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NOTES

TOO MANY CONSONANTS AND NOT ENOUGH CONSONANCE: THE DEVELOPMENT OF THE S&L REGULATORY FRAMEWORK

INTRODUCTION

Savings and loan associations (“S&Ls”),¹ also known as building and loan associations, homestead associations, cooperative banks and thrift institutions,² once handled close to fifty percent of the “mortgage-writing business” in the United States.³ Yet today the S&L industry is plagued by infirmity: Secretary of the Treasury Nicholas F. Brady estimated that over 1,000 S&Ls, about forty percent of the industry, may have to be seized by the government because they are insolvent or unsound.⁴ Moreover, the cost of the S&L bailout to the government—and thus to the taxpayers—could reach \$500 billion.⁵ In response to these startling statistics, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”).⁶

To understand how FIRREA’s provisions will affect the S&L industry,⁷ it is essential to examine those weaknesses in the industry that have created the need for this legislation. By understanding the structure and function of the S&L industry, one can begin to understand the nature of the S&L crisis, and thus why Congress designed FIRREA as it did. The structure and function of the S&L industry is best understood by examining the regulatory legislation that has shaped its development. This ap-

1. The term “S&L” has been subsumed in the term “savings association” under FIRREA. For a discussion of the terminology, see Malloy, *Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation*, 50 Ohio St. L.J. 1117, 1117 n.2 (1989); see also *People ex rel Barrett v. Logan County Bldg. and Loan Ass’n*, 369 Ill. 518, 525, 17 N.E.2d 4, 8 (1938) (“Such associations are more than business corporations; they are quasi-public corporations, chartered to encourage thrift and promote the ownership of homes, with powers and immunities peculiarly their own.” (citation omitted)(emphasis in original)).

2. See Comment, *Banking—Mergers—Is Commercial Banking Still a Distinct Line of Commerce?*, 57 Tul. L. Rev. 958, 960 n.11 (1983). S&Ls were called “thrift institutions” because “they were originally founded to encourage savings among working class individuals.” *Id.* at 961 n.17.

3. See Yang & Gleckman, *The S&L Mess—And How to Fix It*, Bus. Wk., Oct. 31, 1988, at 136.

4. See Rosenbaum, *A Financial Disaster With Many Culprits*, N.Y. Times, June 6, 1990, at D4, col. 1.

5. See Quint, *New Estimate on Savings Bailout Says Cost Could Be \$500 Billion*, N.Y. Times, Apr. 7, 1990, at A1, col. 1.

6. Pub. L. No. 101-73, 103 Stat. 183 (to be codified at various sections of 12 and 15 U.S.C.).

7. For a discussion of FIRREA’s provisions see Note, *Playing With FIRREA, Not Getting Burned: Statutory Overview of the Financial Institutions Reform, Recovery and Enforcement Act of 1989*, in *Annual Survey of Financial Institutions and Regulation, The S&L Crisis: Death and Transfiguration*, 59 Fordham L. Rev. S323 (1991).

proach also gives an overview of FIRREA's legislative history, because FIRREA was intended to strengthen and amend existing regulations, as well as to impose additional requirements on the industry.⁸

This Note focuses on those pieces of S&L legislation that contributed to the regulatory framework now in existence. This examination reveals that most major S&L legislation has been reactive,⁹ designed to cure already-existing problems in the S&L industry. These regulations were then left in place to respond to a different financial atmosphere.¹⁰

Consequently, S&L legislation has been generally ineffective as a regulatory scheme. Whereas regulations are generally intended to prevent undesirable developments within a particular industry,¹¹ S&L regulations have merely responded to various crises.¹² Moreover, despite the numerous regulations in place, the very goal of these regulations—preventing widespread failure of S&Ls¹³—has not been achieved.¹⁴ Part I of this Note examines the origins of the S&L industry in the United States and traces its development from the early 1800s to the Stock Market Crash of 1929 and its immediate aftermath. Part II, covering 1932 to 1950, reviews the main pieces of S&L regulatory legislation arising from the New Deal. Part III, covering 1950 to 1959, discusses the challenges to this regulatory scheme presented by the *Mallonee* litigation and the legislative response to this case. Finally, Part IV examines the S&L legislation that arose between 1960 and 1969.¹⁵ This Note concludes that S&L regulatory legislation has historically been unsuccessful because it has been reactive in nature.

I. THE ORIGINS AND DEVELOPMENT OF THE S&L INDUSTRY

A. *The Origins of the S&L Association*

The first recorded S&L¹⁶ in the United States, the Oxford Provident,

8. *See id.* at S324-25.

9. *Cf.* 3 Documentary History of Banking and Currency in the United States 164 (H. Krooss ed. 1983) (“[T]hroughout history it had always required a severe panic or a long depression to persuade lawmakers and public opinion to attempt bank reform.”).

10. There are some who contend that the Depression was itself a reaction to already-existing problems in the banking structure of the time. *See White, A Reinterpretation of the Banking Crisis of 1930*, 44 J. Econ. Hist. 119, 120 (1984).

11. *See* K. Davis, *Administrative Law and Government* 6-11 (2d ed. 1975).

12. *See supra* notes 9-10 and accompanying text.

13. Malloy, *Balancing Public Confidence and Confidentiality: Adjudication Practices and Procedures of the Federal Bank Regulatory Agencies*, 61 Temp. L. Rev. 723, 726-27 (1988).

14. *See supra* notes 4-5 and accompanying text.

15. *See Note, Causes of the Savings and Loan Debacle*, in *Annual Survey of Financial Institutions and Regulation*, *The S&L Crisis: Death and Transfiguration*, 59 Fordham L. Rev. S301 (1991), which focuses on the S&L regulatory legislation arising in the 1970s and 1980s.

16. The first “building society” on record was founded in 1781 in Birmingham, England. *See* F. Ornstein, *Savings Banking: An Industry in Change* 4 (1985). Building societies originated in the mining and factory towns that had grown under the impetus of the British Industrial Revolution. *See* A. Teck, *Mutual Savings Banks and Savings and Loan*

was organized in 1831 in Frankford, Pennsylvania by newly arrived workers in the town's textile and tanning mills.¹⁷ Each member of the S&L paid an initial sum for each share he purchased in the enterprise and then paid a monthly fee on each share.¹⁸ When sufficient funds had been amassed to finance a home, the member offering the highest premium on repayment was awarded the funds. This process continued until each member had received and repaid a loan, at which time Oxford Provident was dissolved and any remaining money was divided among the members.¹⁹

The idea of the savings association spread²⁰ but the federal government made no attempt to compile statistics on the S&L industry,²¹ much less regulate it.²² By contrast, in the 1860s, the federal banking system was already in place. Specifically, the federal government enacted the National Bank Act of 1864,²³ which established a national banking system in addition to the state banking system already in existence.

This Act created within the Treasury Department the office of the Comptroller of the Currency, which had the power to oversee national banks.²⁴ In reality, however, the federal banking system "was intended

Associations: Aspects of Growth 18 (1968). As the populations of these towns increased due to mass migration from farm areas, as well as to increasing birth rates and decreasing death rates, the demand for housing also increased. *See id.* The workers' wages allowed them to finance these homes, and groups of townspeople pooled their earnings into building societies to enable each member to purchase a home in turn. *See id.* at 18-20. "Savings and loan associations in the United States are descended directly from English building societies . . ." *Id.* at 18.

17. *See* Teck, *supra* note 16, at 22.

18. *See id.* at 23.

19. *See* Ornstein, *supra* note 16, at 6-7. In 1836, a delegation from Brooklyn, New York was dispatched to Frankford to observe Oxford Provident. That same year, the nation's second S&L, the Brooklyn Building and Mutual Loan Association, was formed. *See* Teck, *supra* note 16, at 25.

20. *See generally* Ornstein, *supra* note 16, at 7-11 (discussing "Terminating Plan" and "Permanent Plan" S&Ls); Teck, *supra* note 16, at 40-42 (describing development of the installment share, optional share account, and full-paid share as means for S&Ls to obtain funds necessary to make loans. S&Ls began accepting deposits from investors who did not intend to borrow for home financing purposes).

