be solicited on matters such as these. In principle, the Department strongly supports the independence of the FRB and its unrestricted flexibility to regulate the available money supply. Involvement of the FRB in assistance programs tailored to specific industries could hamper its ability to perform this task.



We would also note that a construction loan program would not seem to be the answer to the problem the NAHB mentions so frequently, that of completed but unsold homes. Furthermore, we would question the immediate need for such a program inasmuch as construction financing is tied to the prime rate which has shrunk nearly four points since late last year. It is our understanding that the supply of such loans has improved considerably in recent months.

7. FmHA Should Implement the Provisions of the Housing and Community Development Act of 1974

To the Department's knowledge, any limitation of USDA implementation of the responsibilities given it in the HCDA of 1974 relate to problems with resource availability and overall Administration budgetary constraints rather than to a policy determination of USDA not to implement the Act.

8. FNMA

a. Initiate a Program of Construction Loans

FNMA is an independent organization and its views on this matter should be obtained. Construction loans involve a type of activity which differs from traditional FNMA operations. The detailed development of relationships with individual builders is required and this could conceivably create administrative difficulties.

b. Purchase Conventionally Financed Multi-Family Mortgages

The Department has no position on this issue and urges that the views of FNMA be solicited.



Legislative

Short-Term

1. Expand the Emergency Home Purchase Assistance Act to Make Conventionally Financed Condominium Units and Multi-Family Projects Eligible

The Administration recommended discretionary authority to deal in conventionally financed condominium and multi-family projects when the Act was considered last fall, and HUD Under Secretary James L. Mitchell again supported this authority before the Subcommittee on Housing and Community Development of the House Committee on Banking, Currency and Urban Affairs in February. The Department supports H.R. 2640, provided the maximum interest rate formula be amended to eliminate the rigid link to certain Treasury rates, permitting HUD to set the rate administratively.

2. Enact H.R. 29 to Provide Homeownership Mortgage Loans at Six Percent

In the Department's opinion, expressed in Under Secretary Mitchell's February testimony before the Subcommittee on Housing and Community Development of the House Committee on Banking, Currency and Housing, available data suggest that a very high level of demand and production can be sustained with interest rates in the 7.5 percent to 8 percent range. Interest rates are now falling toward these levels and the additional stimulus provided by this bill would be counterproductive in that it would add to the Federal deficit. Greater amounts of Federal borrowing could reverse this trend of falling interest rates.

3. Amend the National Housing Act to Permit No Downpayment on the First \$25,000 of Value under FHA

Such actions would, we feel, unnecessarily subject the government to inordinately high loss levels when the terms of FHA insurance are already generous. Available data suggest that when the homeowner's equity participation in his mortgage is reduced to insignificant levels, his incentive to maintain mortgage payments is reduced dramatically.



4. Amend Small Business Act to Qualify Home Builders for SBA Loans

The Department's understanding is that the Small Business Act already provides the legislative authority to permit financing arrangements with home builders. We would have no objection to SBA assistance to home builders.

Long-Term

1. Provide for Tax Exemptions for Interest Earned on Savings in Thrift Institutions

As a matter of policy such a tax exemption would have several negative consequences for the economy that would not, we feel, be in the long run, best interests of the homebuilding industry. First, the tax exemption might cause destabilizing swings in the flow of funds. Second, the loss of Federal revenue might easily lead to requirements for additional Treasury borrowing. Third, as a matter of tax policy such exemptions for upper and middle-income people would be inequitable with respect to lower income citizens and would be a questionable priority among alternative tools for increasing the supply of shelter for all citizens. Fourth, there would be no assurance that increased inflows to thrift institutions would be utilized for mortgage lending.

2. Provide Incentive for Investment in Residential Mortgages through Means of a Variable Tax Credit

The Administration supports the mortgage interest tax credit outlined in the Financial Institutions Act as the preferred approach to providing financed institutions with an incentive to invest in residential mortgages.

3. Enact Legislation Requiring Pension Funds to Invest a Percentage of Their Assets in Residential Mortgages

Requirements for investment in residential mortgages is one of the options to be considered by the proposed interagency task force on Federal policy toward pension funds. However, the Administration believes in general in the proposition that free market forces can more efficiently allocate credit than can the Government.



4. Enact Legislation that Would Mandate the FRB to Use Its Powers to Assure that Interest Rates Do Not Exceed Six Percent for Residential Mortgages

Such legislation, altering the traditional independence of the FRB, is a matter on which the Department would defer to the Congress and the FRB. However, strictly on the policy merits of the proposal, the Department feels that it is unlikely that the use of the FRB's powers could guarantee a 6 percent rate or that such a rate is the appropriate policy target. As noted above, available data indicate that there were high levels of demand sustained when interest rates were in the 7.5 to 8 percent level.







NATIONAL ASSOCIATION OF HOME BUILDERS

National Housing Center

15TH AND M STREETS, N.W., WASHINGTON, D.C. 20005

TELEX 89-2600

TELEPHONE (202) 452-0200

J.S. "MICKEY" NORMAN, JR.
PRESIDENT

February 20, 1975

Mr. L. William Seidman
Assistant to the President
for Economic Affairs
The White House
Washington, D. C. 20500

Dear Mr. Seidman:

As you requested at our meeting yesterday, I am enclosing a Housing Action Program which we strongly recommend to you and the President. Implementation of this program would lead housing out of its present seriously depressed state, thereby significantly helping the unemployment situation and starting the nation's economy back on the road to recovery.

We would appreciate an early response as to the Administration's reaction to each of the points set out in the Program.

Sincerely,

J. S. "Mickey" Norman, Jr.
President

Enclosure



HOUSING ACTION PROGRAM

Statements and comments from Administration officials in recent days and as far back as mid-summer of 1974 have been unrealistically optimistic in relation to the housing situation. The drop in the rate of permits in January presages a future, very low level in housing activity and no appreciable turnaround can occur even by the end of 1975.

Therefore, in response to your request for specific administrative and legislative actions that could be taken immediately for a housing recovery leading to a broad economic recovery, the National Association of Home Builders recommends the following:

ADMINISTRATIVE

1. Special Assistance Programs -
 - a) set the interest rate and points charged under all programs, both GNMA and FHLMC, at the same level and reduce this uniform rate significantly below present 7-3/4% level.
 - b) allow interest rate on existing commitments to be converted to lower rate in effect at time of conversion upon payment of one-half percent fee.
 - c) release remaining \$1.75 billion under Emergency Home Purchase Assistance Act, make available for recommitment funds returned under all programs, and keep the programs active until they are no longer needed.
2. Release and use immediately all frozen low and moderate income housing subsidy funds.
3. Simplify and expedite the Section 8 Program so that it will be workable.
4. Initiate a positive program in HUD with adequate staffing to encourage production of housing and full use of FHA and other housing programs.
5. Lower FHA-VA interest rate substantially in order to lead all mortgage interest rates downward.