21. *See* Teck, *supra* note 16, at 26. The first industry census was taken in 1888, when it was calculated that as many as 3,500 S&Ls existed across the nation, providing at least \$300 million for investment. *See id.*

22. The task of resolving issues in the S&L field thus fell to the judiciary. *See, e.g.,* Riggs v. Capital Brick Co., 128 F. 491, 491-95 (C.C.D. Conn. 1904)(resolving the question of foreclosure by receivers); Interstate Sav. & Loan Ass'n v. Badgley, 115 F. 390, 390-93 (C.C.D. Or. 1902)(dealing with mortgage foreclosures).

23. Act of June 3, 1864, ch. 106, 13 Stat. 99 (codified as amended in 12 U.S.C. § 1865) [hereinafter National Bank Act of 1864]. The "original" national bank act was Act of February 25, 1863, ch. 58, 12 Stat. 665, which was later repealed by the National Bank Act of 1864, § 62, 13 Stat. at 118.

24. *See* National Bank Act of 1864, ch. 106, §§ 1-8, 13 Stat. 99, 99-102. "Although it is often considered to be a fundamental component of the dual banking system, the National Bank Act [of 1864] was intended, at least in part, to hasten the demise of state banking." Friedman and Friesen, *A New Paradigm for Financial Regulation: Getting From Here to There*, 43 Md. L. Rev. 413, 420 (1984)(footnotes omitted).

to foster a captive market," since each member of the system was obliged to purchase United States government bonds.²⁵ The federal government used this captive market to help finance the Civil War,²⁶ and even after the need for these funds had passed, the dual banking system created under the Acts remained in place.²⁷ By creating the bifurcated banking system which is still in existence,²⁸ the National Bank Act of 1864 was in a sense the precursor of the bifurcated S&L regulatory system.²⁹

By 1892, leaders in the S&L industry had organized the United States League of Local Building & Loan Associations, which later became the United States Savings & Loan League.³⁰ In the following year, the United States Bureau of Labor took its first nationwide poll and estimated that 5,860 S&Ls were in full-time operation across the United States.³¹ Within the next two decades, the first federal S&L regulatory legislation appeared³² and federal banking legislation continued to develop.³³

B. *The Rise and Fall of S&Ls: 1920-1932*

The years 1920 to 1929 were crucial in the development of the S&L system. During this decade, the nation experienced a housing boom,³⁴ and the S&L industry, as a vehicle for home financing,³⁵ expanded greatly. S&Ls jumped in number from approximately 8,600 to around 12,000 just before the Stock Market Crash,³⁶ and S&Ls provided thirty-five percent of the mortgages on non-farm residences.³⁷ The prosperity generally associated with the 1920s, however, took its toll on the S&L industry.

Towards the end of the decade, S&Ls failed to attract new depositors, who were using their earnings to speculate on the stock market.

25. 1 M. Malloy, *The Corporate Law of Banks*, § 1.3.1, at 29-30 (1988)(footnote omitted).

26. *See id.* at 30.

27. *See* 1 M. Malloy, *supra* note 25, § 1.3.1, at 28-30.

28. *See id.* at 30.

29. For a discussion of the bifurcated S&L regulatory system, see *infra* notes 137-143 and accompanying text.

30. *See* United States Savings & Loan League, *Savings and Loan Fact Book 1955*, at 80.

31. *See* Teck, *supra* note 16, at 26.

32. *See* Revenue Act of 1918, ch. 18, § 231, 40 Stat. 1057, 1076 (codified as amended in 2 U.S.C. §§ 271, 272, 273-277; 19 U.S.C. § 460); *see also* United States v. Cambridge Loan and Bldg. Co., 278 U.S. 55, 57-63 (1928)(interpreting the tax exemptions created under the Revenue Act of 1918).

33. *See* Federal Reserve Act, ch. 6, 38 Stat. 251 (1913)(codified at various sections of 12 U.S.C.)(creating, *inter alia*, the federal reserve bank system and open market operations as a means of controlling the national money supply).

34. *See* Teck, *supra* note 16, at 47.

35. *See supra* note 1.

36. *See* J. Ewalt, *A Business Reborn: The Savings and Loan Story 1930-1960*, at 6 (1962).

37. *See id.* at 4.

Problems were compounded as depositors also began actively withdrawing funds from accounts for the same reason.³⁸ In order to reverse this trend, S&Ls were forced to offer higher interest rates on deposits than they were receiving on mortgage payments.³⁹

Consequently, during this decade S&Ls adopted the practice of borrowing short-term from commercial banks in order to pay withdrawals on demand; the S&Ls then repaid the loans from incoming receipts.⁴⁰ When the stock market crashed, however, banks found themselves short of funds, and called in the short-term loans. S&Ls, unable to pay because of their own limited reserves, were forced to liquidate to meet the banks' demands.⁴¹ Between 1930 and 1932, depositors panicked in the wake of these liquidations, and a "run"⁴² on deposits eventually led to a banking crisis.⁴³ In fact, the majority of S&L failures resulted from unsafe lending and borrowing practices in place before the Depression.⁴⁴

By 1932, with personal savings at negative \$600 million and consumption expenditures down \$12 billion,⁴⁵ economic conditions forced the government to take action to prevent further deterioration of the financial industry.

38. *See id.* at 13-14.

39. *See White, A Reinterpretation of the Banking Crisis of 1930*, 44 J. Econ. Hist. 119, 128 (1984).

40. *See Ewalt, supra* note 36, at 15.

41. *See id.*; White, *supra* note 39, at 123-27. As one Congressman noted, "[p]resent conditions have shown that it is dangerous, one might say suicidal, for long-term financing agencies to depend on short-term advances for their emergency needs." 75 Cong. Rec. 12,612 (1932) (statement of Rep. Hancock).

See also Note, supra note 15, at S303-04, S309-10 (explaining how inflationary pressures in the 1970s raised interest payments on deposits above loan repayments, thus creating an analogous funds shortage).

S&Ls continued their policy of adapting their business practices to meet then-existing conditions. *See, e.g., infra* notes 111-122, 150-152, 189-194 and accompanying text (describing how S&Ls' banking practices were a response to the Depression); *infra* notes 306-309 and accompanying text (describing additional practices adopted in light of the S&L crisis of the 1960s).

42. If depositors suspect for any reason (unfounded or not) that a bank lacks sufficient reserves to satisfy its obligations to depositors and might fail, they will immediately withdraw their deposits. The bank loses reserves and is even more vulnerable to future deposit outflows. Other depositors who see this happening will begin to question the bank's health and withdraw their funds too. The more depositors withdraw funds, the fewer reserves the bank will have and the more likely it is to fail. The likelier it is to fail, the more likely depositors will show to withdraw their deposits. This snowballing process, called a "run on the bank," usually terminates with the failure of the bank unless something can be done to restore the public's confidence.

F. Mishkin, *The Economics of Money, Banking, and Financial Markets* 310 (1986).

43. At this time, S&Ls adopted the practice of "putting customers on notice," i.e., paying out withdrawals only as money flowed into the institution. *See Ewalt, supra* note 36, at 14-15.

44. *See id.* at 15, 18.

45. United States Savings & Loan League, *Savings and Loan Fact Book 1955*, at 9 (table 1).

II. 1932-1950: THE NEW DEAL LEGISLATION

A. *The Reconstruction Finance Corporation Act*

Congress passed the Reconstruction Finance Corporation Act ("RFC Act")⁴⁶ primarily as an interim device⁴⁷ to enable farmers to obtain loans for 1932 crop production.⁴⁸ In addition, the Reconstruction Finance Corporation ("RFC"), created by the RFC Act, was originally intended to deal with businesses and especially with commercial banks.⁴⁹ Congress did not intend for S&Ls to fall within the RFC Act's coverage. Based partly on a United States Savings & Loan League survey of S&Ls' credit needs, however, Congress decided to extend RFC loans to S&Ls as well.⁵⁰

Because it served as the structural prototype for the Federal Home Loan Bank system,⁵¹ the RFC Act is particularly significant for its structure. Congress created the RFC for a ten year period,⁵² and gave it other powers relating to its functions as a corporation.⁵³ Management of the RFC was entrusted to a Board of Directors including the Secretary of the Treasury, the governor of the Federal Reserve Board, and the Farm Loan Commissioner as members *ex officio*.⁵⁴ In addition, the Act provided for four full-time members chosen by the President of the United States and subject to Senate approval.⁵⁵ The Act provided that not more

46. Ch. 8, 47 Stat. 5 (1932).

47. See Ewalt, *supra* note 36, at 34 ("The RFC was . . . designed for temporary life; estimates pointed to five, or at most 10, years for its activity.").

48. The Secretary of Agriculture was authorized to expend money "for the purpose of making loans or advances to farmers in the several States of the United States in cases where he [found] that an emergency exist[ed] as a result of which farmers [were] unable to obtain loans for crop production during the year 1932 . . ." Reconstruction Finance Corporation Act [hereinafter RFC Act], ch. 8, § 2, 47 Stat. 5 (1932).

49. See Ewalt, *supra* note 36, at 34.

50. See *id.* at 34-35.

Savings and loan associations would probably not have become eligible for RFC loans in the ordinary course of events. . . . [T]he RFC's need to get started pouring out financial succor was so insistent that a savings and loan program might have been sidetracked indefinitely if leaders of the business had not been on hand in Washington to see that the technicalities were worked out for a swift utilization of funds by the associations.

Id.

51. See 75 Cong. Rec. 12,609 (1932); see also *infra* notes 88-89 and accompanying text (describing the structure of the Federal Home Loan Bank Board).

52. See RFC Act, *supra* note 48, § 4, 47 Stat. at 6.

53. See *id.* Powers included the power to

adopt, alter, and use a corporate seal; to make contracts; . . . to sue and be sued, to complain and to defend, in any court of competent jurisdiction, State or Federal; . . . and to prescribe, amend, and repeal, by its board of directors, by-laws, rules, and regulations governing the manner in which . . . powers granted to it by [the] law may be exercised and enjoyed, including the selection of its chairman and vice chairman

Id.

54. See RFC Act, *supra* note 48, § 3, 47 Stat. 5.

55. See *id.*

than four members of the entire Board could belong to the same political party.⁵⁶

The Act authorized and directed Federal Reserve Banks to act as the depositories, custodians and fiscal agents for the RFC in the performing the powers granted under the Act.⁵⁷ The Act likewise authorized the RFC to act as a depository of public money, and it could also be employed as a financial agent for the national government.⁵⁸ In addition, the Act required other government agencies, such as the Treasury, the Federal Farm Loan Board, the Comptroller of Currency and the Interstate Commerce Commission, to provide the RFC with any records relating to the financial condition of the institutions seeking loans.⁵⁹

Under the RFC Act, the federal government subscribed the RFC's initial capital stock of \$500 million.⁶⁰ In turn, the Act empowered the RFC to issue three times its capital stock in the form of bonds and debentures, and to set the interest rates on these obligations.⁶¹ The Act specifically reserved fifty million dollars of the fund for crop production in 1932,⁶² and authorized the RFC to make loans to any bank or thrift institution, even those in receivership or in the process of liquidation.⁶³ Only a total of \$200 million, however, could be loaned to these troubled financial institutions.⁶⁴

The Act prohibited the RFC from extending loans to any enterprise not already in existence at the time the Act was passed.⁶⁵ The Act placed

56. *See id.*

57. *See id.* § 7, 47 Stat. at 8.

58. *See id.* § 12, 47 Stat. at 10.

[T]he corporation shall be a depository of public money, . . . and it may also be employed as a financial agent of the Government; and it shall perform all such reasonable duties, as depository of public money and financial agent of the Government, as may be required of it. Obligations of the corporation shall be lawful investments, and may be accepted as security, for all fiduciary, trust, and public funds the investment or deposit of which shall be under the authority or control of the United States or any officer or officers thereof.

Id.

59. *See id.* § 8, 47 Stat. at 8. These government agencies were authorized to "make available to the corporation, in confidence, such reports, records, or other information as they may have available relating to the condition of financial institutions . . . with respect to which the corporation has had or contemplates having transactions under this Act . . ." *Id.* at 8-9.

60. *See id.* § 2, 47 Stat. 5.

61. *See id.* § 9, 47 Stat. at 9.

62. *See id.* § 2, 47 Stat. 5.

63. *See id.* § 5, 47 Stat. at 6-7.

[T]he corporation is authorized and empowered to make loans, upon such terms and conditions not inconsistent with this Act as it may determine, to any . . . building and loan association . . . including loans secured by the assets of any bank that is closed, or in process of liquidation to aid in the reorganization or liquidation of such banks, upon application of the receiver or liquidating agent of such bank

Id.

64. *See id.* § 5, 47 Stat. at 7.

65. *See id.* "[N]o loan or advancement shall be made by the corporation for the pur-

limits on the amount loaned to any one corporation and its subsidiary or affiliated organizations.⁶⁶ The RFC Act required any institution seeking a loan through the RFC to submit to a full examination of its financial records as a precondition to receiving any funds.⁶⁷

In addition to enumerating the RFC's powers as a government agency, the Act also mandated that the Board of Directors liquidate the RFC after one year, unless the President extended the deadline after determining that it was required.⁶⁸ The Board of Directors was required to liquidate the RFC within ten years. If it failed to do so, the Secretary of the Treasury had the power to effect the liquidation.⁶⁹ The Secretary's power in this regard was not exercised, however, because the RFC was successfully liquidated⁷⁰ and its functions transferred to the Housing and Home Finance Administrator.⁷¹

B. *Federal Home Loan Bank Act of 1932*

As the Depression deepened in the 1930s,⁷² the need for regulating the financial industry became apparent. In 1931, in response to economic conditions, Congress issued questionnaires to 8,000 S&Ls to determine whether they were receptive to a national S&L regulatory agency.⁷³ In

pose of initiating, setting on foot, or financing any enterprise not initiated, set on foot, or undertaken prior to the adoption of this Act." *Id.*

66. *See id.*; *see also infra* notes 312-329 and accompanying text (discussing bank holding companies).

67. *See RFC Act, supra* note 48, § 8, 47 Stat. at 8-9.

68. *See id.* § 13, 47 Stat. at 10.

69. *See id.* § 14, 47 Stat. at 10-11.

70. The RFC's prospective powers were transferred to the Housing and Home Finance Administrator pursuant to Reorganization Plan No. 23 of 1950, 64 Stat. 1279. Its power to conduct any transactions was then terminated at the close of business on June 30, 1954 under the Reconstruction Finance Corporation Liquidation Act, ch. 282, 67 Stat. 230 (1953)(codified in 15 U.S.C. § 603(a)). The RFC as a separate entity was finally abolished under the Reorganization Plan No. 1 of 1957, § 6, 71 Stat. 647, 649. The Plan provided for the retirement of the RFC's capital stock and for the payment of unused funds into the Treasury. *See id.* § 6(b), 71 Stat. at 649.

71. *See* Reorganization Plan No. 1 of 1957, § 2, 71 Stat. 647.

72. *See generally* Burck and Silberman, *Why the Depression Lasted So Long*, in *Great Depressions* 142-149 (J. Sperlberg ed. 1966) (discussing the "economic ignorance of the times" as the primary reason for the Depression's duration).

During this period, competing economic theorists debated the causes of, and cures for, the Depression, and their views are seen in the legislation of the day. The New Deal legislation generally reflects the theories of John Maynard Keynes, who advocated a focus on the demand-side factors of the economy. *See* R. Ruffin & P. Gregory, *Principles of Macroeconomics* 174, 178 (2d ed. 1986); C. Kindleberger, *Manias, Panics, and Crashes* 70-71 (1978). Keynes summed up his economic philosophy in the quote, "in the long run, we are all dead." *See* R. Ruffin & P. Gregory, *supra*, at 174. This short-term perspective manifests itself in the legislation discussed in this Note. *See, e.g., infra* notes 112-122 and accompanying text (discussing the social and economic factors underlying the New Deal legislation).