6. Financial Regulatory Agencies -

- a) re-establish the one-half percent differential on savings for thrift institutions over commercial banks.
- b) substantially reduce the maximum allowable interest rate on certificates of deposit under \$100,000.
- c) Federal Reserve institute a special advance program for construction financing.

7. Farmers Home Administration fully implement all provisions of 1974 Housing Act, with staff and funds necessary to carry out implementation.

8. Federal National Mortgage Association -

- a) initiate a program of construction loans for conventional and FHA-VA single family homes.
- b) establish a program for purchase of conventionally financed multifamily mortgages.

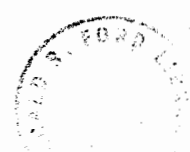
LEGISLATIVE

Short-Term

1. Expand Emergency Home Purchase Assistance Act to make conventionally financed condominium units and multifamily projects eligible and support H.R. 2640 which would also extend the Act and increase funding.
2. Enact H.R. 29, or similar legislation, to provide homeownership mortgage loans at 6%.
3. Amend National Housing Act to permit no downpayment on the first \$25,000 of value under FHA.
4. Amend Small Business Act to qualify home builders for SBA loans and loan guarantees.

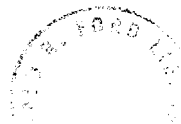
Long-Term

1. Provide for the exemption from taxation of a portion of the interest earned on savings in thrift institutions, or alternatively accomplish the same purpose by means of a tax credit for the saver.



2. Provide an incentive for investment in residential mortgages through means of a variable tax credit.
3. Enact legislation requiring pension funds to invest a percentage of their assets in residential mortgages.
4. Enact legislation that would mandate the Federal Reserve Board to use its powers with respect to the growth of the money supply, the purchase of government securities, and credit allocation to assure that the general level of interest rates is brought down so that residential mortgage interest rates do not exceed 6%.





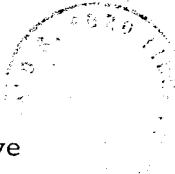
FINANCIAL AND BANKING

Legislative and Other Initiatives

A paper prepared by Treasury on the status of financial legislation and proposals is included in the first section of this Tab. Items discussed include the following:

1. The Financial Institutions Act of 1975 has been prepared for submission to Congress.
2. The Federal Home Loan Bank Board is initiating a program to broaden the powers of Federal Savings and Loan Institutions.
3. The National Credit Union Administration has prepared a draft bill as a substitute for applicable provisions of the FIA.
4. A draft bill providing for Emergency Lending and Guaranteeing powers has been prepared by Treasury staff in consultation with Federal Reserve staff. (The draft bill is included in the second section of this Tab).
5. The Foreign Bank Act of 1975 was submitted to Congress on March 4 by the Federal Reserve. It provides for treatment of foreign banking operations in the U.S. similar to that for domestic banks.
6. The Federal Reserve has proposed emergency bank holding company powers in a bill to permit waiver of delays and restrictions in existing laws.
7. The Federal Reserve is studying reform of bank regulatory structure and procedures.

Proposals to Channel or Control Credit

8. Encourage voluntary expansion of mortgage loans by banks and financial institutions.
 9. Introduce legislation to exempt from State usury laws all mortgage loans with any Federal participation.
 10. Consider using thrift institutions for Treasury tax and loan accounts.
 11. Develop voluntary program to channel credit into areas such as housing or utilities.
 12. Use variable reserve ratios established by the Federal Reserve to create incentives to channel credit on the basis of type of loan.
- 

13. Develop and implement an explicit mandatory credit control scheme.
14. Raise the limits for FDIC and FSLIC insurance on deposits.





STATUS OF FINANCIAL LEGISLATION AND PROPOSALS

The Financial Institutions Act of 1975

This bill contains the Treasury's comprehensive program of financial reform. Originally introduced in the Congress in the fall of 1973 after an extensive review of the findings of the Hunt Commission, the legislation has been redrafted to incorporate changes warranted by the Senate hearings, enactment of other legislation, such as the Housing and Community Development Act of 1974, and consultation between the Treasury and representatives of affected groups. The changes have been relatively minor, however, when measured against the overall scope of the program. The bill will be resubmitted to the Congress within the next two weeks. There probably will be little difficulty in obtaining hearings in the Senate within the next few months, although sponsorship problems remain, and action in the House is a little more uncertain.

The basic intent of the legislation is to strengthen the financial system to enable it to meet changing financial conditions without stress or disruption. Achieving this will eventually remove the need for deposit rate ceilings, which presently contribute to disintermediation during periods of high interest rates. An outcome of the program will be a



reduced need for direct Federal financial and mortgage market support.

The means by which this reform will be achieved is the authorization of increased depositor and borrower services for commercial banks, savings and loan associations and mutual savings banks, combined with the removal of inefficient financial and mortgage market restrictions. As a result, all of these institutions will be authorized to offer such services as checking accounts, NOW accounts, consumer loans and unsecured construction loans. In addition, credit unions will be able to offer such services as mortgage loans, consumer lines of credit, and variable share certificates. As an added stimulus to mortgage lending and in order to equalize the tax treatment of the differing financial institutions a mortgage interest tax credit of 1.5 percent will be available to all individuals and between 1.5 percent and 3.5 percent to all corporations maintaining at least 10 percent of their assets in qualified residential mortgages. In return for this, S&L's and MSB's will give up their present bad debt loss reserve tax preference. They may convert to the new tax treatment at any time prior to 1979 but may not switch back having done so.

Authority for all deposit rate ceilings will expire 5-1/2 years after enactment of the FIA. Before 5 years after enactment, the Secretary of the Treasury will submit a report



to the Congress concerning the competitive strength of the financial sector. It is believed that this provision will greatly reduce opposition to the measure by the thrift industry, without affecting the intent of the bill.

While interest rates are low at present and deposit outflows have ceased, the underlying structural weakness of the financial system remains a serious problem requiring immediate attention. The present lull in monetary pressure should be regarded as an opportunity for action.

Federal Home Loan Bank Program for Family Financial Centers. This program proposes a broadening of the powers of Federal S&L's in much the same way as the FIA and for essentially the same reasons. It is narrower than the Treasury proposal in that it only deals with S&L's, but it treats their problems more intensively. Essentially the program is one of giving S&L's a "new identity" while retaining their housing specialization. They would become family financial centers, offering checking account and other third party payments powers, consumer loans, financial counselling and planning services, investment programs, and tax and trust programs, all geared to the average family's needs. Additionally, the FHLBB would reinforce the ability of S&L's to offer variable rate mortgages,



(See Item I.B. in attached Agenda for House Subcommittee on Financial Institutions Supervision, Regulation and Insurance), and would permit them to raise long term funds through the sale of mortgage-backed bonds.

The Board is going ahead with the regulatory aspects of this program on its own. Proposals have recently been published in the Federal Register concerning automatic bill payment powers (October 17, 1974), the variable rate mortgage (February 14, 1975), and the mortgage-backed bond authority (December 19, 1974). Presumably the FIA will cover much of the remainder of their program.

Credit union legislation. The National Credit Union Administration has prepared a draft bill, apparently intended as a substitute for the credit union provisions of the FIA, which would (1) confer on credit unions essentially the same new powers as the FIA, (2) restructure the National Credit Union Administration, and (3) create a Central Liquidity Facility in lieu of the Discount Fund proposed in the FIA. (See Items I.I. and I.J. in attached Agenda).

The proposed restructuring of NCUA is beyond the scope of the FIA and is not consistent with the early decision within the Administration that the FIA would not address the Hunt Commission's recommendations for restructuring the financial



regulatory agencies. Additional questions are raised by those provisions in the restructuring portion of the draft bill which seek to exempt NCUA from provisions of other laws such as budgeting and civil service personnel provisions.

The Central Liquidity Facility proposed in the NCUA draft bill would go far beyond the limited purpose of providing funds to meet emergency and temporary liquidity problems contemplated for the Discount Fund proposed in FIA. The CLF proposal raises many of the same issues as the National Credit Union Bank proposals which the Treasury opposed in the 93rd Congress. The broad scope of the CLF proposal raises questions of the role of credit unions vis-a-vis competing depository type lending institutions including the tax-exempt status of credit unions. The proposed capital market or Treasury financing for credit unions through the CLF would be a significant departure from the "common bond" membership basis of these institutions, under which loans to members are financed predominately from deposits of members. Authority for the CLF to issue its own obligations in the market raises the issue of proliferation and coordination of Federal agency borrowing activities in the market.

The NCUA draft bill has been sent to Senator Proxmire. (See attached NCUA letter of February 12, 1975).



Emergency lending and guaranteeing powers

Several "Reconstruction Finance Corporation" type proposals were introduced late in the 93rd Congress (e.g. S. 4039, H.R. 17619), and similar proposals have been introduced in the 94th Congress.

Treasury staff in consultation with Federal Reserve staff drafted a bill to create a "Federal Financial Assistance Corporation" which would be authorized to make and guarantee loans and purchase stock in emergency situations. A copy of the draft bill is attached.

The Federal Reserve has reportedly adopted contingency plans for emergency credit to financial institutions and business corporations (see attached March 6, 1975 Wall Street Journal article).

Foreign Bank Act of 1975

This is the Federal Reserve bill which was sent to the Congress on March 4, 1975 and introduced by Senator Proxmire as S. 958 (See Item I.D. in the attached Agenda). The bill establishes equality of treatment between foreign banking operations within the United States and domestic banks by placing branches and agencies of foreign banks under effective Federal control. The bill's chief means of accomplishing this is to define United States branches and agencies of foreign banks as "banks" for purposes of the Bank Holding Company Act.



The Treasury supports the basic objectives of the bill, and has recommended establishment of an interagency group consisting of Treasury, State, the Comptroller of the Currency, OMB, CEA, CIEP, and FDIC to assist OMB in coordinating the reports the various agencies will be asked to submit to the Congress. (See attached March 4, 1975 report to OMB).

Emergency bank holding company powers

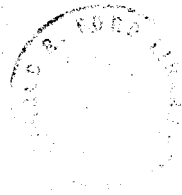
This is Federal Reserve proposed legislation which has sent to the Congress on February 19, 1975 and introduced by Senator Proxmire as S. 890 and by Congressmen Reuss and St. Germain as H.R. 4008. (See Item I.C. in attached Agenda). The legislation would permit the Federal Reserve Board, in emergency situations, to waive provisions of existing law which require that consummation of an acquisition by bank holding company be delayed 30 days and which prohibit acquisitions across State lines.

Bank supervision and regulation

Developments in banking practice over recent years indicate that there are substantial weaknesses in the system of bank supervision and regulation, divided as it is among three Federal agencies and the 50 State bank chartering authorities. The Financial Institutions Act does not address the Hunt Commission's recommendations for restructuring the financial regulatory agencies. The Federal Reserve is



currently studying the question of reform in the bank regulatory structure and procedures, but no legislative proposals have been drafted.



Federal Financial
Assistance Corporation Bill



1/14/75

DEPUTY SECRETARY GARDNER

Richard P. Albrecht

Further Revision of Proposed Federal Financial Assistance Corporation Act

Attached is a suggested revised text of the Federal Financial Assistance Corporation Act. This text embodies the essence of relatively limited suggestions on the previous draft received informally from the Board of Governors of the Federal Reserve System and three changes which have occurred to me. All of the modifications are in Sections 3 and 5.

The first of the three changes which I am suggesting is the elimination of the provision in Section 3(a) for "public" members of the Board. It seems to me that the proposal for a hybrid Board would present both conceptual and operational difficulties. However, the original form of the section, which includes public members, is attached to the draft as Alternate 1.

The second possible change is the revision of Section 5(b) to provide that, except in situations of special emergency, the Board would establish standards for determining when assistance is to be granted rather than determining that a particular sector, entity, or region of the economy is in need of assistance, as in the existing draft. This provision would fulfill the suggestion in one of the footnotes in the previous draft.

The third change is the incorporation as Section 5(g) of an exemption of the determinations of the Board and the operations of the Corporation from the provisions of the National Environmental Policy Act (NEPA). The rather time-consuming procedures of that Act would be inconsistent with the ability of the Corporation to deal effectively with the problems which it is designed to handle.

The footnotes to the previous text have been eliminated since they have not evoked any significant response except on the revision of Section 5(b).

ARNOLD



Please give us such instructions for future action as you may deem appropriate.

Attachments (See Fed Fin. Assistance Comp Act file,
draft dated 1/10/75)



A BILL

To establish a Federal Financial Assistance Corporation to provide financial assistance found to be in the public interest and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Federal Financial Assistance Corporation Act of 1975."

CREATION OF CORPORATION

SEC. 2. There is hereby created a body corporate to be known as the Federal Financial Assistance Corporation which shall be an agency of the United States Government and shall have succession until dissolved by act of Congress. The Corporation shall establish such offices as may be necessary or appropriate in the conduct of its business.

BOARD OF DIRECTORS

SEC. 3.(a)¹ The Corporation shall have a Board of Directors consisting of the Secretary of the Treasury as Chairman of the Board, the Attorney General of the United States, the Chairman of the Board of Governors of the Federal Reserve System and four additional members who shall be appointed by the President from among the officers of any department or agency of the United States who have been appointed with the advice and consent of the Senate. The Chairman and each other member of the Board may designate some other officer or employee of the Government to serve in his place, except in the making of determinations pursuant to Section 5(b) hereof.

¹ An alternate text of this section, continuing the provisions for "public" members of the Board, is attached at the end of this draft.



(b) The Board of Directors shall meet at the call of its Chairman. The Board shall determine the general policies which shall govern the operations of the Corporation.