73. *See* S.Rep. No. 837, 72nd Cong., 1st Sess. 3 (1932). The questionnaire asked the following four questions, with the number of affirmative responses given in brackets:

- (1) Would the facilities provided by the proposed home loan discount banks for borrowing on your home mortgages add desirable flexibility and security to the

light of generally favorable responses,⁷⁴ Congress passed the Federal Home Loan Bank Act ("FHLB Act").⁷⁵ Although the Act was first proposed during President Wilson's second term,⁷⁶ the Depression was the decisive factor in passing the measure.⁷⁷

1. Purpose

Congress listed fourteen separate reasons for passing the FHLB Act,⁷⁸ but those reasons can be reduced to three general goals. First, the FHLB Act was intended to boost the economy by creating a pool of funds for the home financing industry.⁷⁹ Second, it attempted to foster home ownership through favorable treatment of home mortgages.⁸⁰ Finally, Congress sought to change S&Ls from short-term housing lenders to long-term housing lenders.⁸¹ The structure of the Act also indicates an overarching agenda: "the regulatory provisions of this Act reveal an intention on the part of Congress to retain the broadest kind of federal control over the number, powers and existence of these purely legislative creatures."⁸²

conduct of your institution? [5,898]; (2) Would operation of the discount banks increase the amount of credit now available for legitimate use in your community? [6,535]; (3) Is there a demonstrable need for actual home construction, either new houses or remodeling work, that could be undertaken in your community if credit facilities were widened at the present time? [4,264]; and (4) Would the facilities afforded by the proposed discount banks help to relieve the dangers of foreclosure on urban homes and farms? [5,935].

Id.

74. See *supra* note 73. But see 75 Cong. Rec. 12,723 (1932) (statement of Rep. McFadden) (opposed to the enactment of the law).

75. Ch. 522, 47 Stat. 725 (1932) (codified as amended in 12 U.S.C. §§ 1421-1449). See generally Note, *supra* note 7 (discussing changes in the Federal Home Loan Bank system effected by FIRREA.)

76. See H.R. Rep. No. 1418, 72nd Cong., 1st Sess. 4 (1932); W. Woerheide, *The Savings and Loan Industry: Current Problems and Possible Solutions* 3 (1984).

77. See W. Woerheide, *supra* note 76, at 3.

78. See H.R. Rep. No. 1418, 72nd Sess., 1st Sess. 9-12 (1932).

79. See 1 M. Malloy, *supra* note 25, § 1.3.4, at 52.

80. See 75 Cong. Rec. 12,612 (1932). "This legislation is intended to stimulate home ownership in normal times and to protect and safeguard that ownership in times of business depression and financial stress . . ." *Id.* (statement of Rep. Hancock).

81. See, e.g., *id.* at 12,608 (1932) ("A prime purpose of the home loan bank bill is to promote the development of the long-term amortized mortgages which are so essential for further home ownership. . . . The Federal home-loan bank system will care only for the long-time credit needs of the home financing business.") (statement of Rep. Hancock); *id.* at 12,612 (1932) ("The home-loan bank system is designed to divorce two incompatible fields of finance—short-term commercial lending and long-term home financing.") (statement of Rep. Hancock).

82. *Fahey v. O'Melveny & Myers*, 200 F.2d 420, 443 (9th Cir. 1952), *cert. denied*, 345 U.S. 952 (1953). The Ninth Circuit also noted that "[t]he real significance of the Federal Home Loan Bank Act lies in the fact that by this legislation Congress made sure that it retained permanent control over the nationwide bank system it created in 1932." *Id.* at 455 (emphasis in original).

2. Structure and Powers

The FHLB Act directed that no less than eight and no more than twelve Federal Home Loan Bank Districts be established as soon as practicable.⁸³ Under the Act, one Federal Home Loan Bank ("FHLB") per district acted as the central institution for that region.⁸⁴

The wide variety of institutions, as well as the diversity of individual state regulations, mandated that Congress establish a supervisory body to oversee the regional FHLBs.⁸⁵ Congress therefore created the Federal Home Loan Bank Board ("FHLBB")⁸⁶ to coordinate this system of districts and central institutions.⁸⁷ The FHLBB was composed of five full-time employees of the FHLB system.⁸⁸ The President of the United States appointed the Board members, subject to Senate approval, with the proviso that no more than three Board members could belong to the

83. See Federal Home Loan Bank Act [hereinafter FHLB Act], ch. 522, § 3, 47 Stat. 725, 726 (1932). The FHLBB originally decided on eleven districts, each encompassing several states (the financial center for each district is indicated in parentheses): District One (Boston): Maine, Vermont, New Hampshire, Massachusetts, Connecticut, and Rhode Island. District Two (New York City): New York and New Jersey. District Three (Pittsburgh): Pennsylvania, Delaware, and West Virginia. District Four (Greensboro): Maryland, Washington, D.C., Virginia, North Carolina, South Carolina, Georgia, Alabama, and Florida. District Five (Cincinnati): Ohio, Kentucky, and Tennessee. District Six (Indianapolis): Michigan and Indiana. District Seven (Chicago): Wisconsin and Illinois. District Eight (Des Moines): Minnesota, Iowa, Missouri, North Dakota, and South Dakota. District Nine (Little Rock): Arkansas, Mississippi, Louisiana, Texas, and New Mexico. District Ten (Topeka): Colorado, Nebraska, Kansas, and Oklahoma. District Eleven (San Francisco): Washington, Oregon, Idaho, Montana, Wyoming, California, Nevada, Utah, Arizona, Alaska, and Hawaii. See United States Savings and Loan League, Savings and Loan Fact Book 1959, at 93 (chart 45).

In 1964, District Eleven was divided. The new District Eleven (San Francisco) included California, Nevada and Arizona. District Twelve (Spokane) included Washington, Oregon, Idaho, Montana, Utah, Wyoming, Alaska and Hawaii. See United States Savings and Loan League, Savings and Loan Fact Book 1964, at 111.

84. See FHLB Act, *supra* note 83, § 3, 47 Stat. at 726. "

When "created," the [Federal Home Loan Banks were] authorized and required to perform the functions designated in the Act under a so-called 'organization certificate' . . . which document [was] issued under authority vested in the [Federal Home Loan Bank] Board. This certificate [was] evidence of the corporate existence of such banks as an integral part of what is frequently referred to as the Federal Home Loan Bank System. By regulations of the Board these 'organization certificates' [were] to be deemed the 'charter' of a bank.

Fahey v. O'Melveny & Myers, 200 F.2d 420, 442 (9th Cir.), *cert. denied*, 345 U.S. 952 (1953).

85. See 75 Cong. Rec. 12,611 (1932) (statement of Sen. Hancock).

86. Both the name and the structure of the FHLBB have changed. For a discussion of the FHLBB's various name changes, see *Home Loan Bank Board v. Mallonee*, 196 F.2d 336, 342 n.3 (9th Cir. 1952), *cert. denied*, 345 U.S. 952 (1953). Because these alterations do not impact on the role of the FHLBB in the S&L industry, this Note will consistently refer to the Board as the FHLBB.

87. See FHLB Act, *supra* note 83, § 17, 47 Stat. at 736-37.

88. See *id.* Initially, the first Board member was chosen to serve for two years, the second to serve for three years, and so on. After the expiration of this original term, new members served for six years. *Id.* This selection process ensured that a new Board member would be selected each year.

same political party.⁸⁹

Congress granted the FHLBB the power to adopt, amend and enforce the rules and regulations necessary to effect the provisions of the Act.⁹⁰ In addition, the FHLBB could remove or suspend employees and agents of the FHLB System, including the officers and directors of S&Ls.⁹¹ While such powers are broad and therefore open to abuse, the courts have traditionally deferred to the discretion of the FHLBB and the District Banks on these specialized matters.⁹²

Each District Bank, in turn, was managed by a Board of Directors.⁹³ Each Board consisted of eleven directors, two of whom were appointed by the FHLBB.⁹⁴ The other nine directors were nominated by FHLB member institutions and elected by the already-appointed directors.⁹⁵ Each FHLB was empowered to borrow money, issue debentures and bonds⁹⁶ and promulgate rules and regulations for the various functions of member institutions.⁹⁷ Where home owners could not obtain mortgage money from "any other source," they could obtain such funds from any bank organized under the FHLB Act.⁹⁸ The Act also allowed for the

89. *See id.* This structure parallels the one created by Congress for the Board of Directors of the RFC. *See supra* notes 54-56 and accompanying text.

90. *See* FHLB Act, *supra* note 83, § 17, 47 Stat. at 736-37. Current rules and regulations promulgated for the FHLB System are found in 12 C.F.R. § 544.

91. *See* FHLB Act, *supra* note 83, § 17, 47 Stat. at 737.