(c) The members of the Board and their designees, as such, shall not receive compensation for their services.

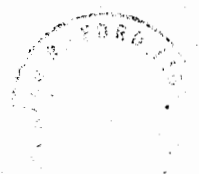
ADMINISTRATOR AND STAFF

SEC. 4.(a) The Board of Directors, upon the recommendation of the Chairman of the Board, shall appoint a qualified individual to serve as Administrator of the Corporation at the pleasure of the Board. The Administrator, subject to the direction of the Board, shall manage and supervise the affairs of the Corporation. The Administrator shall be compensated at a rate not in excess of level III of the Executive schedule under section 5314 of title 5, United States Code.

(b) The Administrator, with the approval of the Board, shall select and effect the appointment of qualified persons to fill such other offices as may be provided for in the bylaws, and such persons shall be the officers of the Corporation and shall discharge such executive functions, powers, and duties as may be provided for in the bylaws or by the Board of Directors.

PROVISION OF FINANCIAL ASSISTANCE

SEC. 5.(a) The Corporation is authorized on terms and conditions determined by the Board of Directors to provide financial assistance

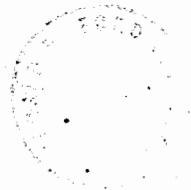


o entities, as defined in this Act, for projects, programs, or activities, the continuance or initiation of which are essential to the national interest, as determined in accordance with the following subsection.

(b) After considering such information as, in its sole discretion, it deems appropriate, the Board may make a determination or determinations from time to time that a sector or sectors, or one or more entities therein, of the economy of the nation, or a region thereof, as defined by the Board in its determination, is in need of financial assistance, that without such assistance the national interest will be seriously damaged, and that such assistance is not likely to be otherwise available on reasonable terms. Each such determination shall be transmitted to the Congress and shall be final upon the thirtieth day of session of the Congress after the date of its transmittal unless the Congress disapproves it by concurrent resolution adopted within such period.²

(c) No financial assistance shall be extended to any project, program, or activity unless the Board finds, in its sole discretion, that (i) such project, program, or activity falls within a determination which has become final under the preceding subsection and has not been revoked by the Board, (ii) capital and credit for the project, program, or activity are not otherwise available on reasonable terms, and (iii) the prospective earning power of the entity to be provided with assistance, together with the character and value of any security pledged, is reasonably sufficient to protect the financial interest of the United States.

² An alternate text of this section, providing for the determination by the Board of standards for the furnishing of assistance, is attached at the end of this draft.



(d) Financial assistance by the Corporation shall provide for interest or other return (in addition to guarantee fees, and service charges, if any) determined by the Corporation to be reasonable, taking into account the prevailing rates and terms in the private market for similar capital or credit and the risks assumed by the Corporation.

(e) The Corporation is authorized to charge commitment, guarantee, and other fees adequate to cover all expenses and to provide for the accumulation of reasonable contingency reserves.

(f) The total of financial assistance provided by the Corporation under this Act, including the full amount of guarantees issued by the Corporation, shall not exceed \$5,000,000,000.

(g) Because of the nature of the determinations of the Board and of the operations of the Corporation, including their urgent quality, they shall not be subject to the provisions of the National Environmental Policy Act of 1969, P. L. 91-190, 83 Stat. 852.

DEFINITIONS

SEC. 6(a) For the purposes of this Act, financial assistance means to make, participate in, purchase, or guarantee loans and other evidences of indebtedness or lease or lease-purchase contracts, or purchase non-voting redeemable preferred stock or similar security issued by any entity, provided that financial assistance shall not include assistance with respect to obligations the income from which is not included in gross income for the purposes of chapter 1 of the Internal Revenue Code of 1954 unless such obligations are held by an agency owned in whole or in part by the United States.



(b) An entity eligible for financial assistance from the Corporation shall include a corporation, partnership, limited partnership, trust or other legal entity and may include municipal corporations or other governmental units when acting in a proprietary capacity.

OBLIGATIONS OF THE CORPORATION

SEC. 7.(a) The Corporation is authorized, with the approval of the Secretary of the Treasury, to issue and have outstanding obligations having such maturities and bearing such rate or rates of interest as may be determined by the Corporation. Such obligations may be redeemable at the option of the Corporation before maturity in such manner as may be stipulated therein.

(b) The Secretary of the Treasury is authorized to purchase any obligations issued pursuant to subsection (a) of this section, and for such purpose the Secretary of the Treasury is authorized to use as a public debt transaction the proceeds of the sale of any securities hereafter issued under the Second Liberty Bond Act, and the purposes for which securities may be issued under the Second Liberty Bond Act are extended to include such purchases. Each purchase of obligations by the Secretary of the Treasury under this subsection shall be upon such terms and conditions as to yield a return at a rate not less than a rate determined by the Secretary of the Treasury, taking into consideration the current average yield on outstanding marketable obligations of the United States of comparable maturities. The Secretary of the Treasury may sell, upon such terms and conditions

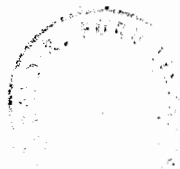


and at such price or prices as he shall determine, any of the obligations acquired by him under this subsection. All purchases and sales by the Secretary of the Treasury of such obligations under this subsection shall be treated as public debt transactions of the United States.

GENERAL POWERS

SEC. 8. The Corporation shall have power --

- (a) to sue and be sued, complain and defend, in its corporate name;
- (b) to adopt, alter, and use a corporate seal, which shall be judicially noticed;
- (c) to adopt, amend, and repeal bylaws, rules and regulations as may be necessary for the conduct of its business;
- (d) to conduct its business, carry on its operations, and have offices and exercise the powers granted by this Act in any State without regard to any qualification or similar statute in any State;
- (e) to lease, purchase, or otherwise acquire, own, hold, improve, use, or otherwise deal in and with any personal property, or any interest therein, wherever situated, and to acquire, hold, own, improve, use or otherwise deal in and with any real property which the Corporation deems it appropriate to acquire for an obligation previously contracted;
- (f) to accept gifts or donations of services, or of property, real, personal, or mixed, tangible or intangible, in aid of any of the purposes of the Corporation;



(g) to sell, convey, mortgage, pledge, lease, exchange, and otherwise dispose of its property and assets;

(h) to appoint such officers, attorneys, employees, and agents as may be required, to define their duties, to fix and to pay such compensation for their services as may be determined, subject (except as provided in section 4(a) hereof) to the civil service and classification laws, to require bonds for them and pay the premium thereof;

(i) to enter into contracts, to execute instruments, to incur liabilities, and to do all things as are necessary or incidental to the proper management of its affairs and the proper conduct of its business;

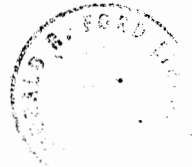
(j) to act through any corporate or other agency or instrumentality of the United States, and to utilize the services thereof on a reimbursable basis, and any such agency or instrumentality is authorized to provide services as requested by the Corporation; and

(k) to determine the character of and the necessity for its obligations and expenditures, and the manner in which they shall be incurred, allowed, and paid, subject to provisions of law specifically applicable to Government corporations.

REPORTS

SEC. 9. The Corporation shall transmit to the President and the Congress the following:

(a) within 30 days after the end of each calendar quarter, a summary report specifying the nature, amount, and purpose of each extension of financial assistance within the quarter;



(b) as soon as practicable after the end of each fiscal year, a complete annual report of its operations and activities therein.

GOVERNMENT CORPORATION CONTROL ACT

SEC. 10. Section 101 of the Government Corporation Control Act (31 U.S.C. 846) is amended by inserted "Federal Financial Assistance Corporation;" immediately following "Reconstruction Finance Corporation;"

EXEMPTIONS

SEC. 11.(a) The Corporation, its property, its franchise, capital, reserves, surplus, security holdings, and other funds, and its income shall be exempt from all taxation now or hereafter imposed by the United States or by any State or local taxing authority, except that (1) any real property and any tangible personal property of the Corporation (other than that required to carry on its operations) shall be subject to Federal, State, and local taxation to the same extent according to its value as other such property is taxed, and (2) any obligations issued by the Corporation shall be subject both as to principal and interest to Federal, State, and local taxation to the same extent as the obligations of private corporations are taxed.

(b) The acquisition and disposition of assets by the Corporation in the discharge of its functions shall not be included in the totals of the budget of the United States Government and shall be exempt from any general limitation imposed by statute on expenditures and net lending (budget outlays) of the United States.



SEPARABILITY

SEC. 12. If any provision in this Act is held invalid, the validity of the remainder of the Act shall not be affected.



Alternate 1 - Section 3

(a)The Corporation shall have a Board of Directors consisting of the Secretary of the Treasury as Chairman of the Board, the Attorney General of the United States, the Chairman of the Board of Governors of the Federal Reserve System and two additional members who shall be appointed by the President from among the officers of any department or agency of the United States who have been appointed with the advice and consent of the Senate or shall be qualified members of the public appointed by the President with such advice and consent. The Chairman and each other member of the Board who is an officer of any department or agency of the United States may designate some other officer or employee of the Government to serve in his place, except in the making of determinations pursuant to Section 5(b) hereof.

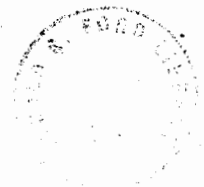
(b)The Board of Directors shall meet at the call of its Chairman. The Board shall determine the general policies which shall govern the operations of the Corporation.

(c)The members of the Board and their designees, as such, shall not receive compensation for their services, provided that any member who is not otherwise an officer of the Federal Government shall receive \$300 per diem when engaged in the actual performance of his duties plus reimbursement for travel, subsistence, and other necessary expenses incurred in the performance of such duties.



Alternate 2 - Section 5(b)

(b) After considering such information as, in its sole discretion, it deems appropriate, the Board may, from time to time, make a determination or determinations (i) establishing or amending standards for the provision of financial assistance under this Act, which standards shall include provisions for determining that a sector or sectors, or one or more entities therein, of the economy of the nation, or a region thereof, is in need of financial assistance, that without such assistance the national interest will be seriously damaged, and that such assistance is not likely to be otherwise available on reasonable terms or (ii) in case of special emergency found by the Board, establishing that a specific sector or sectors, entity or entities, or region, as aforesaid, is in need of financial assistance and that with respect to it the other conditions referred to in the preceding clause exist. Each determination hereunder shall be transmitted to the Congress and shall be final after a period of thirty days has elapsed while Congress is in session unless the Congress disapproves it by concurrent resolution adopted with such period.







THE GENERAL COUNSEL OF THE TREASURY
WASHINGTON, D.C. 20220

MAR 4 1975

Director, Office of Management and Budget
Executive Office of the President
Washington, D.C. 20503

Attention: Assistant Director for
Legislative Reference

Sir:

This is in response to your letter of January 30, 1975 requesting the comments of the Department of the Treasury on S. 4205, the "Foreign Bank Act of 1974", introduced in the last Congress on December 3, 1974 at the request of the Federal Reserve Board. We understand that the Board plans to present the bill for introduction in this Congress on February 24, 1975.

Description of the bill

The bill establishes equality of treatment between foreign banking operations within the United States and domestic banks by placing branches and agencies of foreign banks under effective Federal control. The bill's chief means of accomplishing this is to define United States branches and agencies of foreign banks as "banks" for purposes of the Bank Holding Company Act.

The Bank Holding Company Act would then apply to virtually all foreign banks conducting depository and bank lending functions in the United States. The bill thus subjects branches and agencies of foreign banks to the Act's restrictions on multistate branching and nonbank activities. Multistate operations, nonbank activities, and securities affiliates in existence on December 3, 1974 would be permanently grandfathered.

Under the bill, all subsidiaries, branches, and agencies of foreign banks having worldwide assets of \$500 million or more would be required to become members of the Federal Reserve System. Reserve requirements and other Federal Reserve regulations would then apply to their United States operations, and they would have access to the Federal Reserve's lending facilities. In addition, all foreign banks covered by the bill would be required to carry coverage of the Federal Deposit Insurance Corporation.

The bill would make it possible for foreign banks to establish National Banks and Edge Corporations. It would amend the National Bank Act to allow up to half of the directors of



a national bank to be noncitizens. In addition, the Comptroller would be authorized to license a "Federal" branch of a foreign bank in any state to conduct a banking business on the same basis as a national bank in that state whether or not the state restricted entry of foreign banks.

With respect to Edge Corporations, under current law, a majority of shares must be owned or controlled by citizens of the United States and all of the directors must be citizens of the United States. The bill would grant the Federal Reserve Board authority to waive these requirements.

Section 25 of the bill introduces a new Federal licensing requirement applicable to all foreign banks entering the United States market. It provides that a Federal banking license must be obtained from the Comptroller of the Currency as a precondition of the establishment of such banks under state law. Licenses may be issued only with the approval of the Secretary of the Treasury. The Secretary is required to grant the Secretary of State and the Board of Governors of the Federal Reserve System an opportunity to examine applications and to submit views prior to his issuance of a license.

The permanent grandfathering provisions of the bill permit expansion of a foreign bank in the grandfathered banking form within a given state--for example, by additional branches if it previously had branches. In addition, the bill permits a foreign bank to convert grandfathered operations to another form--for example, from agencies to branches--and to expand in the converted form in the state of its present operation in accordance with state law. Securities affiliates are also permanently grandfathered; however, foreign banks would not be permitted to acquire or to establish additional securities affiliates.

The espoused objectives of the bill are to create a unified Federal policy toward foreign banks and to bring about equality of treatment of domestic banks and foreign banking operations in the United States. In the past, there has been no coordinated policy toward foreign banks at the Federal level and their regulation has been a matter of state law. However, treatment by the states has been inconsistent, giving some foreign banks advantages over their American counterparts.