92. *See* 1 M. Malloy, *supra* note 25, § 1.3.4, at 60; *see also* Bridgeport Fed. Sav. & Loan Ass'n v. Federal Home Loan Bank Bd., 307 F.2d 580 (3rd Cir. 1962)(upholding FHLBB decision granting branching application), *cert. denied*, 371 U.S. 950 (1963); Federal Home Loan Bank Bd. v. Rowe, 284 F.2d 274 (D.C. Cir. 1960)(upholding FHLBB decision denying branching application); First Nat'l Bank of McKeeseport v. First Fed. Sav. & Loan Ass'n, 225 F.2d 33 (D.C. Cir. 1955)(upholding FHLBB decision granting branching application). The cases best addressing the powers of the FHLBB are examined under the *Mallonee* litigation, *infra* notes 225-247 and accompanying text.

93. *See* FHLB Act, *supra* note 83, § 7(a), 47 Stat. at 730.

94. *See id.* § 7(a)-(b), 47 Stat. at 730.

95. In order to implement this provision, the Act authorized the FHLBB to select the original nine directors as well, who served until the end of 1932. *See id.* § 7(c), 47 Stat. at 730. The Act then divided all member institutions into three groups according to size, and three individuals involved in the home-financing industry were elected from each group. "Class A" directors from Group A (large) institutions were originally elected for a one-year term. "Class B" directors from Group B (medium) institutions were originally elected for a two-year term. "Class C" directors from Group C (small) institutions were originally elected for a three-year term. After these initial terms had expired, all directors were elected for three year terms. *See id.* § 7(d), 47 Stat. at 730. *See also supra* note 55 and accompanying text (RFC Act created a similar system of directors).

96. The debentures and bonds were tax-exempt under Section 13 of the Act. *See* Michigan Nat'l Bank v. Mich., 365 U.S. 467, 483 (1961)(upholding the constitutionality of taxation schemes on the assets of banks and S&Ls); Hoenig v. Huntington Nat'l Bank, 59 F.2d 479 (6th Cir. 1932)(same).

97. *See* FHLB Act, *supra* note 83, § 11(b), 47 Stat. at 733.

98. *See id.* § 4(d), 47 Stat. at 727. Section 3 of the Home Owners' Loan Act of 1933 repealed § 4(d) of the FHLB Act, and transferred the function to the Home Owners' Loan Corporation. *See* Home Owners' Loan Act of 1933, ch. 64, § 4, 48 Stat. 128, 129-32 (codified as amended in 12 U.S.C. §§ 1461-1464). Section 4(f) of the Home Owners' Loan Act authorized the FHLB to make direct cash advances to homeowners who could not obtain advances from "ordinary lending agencies." *See id.* § 4(f), 48 Stat. at 131.

liquidation or reorganization of any FHLB where such action furthered the goals of the Act.⁹⁹

With this supervisory scheme in place, the Act allowed "eligible" financial institutions to become members, or non-member borrowers,¹⁰⁰ of the FHLB system.¹⁰¹ Under the Act, an institution was eligible for FHLB loans if it (1) was organized under state or federal law; (2) was subject to inspections and regulation; and (3) made long-term home mortgage loans.¹⁰² Even if an institution met these three requirements, the FHLBB could still refuse to lend funds to an institution "if, in the judgment of the [B]oard, its financial condition [was] such that advances [could] not safely be made . . . or the character of its management or its home-financing policy [was] inconsistent with sound and economical home financing, or with the purposes of this Act."¹⁰³ The Act authorized the Department of the Treasury, the Comptroller of the Currency and the Federal Reserve Board to disclose any information that would aid the individual FHLBs in determining eligibility.¹⁰⁴ An eligible institution that wished to join the FHLB system simply subscribed for stock in the Federal Home Loan Bank in its district,¹⁰⁵ and was thereafter permitted to apply for advances in writing.¹⁰⁶ If the application was approved, the FHLB advanced the funds, which were secured by home mortgages held by the institution.¹⁰⁷

Members were allowed to withdraw from the FHLB system voluntarily by applying in writing to the Federal Home Loan Bank in its district.¹⁰⁸ The District Bank could also remove an institution from

99. See FHLB Act, *supra* note 83, § 26, 47 Stat. at 740.

100. A "nonmember borrower" was an institution eligible for membership under § 4(a), but precluded from subscribing for FHLB stock by the laws of the state in which it was organized. As the name suggests, however, such institutions were still able to secure loans and advances from the Federal Home Loan Banks in their districts. See FHLB Act, *supra* note 83, § 6(e), 47 Stat. at 728.

101. See *id.* § 4(a), 47 Stat. at 726.

102. See *id.* An institution not subject to inspection under state law could still be eligible if it agreed to an inspection by the Board of Directors for that district. See *id.* § 4(c), 47 Stat. at 727; see also *supra* note 81 and accompanying text (concerning long-term lending).

103. FHLB Act, *supra* note 83, § 4(a), 47 Stat. at 727.

104. See *id.* § 22(a), 47 Stat. at 739. See also *supra* note 59 and accompanying text (same powers granted under the RFC Act). *But see* *United States v. Kanan*, 225 F. Supp. 711, 715 (D. Ariz. 1963) (receiver of member institution went beyond discretion in requesting investigation and information from FBI).

105. The capital stock of each Federal Home Loan Bank was divided into shares of \$100 each. See FHLB Act, *supra* note 83, § 6(b), 47 Stat. at 727. Every member institution was required to subscribe for stock equal to "[one] per centum of the aggregate of the unpaid principal of the subscriber's home mortgage loans, but not less than \$1,500." *Id.* § 6(c), 47 Stat. at 727.

106. See *id.* § 9, 47 Stat. at 731. Section 22(b) required every applicant to submit to an examination of its financial records as a precondition to receiving the funds. See *id.* § 22(b), 47 Stat. at 739.

107. See FHLB Act, *supra* note 83, § 10(a), 47 Stat. at 731.

108. See *id.* § 6(i), 47 Stat. at 729.

membership upon a determination, after an internal hearing, that the member failed to comply with any provision of the Act or that it engaged in unsound practices.¹⁰⁹ Moreover, where the Board found illegal practices, such as falsification of statements, embezzlement and unauthorized use of the designation "FHLB," the Act provided for both fines and imprisonment.¹¹⁰

3. Reactive Theory

The government generally regulates financial markets only in response to an economic crisis.¹¹¹ The FHLB Act supports this characterization of S&L legislation: it was enacted in response to the Depression. Three factors created the impetus for change in the S&L system. First, economic factors mandated government action. Personal savings fell from \$4.2 billion in 1929 to negative \$600 million in 1932, consumption expenditures fell from \$79 billion in 1929 to \$49.3 billion in 1932, and disposable income fell from \$83.1 billion in 1929 to \$48.7 billion in 1932. This resulted in a net savings fall from 5.1% of disposable income in 1929 to -1.2% in 1932.¹¹² In light of these statistics, Congress admitted that the Act was "based upon the principle of creating a central bank during the present emergency . . . and releas[ing] ready money for further use during the depression."¹¹³

Second, political pressure mandated some action to rescue homeowners facing foreclosures.¹¹⁴ The FHLB Act decreased competition between S&Ls for scarce funds by making government funds readily available to eligible institutions. The S&Ls could use the funds to meet withdrawal demands¹¹⁵ and thereby reduce foreclosures as a way to meet financial needs. Without the FHLB loans, the few competitive S&Ls

109. See *id.* §§ 5, 6(i), 47 Stat. at 727, 729.

110. See *id.* § 21(a)-(d), 47 Stat. at 738. Under Act of June 25, 1948, ch. 645, § 21, 62 Stat. 862, criminal penalties were transferred to Title 18 of the U.S.C.

111. See Malloy, *supra* note 13, at 726; C. Kindleberger, *Manias, Panics, and Crashes* 3-7 (1978).

112. See United States Savings & Loan League, *Savings and Loan Fact Book* 1955, at 9.

113. 75 Cong. Rec. 12,627 (1932).