Recommendation

While we support the basic objectives of the bill, it is an extremely complicated measure with broad interagency implications. Without delaying the submission of the bill, we recommend and are prepared to establish an interagency group consisting of Treasury,

State, the Comptroller of the Currency, OMB, CEA, CIEP, and FDIC. This interagency group would endeavor to resolve the remaining issues and develop an Administration position that could provide the basis for your coordination of the reports the various agencies will be asked to submit to the Congress.

Based on our review to date, we have identified the following issues which we believe have sufficient merit to receive the attention of the interagency group we are proposing.

1. National Treatment

On April 12, 1974, the Executive Committee of the Council on International Economic Policy reached a decision to support the Federal Reserve Board's basic proposal of Federal regulation of foreign banks so long as it remained consistent with the principle of national treatment. Treasury stands behind the application of this principle to new foreign banking legislation. Nonetheless, a few of the provisions of S. 4205 constitute at least literal deviation from national treatment.

a. Federal Reserve membership and FDIC coverage

The requirement that certain foreign banks licensed under the Act become members of the Federal Reserve System contrasts with optional membership by domestic banks. Federal Reserve membership confers substantial privileges, but at least some foreign banks would not wish to become members.

Membership would be required only of foreign banks operating here which possess world-wide assets of \$500 million or more. Only a handful of U.S. banks of this size are not members, and, thus, the provision constitutes the practical equivalent of national treatment. De facto national treatment also occurs in the case of the parallel requirement for FDIC coverage in view of the near universality of FDIC coverage of U.S. banks. Nonetheless, since the Federal Reserve membership requirement applies only to foreign banks, it can be challenged as a literal departure from national treatment.

b. Federal Licensing

The bill requires a foreign bank to obtain a federal license as a prerequisite to applying for a state charter. While foreign banks may criticize this as a departure from national treatment since it is not required of domestic banks applying for state charters, that appears unlikely. We know of no country that permits foreign banks to establish banking entities within their borders without government or central bank approval.



c. Application of the Bank Holding Company Act

The Bank Holding Company Act approach, which is central to the structure of the bill, treats as bank holding companies foreign institutions that would not be so regarded if incorporated in the United States. The difference in treatment between domestic and foreign entities in this regard is a departure from national treatment.

2. Federal Reserve Membership

This requirement is likely to be an object of controversy during the legislative process. Even a segment of the United States banking industry may criticize it as the opening wedge for required membership by domestic banks. Alternatives would be selective application of Federal Reserve requirements essential to effective control of monetary policy or creation of a special membership category for foreign banks.

The bill defines branches and agencies of foreign banks as "banks" for purposes of the Federal Reserve Act. As a result, all such branches and agencies that under the bill would be required to become members of the Federal Reserve System, would have the same rights and duties as any other member. Accordingly, United States branches of foreign banks would have access to emergency assistance from the Federal Reserve as a lender of last resort on the same basis as U.S. subsidiaries of foreign banks and domestic banks. The Federal Reserve Board has expressed the hope that foreign central banks will unequivocally accept responsibility for foreign branches in the United States. However, such statements may be of little weight as against the legal entitlement of foreign member banks to assistance under the bill.

Moreover, the Federal Reserve Board's legal staff has informally advised Treasury that the Board would expect a U.S. bank to support an imperiled overseas branch. In fact, the Board would strongly criticize as an adverse reflection on U.S. banking the failure of a United States parent to support even a foreign subsidiary which found itself in difficulty. Several U.S. banks have, in fact, undertaken such support operations on behalf of their foreign affiliates. Thus, it would be undesirable for the



bill to result in a double exposure of the Federal Reserve in having to assist foreign branches here and yet having to stand behind U.S. bank support for their branches abroad. The Board's legal staff feels that the Board's lender of last resort functions are discretionary and create no absolute liability. Nonetheless it would be difficult to exclude foreign members from emergency assistance without engaging in discrimination.

3. Federal Licensing Requirement

The bill provides for the issuance of Federal banking licenses by the Comptroller of the Currency subject to the approval of the Secretary of the Treasury and with the consultation of the Federal Reserve Board and the Secretary of State. The bill would prohibit the issuance of a license if its issuance would "adversely affect the domestic or foreign commerce of the United States." The Federal licensing requirement is an important feature of the bill giving the Federal Government control over foreign bank entry into the United States market and this Department believes that such a provision is desirable.

4. The Bank Holding Company Act Approach

The bill's basic approach of making foreign branches and agencies subject to the provisions of the Bank Holding Company Act is a shorthand method of applying restrictions on multi-state branches, participation in investment banking, and on nonbank activities. This approach is somewhat anomalous and artificial in that it results in branches and agencies being treated in the same manner as subsidiaries for purposes of the Act's definition of "banks" falling within its purview. This is inconsistent with United States case law which has differentiated between branch systems and holding company systems. The Comptroller of the Currency has consistently attempted to maintain this distinction in litigation. Treating branches as bank holding company operations, even for the limited purposes of S. 4205, involves some risk that such treatment might serve as a precedent in other areas as well.

The bill lodges the new Federal licensing authority in the Comptroller of the Currency. However, Section 3(a) of the Bank Holding Company Act provides that any action which would cause a company to become a bank holding company requires the approval of the Federal Reserve Board. Duplication arises in that since, under the bill, the establishment of a foreign branch or agency would, by definition, be an action falling under Section 3(a), it would require Federal Reserve Board approval notwithstanding the prior issuance of a Federal license with the participation of the Board.



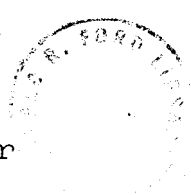
One effect of the Bank Holding Company Act approach is to exclude foreign banks from securities business not permitted U.S. banks under the Glass-Steagall Act restrictions. The question of whether the Glass-Steagall Act restrictions should be retained in U.S. law generally is presently under study by the inter-agency capital markets working group headed by Assistant Secretary Parsky. However, pending any amendment of the Glass-Steagall Act's restrictions on investment banking, this Department feels strongly that, with the exception of grandfathered operations, foreign banks conducting banking operations in the United States should be subject to the same restrictions on investment banking as domestic banks. This approach is consistent with the principle of national treatment and should be observed notwithstanding that, in many foreign countries, the commercial banking and securities businesses are combined.

The Federal Reserve does not believe the bill deals with the problem of regulating consortium banks which are not covered by the Bank Holding Company Act because the extent of ownership by each foreign bank is less than that necessary for control under that Act.

We believe it is possible to amend the bill to clarify this uncertainty. If a consortium bank is established in the United States as a domestic banking corporation, it is subject to all of the appropriate state and federal laws related to the chartering of banks. If a foreign consortium bank wishes to establish an agency or branch or banking affiliate in the United States, the provisions of the bill encompass such activities. The provisions of the bill also provide for licensing all foreign banks by the Comptroller of the Currency subject to the approval of the Secretary of the Treasury and consultation with the Federal Reserve Board. This section of the Act should be expanded to attempt to deal with the consortium question in a non-discriminatory manner.