114. See 75 Cong. Rec. 12,619 (1932). Rep. LaGuardia read the following letter from a constituent:

Dear Congressman: The New York Tribune this morning on the front page indicates a loan has been made by the Reconstruction Finance Corporation to Prudence Co. (Inc.) of New York. . . . [I]sn't there some way you and your fearless coterie in the House can stop the raids of these crooks on Government money? I had a mortgage from one of this crowd's affiliated companies on a little house in Brooklyn. . . . When I lost my job . . . they foreclosed, sold me out

I couldn't get \$3,500 to save my house, but [Prudence Co.] can get four hundred and twenty-eight times that much to hold their high-paying jobs and swing along until after the depression is over and then wade in for the kill.

Id.

115. See Ornstein, *supra* note 16, at 35.

would have garnered all the scarce funds available, resulting in even more foreclosures by the S&Ls that were unable to compete. The Act thus relieved political pressure by rescuing homeowners, and it simultaneously curried public favor by accomplishing the popular New Deal objective of decreasing market competition.¹¹⁶

Third, the structure and condition of the Act reveal that it was formulated in response to a crisis situation, and a close examination reveals that it is an amalgam of other regulatory legislation. For example, the structure of the RFC's regulatory board¹¹⁷ is similar to that of the FHLBB¹¹⁸ despite the obvious differences in the needs of homeowners and farmers.¹¹⁹ Likewise, the penalty scheme of the FHLB Act¹²⁰ is quite similar to the scheme created under the National Bank Act of 1864,¹²¹ despite the obvious differences between S&Ls and banks.¹²² Such patchwork legislation was ill-suited to the unique characteristics of the S&L industry.

C. *Home Owner's Loan Act of 1933*

The year 1933 brought even more drastic measures to cushion the effects of the Depression and foster economic recovery. In March, President Roosevelt declared the Banking Holiday,¹²³ which "drew a line of demarcation between all financial institution history which had gone before and any which would come after."¹²⁴ With the economy still reeling, however, additional S&L regulatory legislation was passed.

1. Purpose

By April 1933, an estimated forty percent of home mortgages were in default, with a resulting epidemic of foreclosures by home-financing institutions.¹²⁵ Congress responded by enacting the Home Owners' Loan Act ("HOLA")¹²⁶ on June 13, 1933.¹²⁷ Its primary purpose was "to protect

116. See Fischel, Rosenfield, and Stillman, *The Regulation of Banks and Bank Holding Companies*, 73 Va. L. Rev. 301, 303 (1987); Isaac, *The Role of Deposit Insurance in the Emerging Financial Services Industry*, 1 Yale J. on Reg. 195, 197 (1984).

117. See *supra* notes 54-56 and accompanying text.

118. See *supra* notes 88-99 and accompanying text.

119. See 75 Cong. Rec. 12,617 (1932).

120. See FHLB Act, *supra* note 83, § 21, 47 Stat. at 738-39.

121. See ch. 106, § 55, 13 Stat. 99, 116 (1864).

122. See 75 Cong. Rec. 12,724 (1932)(letter of Chester Morrell, Secretary of the Federal Reserve Board).

123. Proclamation No. 2040, 48 Stat. 1691 (1933); see also Burck and Silberman, *Why the Depression Lasted So Long*, in *Great Depressions* 142, 144 (J. Sperlberg ed. 1966)(The holiday was prompted by the fact that "[i]n the first two months of 1933 [money] hoarding increased by \$900 million, and the merest rumor was enough to start a run on a bank.").

124. Ewalt, *supra* note 36, at 92.

125. See *id.* at 36-37.

126. Ch. 64, 48 Stat. 128 (1933)(codified as amended in 12 U.S.C. §§ 1461-1464).

127. Three days later, Congress created the Federal Deposit Insurance Corporation under the Banking Act of 1933, ch. 89, § 8, 48 Stat. 162, 168 (codified at 12 U.S.C.,

small-home owners from foreclosure and to relieve them of a portion of the burden of excessive interest and principal payments incurred during the period of higher values and higher earning power.”¹²⁸ In addition, HOLA was intended “to encourage thrift . . . and to build up a great cooperative financial structure, dealing strictly with homes.”¹²⁹

2. Structure and Powers

HOLA created the Home Owners’ Loan Corporation (“HOLC”),¹³⁰ which was empowered to acquire home mortgages in exchange for tax-exempt bonds.¹³¹ The HOLC, as holder of the mortgages, then allowed the mortgagors a longer period of repayment, which decreased the mortgagors’ monthly payments.¹³² In addition, mortgage principal payments were deferred for three years to ease mortgagors’ financial distress.¹³³ The HOLC was also authorized to make cash advances to mortgage holders to pay taxes and real estate assessments.¹³⁴ This structure thus protected the homeowner—who could more readily meet the favorable terms offered by the HOLC—from foreclosure.¹³⁵

The HOLA also authorized the FHLBB to provide for the “organiza-

distributed throughout chapters 2, 3, and 6). The practice of insuring deposits was initiated because the public lacked confidence in the banking system and was thus afraid to deposit money that could be used for investment. Banks also hesitated to lend money for investment because they feared that the loans might not be repaid. Deposit insurance restored confidence in the system and therefore contributed to credit expansion. See H.R. Rep. No. 150, 73rd Cong., 1st Sess. 6 (1933).

128. 77 Cong. Rec. 1618 (1933)(letter from President Franklin Roosevelt); see also First Fed. Sav. & Loan Ass’n v. Loomis, 97 F.2d 831, 840 (7th Cir. 1938)(upholding Congress’ authority to enact HOLA because of the need to protect home owners, and to preserve and promote a sound home financing system).

129. S. Doc. No. 74, 73rd Cong., 1st Sess. 3 (1933); see also H.R. Doc. No. 448, 78th Cong., 2nd Sess. 5 (1944)(“while Home Owners’ Loan Corporation was created primarily for the direct relief to home owners, it was also regarded as a financing device for the effective rehabilitation of a dangerously undermined mortgage structure.”).

130. See Home Owners’ Loan Act of 1933 [hereinafter HOLA], ch. 64, § 4(a), 48 Stat. 128, 129; see also H.R. Doc. No. 448, 78th Cong., 2d Sess. (1944)(HOLC’s annual report to Congress); H.R. Doc. No. 668, 78th Cong., 2d Sess. (1944) (same); H.R. Doc. No. 71, 79th Cong., 1st Sess. (1945)(same).

131. See HOLA, *supra* note 130, §§ 4(b)- (d), 48 Stat. at 129-30. Section 4(b) granted the FHLBB the authority to determine the amount of stock to be held by the HOLC, and Congress set the interest rate ceiling on the bonds at four percent. See *id.* § 4(b)-(c), 48 Stat. at 129.

132. See *id.* § 4(d)(2), 48 Stat. at 130.

Each home mortgage or other obligation . . . shall be carried as a first lien or refinanced as a home mortgage by the Corporation . . . and shall be amortized by means of monthly payments sufficient to retire the interest and principal within a period of not to exceed fifteen years. . . . The Corporation may at any time grant an extension of time to any home owner for the payment of any installment of principal or interest owed by him to the Corporation.

Id.

133. See HOLA, *supra* note 130, § 4(d), 48 Stat. at 130.

134. See *id.* § 4(d)(2), 48 Stat. at 130.

135. The HOLC’s programs, however, were obvious targets of corruption—many homeowners stopped making mortgage payments in the hopes of meeting HOLC criteria

tion, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations.'¹³⁶ Federal S&Ls were granted automatic membership in the FHLB system¹³⁷ and also enjoyed tax exemptions on certain assets.¹³⁸ In order to establish the federal S&L system, Congress gave the FHLBB the discretion to issue charters¹³⁹ only to those institutions of good moral character and only for S&Ls in areas where there was a probability of usefulness and success.¹⁴⁰ These powers were later interpreted as authorizing the FHLBB to make branching decisions as well.¹⁴¹

Moreover, HOLA allowed state-chartered S&Ls that were members in the FHLB system to convert to federal charters,¹⁴² a provision that proved troublesome on two grounds. First, federally chartered S&Ls eventually sought to convert to state charters, which raised federalism questions between federal and state regulators. Congress resolved this issue when it amended HOLA to allow for this conversion.¹⁴³ Second, S&Ls converting from federal to state charters questioned the FHLBB's authority to oversee the federal-to-state conversion process. The courts agreed with the S&Ls and found that the FHLBB lacked this power.¹⁴⁴

The FHLBB was empowered to liquidate or appoint a receiver or conservator for any federal S&L without a prior hearing.¹⁴⁵ Congress, how-

so that their mortgages could be assumed on more favorable terms. *See Ewalt, supra* note 36, at 41.

136. HOLA, *supra* note 130, § 5(a), 48 Stat. at 132; *see also* Durnin v. Allentown Fed. Sav. & Loan Ass'n, 218 F.Supp. 716, 718 (E.D. Pa. 1963) ("A federal savings and loan association is without doubt an instrumentality of the United States.").

137. *See* HOLA, *supra* note 130, § 5(f), 48 Stat. at 133.

138. *See id.* § 5(h), 48 Stat. at 133-34.

139. Chartering is the practice of establishing [an] entity designed to engage in the functions of a depository institution. A regulatory official or agent must review the charter and approve it before it can engage in such business, with the consequence that these rules amount to a restriction on entry into the market. 1 M. Malloy, *supra* note 25, § 1.3, at 22 n.1.

140. *See* HOLA, *supra* note 130, § 5(e), 48 Stat. at 133; *see also* Federal Home Loan Bank Bd. v. Rowe, 284 F.2d 274, 275 (D.C. Cir. 1960) ("A delicate balance of the Board's judgment clearly was required in determining the likelihood of successful operations, not only for the welfare of shareholders in the association but with regard to the possible impairment of confidence in the stability of other thrift institutions."). Current rules and regulations for federal S&Ls are found in 12 C.F.R. ch. V (1990).

141. *See supra* note 92; *see also* Central Sav. & Loan Ass'n v. Fed. Home Loan Bank Bd., 293 F.Supp. 617, 623 (S.D. Iowa 1968) ("[I]t is abundantly clear that decisions with respect to applications for charters, branches . . . and similar matters relating to federal savings and loan associations are committed to the exclusive discretion of the Board."), *aff'd*, 422 F.2d 504 (8th Cir. 1970).

142. *See* HOLA, *supra* note 130, § 5(i), 48 Stat. at 134.

143. *See* Act of July 3, 1948, ch. 825, 62 Stat. 1239 (codified as amended in 12 U.S.C. § 1464(i)).

144. *See, e.g.,* Federal Home Loan Bank Bd. v. Greater Delaware Valley Fed. Sav. & Loan Ass'n, 277 F.2d 437, 439-40 (3rd Cir. 1960) (federal S&L under investigation could convert to state charter despite FHLBB protest because federal-to-state conversion process governed by state financial agencies).

145. *See* HOLA, *supra* note 130, § 5(d), 48 Stat. at 133; *see also* Fahey v. Calverley, 208 F.2d 197, 200 (9th Cir. 1953) ("A receivership proceeding is never an end in itself, but

ever, recognized that this power was drastic and should be used only in extreme circumstances.¹⁴⁶ Eventually, the constitutionality of the liquidation/receivership power was challenged on due process grounds, and was upheld in *Fahey v. Mallonee*.¹⁴⁷

HOLA also imposed penalties for embezzlement, falsification of records or overvaluation of securities¹⁴⁸ in a fashion similar to the National Bank Act of 1864, the RFC Act and the FHLB Act. Finally, HOLA provided for the liquidation of the HOLC after the objectives of HOLA had been accomplished. The FHLBB was directed to oversee the liquidation and to pay any surplus of funds into the United States Treasury.¹⁴⁹

3. Reactive Theory

The economic conditions of 1933 support the inference of reactive legislation. Congressional statements, however, as well as HOLA's very structure, further attest to its enactment as a curative measure, rather than as an addition to a regulatory framework.

Congress admittedly passed HOLA in response to the rash of foreclosures between 1932 and 1933.¹⁵⁰ Furthermore, provisions in HOLA (including the creation of the HOLC) were to take effect seven to ten days after the law was passed.¹⁵¹ This indicates that Congress was attempting to solve a pressing problem. Finally, the provision requiring the liquidation of the HOLC¹⁵² was not designed to strengthen the S&L industry in the future. Rather, the HOLC was originally designed to remedy the problems of the past, with no contribution to an enduring S&L industry. Moreover, to the extent that HOLA was a vehicle for the creation of the HOLC, the same is also true for HOLA.

is always ancillary to a principal proceeding." (citation omitted)), *cert. denied*, 347 U.S. 955 (1954).

146. Congress noted that impending S&L failures constituted an emergency situation such that

the [FHLBB] has no alternative but to move in quickly and take control of the association to conserve the assets for the protection of the shareholders. Absent a genuine emergency, [FHLBB] action of this kind is arbitrary and unlawful, and bespeaks a callous disregard for the ruinous consequences of summary seizure action, which inevitably includes a 'run' on the association by panicked depositors, the disruption of business and community relationships carefully built up over the years by the association, and rapid depletion of its assets.

H.R. Rep. No. 2083, 86th Cong., 2d Sess. 7 (1960).

147. 332 U.S. 245 (1947). See *infra* notes 232-240 and accompanying text for a further discussion of this case.

148. See HOLA, *supra* note 130, § 8, 48 Stat. at 134-35.

149. See *id.* § 4(k), 48 Stat. at 132.

150. See S. Doc. No. 74, 73rd Cong., 1st Sess. 3 (1933) ("Home Owners' Loan Corporation is for the relief of home owners in distress with their mortgages.").

151. See *id.*

152. See HOLA, *supra* note 130, § 4(k), 48 Stat. at 132. The HOLC was abolished in Act of June 30, 1953, ch. 170, § 21, 67 Stat. 126.

D. *National Housing Act of 1934*

1. Purpose

After conducting hearings on financing and employment in the housing field,¹⁵³ Congress enacted the National Housing Act ("NHA").¹⁵⁴ Its overall purposes were to improve national housing and to stimulate the sluggish economy. Specifically, the Act targeted the home finance industry, seeking to prevent risky new mortgages and to decrease the need for second mortgages.¹⁵⁵ The NHA also sought to provide home owners with funds for home maintenance and improvement.¹⁵⁶ Congress felt that these objectives could best be achieved by restoring confidence in the S&L system through an insurance program.¹⁵⁷ In sum, the Act insured financial institutions and mortgages to induce lending,¹⁵⁸ and insured deposits to provide the S&Ls with the funds necessary to make loans.¹⁵⁹

2. Structure and Powers

The NHA established the Federal Housing Administration ("FHA") and the position of Administrator of the FHA.¹⁶⁰ The Administrator was authorized to incur a total liability of \$200 million for the FHA by insuring eligible financial institutions against losses on defaulted loans.¹⁶¹ Once an institution obtained insurance, it could also secure loans from the FHA by using its own mortgages as collateral.¹⁶²

Title II of the NHA created the Mutual Mortgage Insurance Fund ("MMIF"), a revolving fund of up to \$1 billion used to carry out the

153. See H.R. Rep. No. 1922, 73rd Cong., 2d Sess. 1 (1934).

154. Ch. 847, 48 Stat. 1246 (1934)(codified as amended in 12 U.S.C. §§ 1701-1730).

155. See H.R. Rep. No. 1922, 73rd Cong., 2d Sess. 1 (1934).

156. See *id.* at 2. In furtherance of this goal, the NHA amended the FHLB Act to authorize FHLBs to make home improvement loans. National Housing Act [hereinafter NHA], ch. 847, § 502, 48 Stat. 1246, 1261 (1934).

157. H.R. Rep. No. 1922, 73rd Cong., 2d Sess. 2 (1934).

158. See *infra* notes 161-171 and accompanying text.

159. Some members of Congress, however, realized the potential for losses in the billions under this insurance scheme. See 78 Cong. Rec. 11,194 (1934)(statement of Rep. Hancock)("I wish [Rep. Cavicchia] would state to the House what in his opinion would be the potential liability of the United States Government if we . . . permitted the Government to guarantee or insure mortgages, old and new, to an unlimited amount, with possible losses up into the billions?").

160. See NHA, *supra* note 156, § 1, 48 Stat. at 1246.

161. See *id.* § 2, 48 Stat. at 1246. The Administrator was empowered to insure banks, trust companies, personal finance companies, mortgage companies, building and loan associations, installment lending companies, and other such financial institutions, which are approved by him as eligible for credit insurance, against losses which they may sustain as a result of loans and advances of credit, and purchases of obligations representing loans and advances of credit, made by them subsequent to the date of the enactment of this Act and prior to January 1, 1936

Id.