5. Discretionary Edge Act and National Bank Participation

The bill would alleviate existing restrictions on participation of foreign nationals in Edge Corporations and national banks. However, the bill's means of accomplishing this would be to permit the Federal Reserve Board and the Comptroller of the Currency to waive to a certain extent the present limitations. Some thought should be given to whether the alleviation of these restrictions should be by statute rather than discretionary, although the Board apparently feels, with some justification, that foreign entry into these



areas may be controversial and more acceptable if some discretion is retained in the regulatory agencies.

6. Reciprocity

The bill contains several provisions which we understand are indirect references to the issue of reciprocity for United States banks operating in foreign markets. For example, the bill's licensing provision provides that a Federal license may not be issued if its issuance would "adversely affect the domestic or foreign commerce of the United States." This provision, looked at only on its face, would appear to be unnecessarily imprecise. However, we understand that the provision is intended to build into the licensing process some discretion to withhold a license where the home country of the applicant does not grant reciprocity to United States banks. A similar provision is contained in the section governing Federal Reserve Board approval of foreign bank ownership of an Edge Corporation.

The question occurs as to whether the issue of reciprocity can be dealt with more openly. The Federal Reserve Board apparently has some concern that explicit mention of reciprocity may give rise to demands by foreign banks and foreign governments for rights for foreign banks in the United States based on an interpretation of "reciprocity" at variance with the U.S. interpretation. Accordingly, there may be some merit in maintaining a "low profile" on the point and handling specific reciprocity problems through international negotiations.

7. Grandfathering Provisions

The purpose of grandfathering nonconforming enterprises when regulatory legislation is enacted is to prevent the harshness of forced divestiture or curtailment of vested interests emplaced during the status quo ante. Arguably, the bill's grandfathering provisions go beyond this in permitting expansion of banking operations from a grandfathered base.

For example, if a foreign bank operates a grandfathered branch in a secondary state into which it would not have been permitted to expand had the bill been enacted prior to the branch's establishment, it would be authorized to continue to expand in that state by establishment of additional branches. This provision for further intrastate branching apparently goes beyond what is necessary to protect the vested interest. The Federal Reserve Board apparently believes that the provision is necessary to prevent the grandfathered branch from being frozen in its market. However, this rationale would not justify additional intrastate branching outside of the home

office community in all cases. Such additional branches in other communities may arguably be regarded as entering new markets. Still, some banks might argue that it would not have been a sound business decision to enter such a state if it could have been anticipated that expansion rights would later be cut off.

The bill would also permit conversion of a grandfathered banking operations into another form, e.g., from an agency into a branch, and then expansion in the new form. The Board apparently feels that there is no harm in according foreign banks affected by the bill a "last chance" to elect the form in which they wish to have their operations grandfathered. There is concededly some merit in this; however, the reservations which apply to future intrastate branching apply to the conversation and expansion option as well.

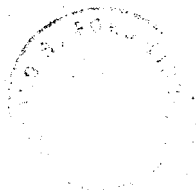
Thus, at least from a legalistic standpoint, the grandfathering provisions may go beyond what the United States would ordinarily feel compelled to extend to satisfy the basic standards of fairness upon which the practice of grandfathering is premised. Some domestic banks may object to the apparent generosity of these provisions. Nonetheless, the flexibility which existing foreign bank operations in the United States are afforded under the grandfathering provisions may do much to mollify foreign opposition to the bill and to avoid retaliation. It may be expected that a number of domestic banks concerned about their foreign operations may find the grandfathering provisions desirable for the effect they may have on the regulatory environment abroad.

Sincerely yours,



Richard R. Albrecht
General Counsel





Fed Adopts Contingency Plans to Rescue Ailing Firms to Prevent Economic Shock

By JAMES P. GANNON

Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON — The Federal Reserve Board has mapped out a set of contingency plans under which it would rescue financially shaky corporations, banks or thrift institutions to prevent any big economic shock.

The Fed is closely monitoring the financial condition of a "handful" of large U.S. corporations and as many as 50 or 60 of the nation's nearly 14,000 banks for any signs of threatened insolvency. The names of those being watched are thus far a tightly kept secret.

Arthur Burns, Fed chairman, is known to believe that the Fed has some responsibility to provide emergency loans to large corporations or financial institutions whose failure might trigger a series of bankruptcies or create panic in financial markets. He is reluctant to advocate establishment of a separate agency, such as the Depression years' Reconstruction Finance Corp., to aid failing businesses, but he would support that idea if a major corporate-rescue plan seemed necessary.

The Fed's contingency plans and Mr. Burns' views were made known to reporters under conditions that don't permit naming of sources. They are, however, authoritative.

The disclosure of the Reserve Board's contingency bailout plans didn't firmly suggest that the Fed actually believes such extraordinary aid will be necessary. The nation's central bank in the past has undertaken a few emergency-rescue efforts, as it did last year in providing up to \$1.7 billion in loans to Franklin National Bank of New York before that bank was declared insol-

vent and the bulk of its assets sold.

The Franklin National case and other bank-industry troubles last year caused concern at the Fed about the need for a contingency plan to shore up shaky banks. While concern about the banks has eased in recent weeks, the severe recession is putting some general business corporations under financial strains, raising the threat of widespread failures.

The Reserve Board has laid separate contingency plans for emergency aid to banks, to savings and loan associations and savings banks, to other financial institutions and to general business corporations. The details of these plans weren't disclosed, but it was said they could involve either direct loans from the Fed to the troubled concern, or extraordinary Fed loans to banks that, in turn would use them for loans to the ailing concern.

Mr. Burns isn't sure just how far along the corporate-bailout path the Fed would go. The Reserve Board would be more inclined to act as a rescue agency only if one or two corporations needed help than if there were many. Mr. Burns would prefer to hand the rescue effort over to a congressionally created agency if it appeared a large number of corporations needed emergency loans.

Congressional leaders of both the Republican and Democratic parties have called for creation of an RFC-type agency to aid failing businesses. The Ford administration is cool to that idea, and so is Mr. Burns. The Fed chief fears that if Congress set up an RFC now, commercial banks that currently are extending credit to troubled companies would stop doing so and try to "dump" their shaky clients into the lap of such an agency, raising the prospect that U.S. taxpayers ultimately would get stuck with bad-loan losses.

It's understood, however, that Mr. Burns would favor creation of an RFC if the business-bailout effort seemed likely to become very large or long-lasting. At the moment, he's keeping his options open—hoping the country can get through the recession without a corporate-rescue agency, but prepared to propose one if it can't.





NATIONAL CREDIT UNION ADMINISTRATION
Washington, D.C. 20456

Office of the Administrator

February 12, 1975

Honorable William Proxmire
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This is in further response to your letter of December 12, 1974, in which you asked for my views and recommendations for changes in credit union powers in anticipation of legislation in this area that you and your Committee may wish to consider.

As you mentioned, the Financial Institutions Act, the 1973 bill, is considered out of date. By the same token, the views of many of those who commented on or testified concerning that bill have also probably been changed, to a greater or lesser degree, as a result of time and the onrush of events and developments. Some of these developments were not before us at an earlier time and therefore did not come within our scope of consideration. I must admit that I did not anticipate the dramatic evolvement of electronic funds transfers systems (EFTS), the paralyzing rise in interest rates, public and private floating of debentures or other security instruments, and other disconcerting effects of disintermediation. In addition, there has been an open and declared refocus by other institutions in the financial community from their generally pursued areas of interest toward the long-ignored small consumer loan field, which has until recently been amply serviced by our Federal and state credit unions.

With this bit of overview as a frame for my response, it seems to me that there are several areas in which legislative updating of the Federal Credit Union Act are vitally necessary if credit unions are to continue to provide the services expected of them and for which they have amply demonstrated their capacity.

First, there is a need to authorize credit unions to make use of variable share and interest rates to reflect changes in the financial marketplace that occur from time to time. The 1973 and 1975 FIA provide this important authority.



Second, there is a need for a central liquidity facility (CLF). Such a discount fund was included in FIA '73. It had limited emergency type operational capability, which at the time appeared to be adequate for the needs of credit unions. A very similar central discount fund bill also appears in FIA '75. Since consideration of the 1973 bill we have all, of course, learned a lot more about the needs of credit unions and not too remarkably discovered that they have much the same type of need as do banks and savings and loan institutions. A central liquidity facility must offer more than a last resort type of emergency funding capacity and must be readily responsive to the requirements of credit unions in times of tight money, in times of disintermediation, and in times of local money shortages of a temporary nature.

As mentioned in my response of December 19, 1974, a series of conceptual reports concerning a central liquidity facility for credit unions, as well as a proposed restructuring of the National Credit Union Administration, were being discussed, reviewed, and reactions recorded at seminars throughout the country. Results of those meetings, including reports on overall reactions, have been reported to us by the two national trade associations, CUNA and NAFCU.

With these results in hand I am in a better position to provide you with a substantive response on the matter of a liquidity facility by providing you with the attached rough draft of proposed legislation, which in summary provides for the establishment of the already mentioned CLF in lieu of the central discount fund provided for in the Financial Institutions Act. The rough draft also provides for the restructuring of the National Credit Union Administration.

This preliminary legislative effort is, as you know from my earlier letter to you, a product of the consulting firm employed by us to produce a concept of CLF suitable and appropriate to meet the needs of credit unions. I recognize that the attached rough draft does not meet minimum technical standards for introduction as a bill in Congress. It is, in fact, no more than the consulting firm's rough draft with our additions, substitutions, deletions, and technical changes provided, but without any attempt at improved draftsmanship, in order that the draft more accurately reflect our view of what such a proposed bill should ultimately contain.

Third, lines of credit, or replenishment type loans, will provide credit union shareholders with the convenience available to customers of other financial institutions and retail establishments. It will also make for a more efficient operation in the credit union by reducing the repetitious paper mailings to shareholders for renewal notes. Lines of credit are included in FIA '75.

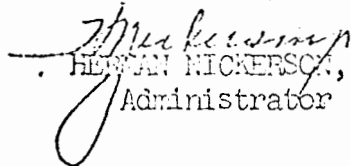
Fourth, credit unions should be authorized to provide their shareholders with 30-year home mortgage secured loans, subject, of course, to Administration regulatory restrictions.

These areas of legislative updating are, in my view, vitally necessary for the continuing viability of credit unions in a changing competitive financial environment. There are many other changes in the law which will no doubt be offered for your consideration by our credit union leaders. I am familiar with many of the suggested changes being discussed, and subject to what may be specifically and finally proposed, I find very few of such changes that I could not wholeheartedly support.

I trust these comments and views may be helpful to you and your Committee.

With all good wishes, I am

Sincerely yours,


HERMAN NICKERSON, JR.
Administrator

Attachment



SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
PROPOSED AGENDA

March 5, 1975

I. LEGISLATIVE ITEMS

- A. Electronic Funds Transfer Systems Commission -- established by P.L. 93-495
Discussion of Moratorium Legislation (H.R. 1619)
Review of Comptroller's CBCT Ruling
- B. Variable Rate Mortgages
Federal Reserve Board Regulations -- published February 14 -- comment 90 days
Senate Full Committee hearings scheduled April 14-17
- C. Liberalized Bank Holding Acquisition of Failing Banks
H.R. 4008 introduced (by request) on February 27 by Reuss and St Germain
- D. Foreign Bank Operations in the United States
Federal Reserve proposal submitted 3/4/75
Essentially identical to 93rd Congress submission introduced (by request) by Patman
- E. Bank Secrecy Act Amendments
Individual right to privacy (33 bills introduced in 93rd Congress -- 94th Congress principal sponsors, Stark, Koch, Rousselot)
- F. Status of USMB (San Diego) Failure Investigation 93rd Congress. Printed hearings distributed
Discussion of need for extensive oversight investigation encompassing Franklin National and Security National failures.
- G. Elimination of Check Cashing Fees for Government Checks (i.e., Social Security, railroad retirement, etc.)
- H. Free Merchandise and Other Give-aways by financial institutions reviewed in connection with any substantive financial reform legislation
- I. Credit Union Control Liquidity Facility
- J. Review of National Credit Union Restructuring Proposals



- K. Regulation Q (expiration date, December 31, 1975, pursuant to Sec. 107, P.L. 93-495) Element of Financial Institution Reform Proposal

II. REPORT REVIEW AND REVIEW OF STATUTORY "EXPERIMENTS" LEADING TO POSSIBLE SUBCOMMITTEE ACTION

- A. Advisory Commission on Intergovernmental Relations' study of "doing business taxes" pursuant to Sec. 7(a), P.L. 93-100. (Moratorium upon the imposition of designated taxes upon depositories expires January 1, 1976)
- B. 100% Insurance of Public Unit Deposits -- 2-year study by Advisory Commission on Intergovernmental Relations authorized by Sec. 101(f)(1) of P.L. 93-495.
- C. Conversion of Savings and Loan Associations -- review of limited number of conversions authorized during continuation of existing moratorium (June 30, 1976). Sec. 105 (d)(j)(1), P.L. 93-495
- D. Review of "NOW" account experiment authorized by P.L. 93-100 for Massachusetts and New Hampshire
- E. Review of bank securities disclosure publication requirement directed by Sec. 105(b)(i), P.L. 93-495. (publication date, February 28, 1975)
- F. Consideration of EFTS experiment questions after appointment of Commission members and staff