162. See *id.* § 3, 48 Stat. at 1247.

other provisions of Title II.¹⁶³ Under those provisions, the Administrator was empowered to insure the mortgages of eligible financial institutions¹⁶⁴ and to promulgate rules and regulations necessary to achieve the purposes of the Act.¹⁶⁵ In addition, the Administrator was authorized to insure mortgages for property held by federal or state governments if used to provide low income housing.¹⁶⁶ These mortgages were not subject to the eligibility requirements imposed on ordinary financial institutions.¹⁶⁷

Under the NHA scheme, when a mortgagor defaulted on his obligation, the financial institution would convey the mortgage or the title of the foreclosed property to the FHA.¹⁶⁸ In return, the FHA reimbursed the institution for the unpaid principal on the mortgage, plus all payments made by the institution for taxes and insurance on the property.¹⁶⁹ In addition, the institution received a redeemable "certificate of claim" for an amount, determined by the Administrator, equal to the expected return if the mortgagor had honored the obligation.¹⁷⁰

The NHA also provided for the insurance of S&L accounts. Title IV established the Federal Savings and Loan Insurance Corporation ("FSLIC") to administer this function:

There is hereby created a Federal Savings and Loan Insurance Corporation . . . which shall insure the accounts of institutions eligible for insurance as hereinafter provided, and shall be under the direction of a board of trustees The members of the Federal Home Loan Bank Board shall constitute the board of trustees of the Corporation¹⁷¹

The FSLIC issued capital stock in the amount of \$100 million, divided into shares of \$100 each.¹⁷² The NHA then amended HOLA to provide the HOLC with the funds needed to subscribe for the full amount of the FSLIC stock.¹⁷³

Title IV required that any S&L seeking deposit insurance had to apply

163. *See id.* §§ 202, 203, 48 Stat. at 1248.

164. *See id.* § 203(b), 48 Stat. at 1248 (seven eligibility requirements for insurance coverage under Title II).

165. *See id.* § 203(d); *see also supra* notes 91, 96-97 and accompanying text (Federal Home Loan Banks and the FHLBB held similar powers).

166. *See NHA, supra* note 156, § 207, 48 Stat. at 1252.

167. *See id.*

168. *See id.* § 204(a), 48 Stat. at 1249. The Administrator was permitted to trade, handle or dispose of real property "[n]otwithstanding any other provision of law." *Id.* § 204(e), 48 Stat. at 1250. Where the institution failed to turn over the title, or where the mortgagor paid in full, the institution's rights under Section 204 terminated. *See id.* § 205(f), 48 Stat. at 1250.

169. *See id.* § 204(a), 48 Stat. at 1249.

170. *See id.* § 204(c), 48 Stat. at 1250.

171. *Id.* § 402(a), 48 Stat. at 1256; *see also* *Federal Sav. & Loan Ins. Corp. v. Third Nat'l Bank in Nashville*, 153 F.2d 678, 680-81 (6th Cir. 1946) (recognizing FSLIC as an instrumentality of the United States).

172. *See NHA, supra* note 156, § 402(b), 48 Stat. at 1256.

173. *See id.* § 506(a), 48 Stat. at 1263-64.

to the FSLIC and submit to an examination of its financial condition.¹⁷⁴ The FSLIC was directed to reject the application of any institution (1) if its financial policies were unsafe or (2) if the "character" of the management was inconsistent with the goals of Title IV.¹⁷⁵ Deposits at approved institutions were insured up to \$5000 for any one investor/depositor.¹⁷⁶

The Act placed various restrictions on S&Ls whose deposits were insured by the FSLIC. First, it required insured S&Ls to maintain "adequate" reserves, as designated under the FSLIC's regulations.¹⁷⁷ Second, insured S&Ls were prohibited from making loans outside a fifty-mile radius of their principal office.¹⁷⁸ Finally, insured S&Ls could not issue instruments with a guaranteed yield or fixed maturity date without FSLIC approval.¹⁷⁹

Under Title IV, depositors in an insured S&L received insurance payouts in the event of the institution's failure.¹⁸⁰ Upon default, the FSLIC could either (1) notify each account holder of a new insured account in another institution (if an institution willing to assume the accounts could be found)¹⁸¹ or (2) pay the account holder 10% in cash, 50% of the remainder within one year, and the balance in non-interest-bearing bonds within three years.¹⁸² An institution could withdraw from the FSLIC membership by written notice to the FSLIC. In addition, the FSLIC was authorized to terminate the insurance coverage of any institution found to be in violation of the provisions of the NHA.¹⁸³

The FSLIC was also empowered to liquidate any insured institution, state or federal, or to act as a conservator or receiver for federal S&Ls.¹⁸⁴ Where state-chartered S&Ls were federally insured, only state courts had

174. *See id.* § 403(b), 48 Stat. at 1257-58.

175. *See id.* § 403(c), 48 Stat. at 1258.

176. *See id.* § 405(a), 48 Stat. at 1259.

177. *See id.* § 403(b), 48 Stat. at 1257-58. The reserve requirement was in addition to premium payments on the insurance itself, which were set out in Section 404 of the NHA. *See id.* § 404, 48 Stat. at 1258.

178. *See id.* § 403(b), 48 Stat. at 1258.

179. *See id.*

180. *See id.* § 405(b), 48 Stat. at 1259.

181. *See id.* § 405(b), 48 Stat. at 1259. This procedure is known as a "Purchase and Assumption Transaction." *See Phillips, Asserting and Defending Claims Involving an FSLIC Relationship*, 20 St. Mary's L.J. 827, 835 (1989).

182. *See NHA, supra* note 156, § 405(b), 48 Stat. at 1259; *see also* Federal Sav. & Loan Ins. Corp. v. Huttner, 401 F.2d 58, 61-62 (7th Cir. 1968) (FSLIC does not insure expected earnings on savings deposits; FSLIC membership does not "convert the status of association members from that of investors to that of creditors" of FSLIC).

183. *See NHA, supra* note 156, § 407(b), 48 Stat. at 1261. In cases of involuntary termination, insurance coverage continued for a period of five years on already existing accounts. *See id.* § 407(b), 48 Stat. at 1261.

184. *See id.* § 406, 48 Stat. at 1259; *see also* Phillips, *supra* note 181, at 833 (describing FSLIC's powers as receiver or conservator). Allowing a conservator or receiver under FSLIC "in no way amend[ed] the provisions of Section 5 of the Home Owners' Loan Act, whereby the [FHLBB was] authorized to provide in its rules and regulations for the appointment of a conservator and for the merger, consolidation, etc., of savings and loan

the power to appoint a conservator or receiver; however, the state court was allowed to designate the FSLIC for this purpose.¹⁸⁵ Once the FSLIC seized the institution as a receiver or conservator, it was empowered to continue the business of the insured S&L, including settling and releasing claims for or against the S&L.¹⁸⁶ The FSLIC could do "all other things necessary" to effect the receivership or conservatorship, and was subject only to the authority of the court or other public authority.¹⁸⁷ Finally, the NHA authorized the FSLIC to impose both fines and imprisonment for embezzlement, falsification of documents, forgery or other crimes perpetrated against either the FHA or the FSLIC.¹⁸⁸

3. Reactive Theory

Three factors support the theory that the NHA, like its predecessors, was a response to an economic crisis. First, the economy was still suffering from the effects of the Depression, and therefore S&Ls needed additional protection.¹⁸⁹ Consequently, Congress was compelled to legislate until there was some positive effect on the economy. The NHA "represents another major attack by the administration in the struggle to overcome the forces of destruction to bring about a restoration of normal employment conditions in the United States."¹⁹⁰

Second, despite the legislation recently enacted, the public still lacked confidence in the S&L industry. The insurance provisions of the NHA were thus designed to foster confidence,¹⁹¹ a goal that spoke more to the

associations . . ." Home Loan Bank Bd. v. Mallonee, 196 F.2d 336, 342-43 n.3 (9th Cir. 1952), *cert. denied*, 345 U.S. 952 (1953).

185. See NHA, *supra* note 156, § 406(c), 48 Stat. at 1260.

186. See *id.* § 406(d), 48 Stat. at 1260.

187. See *id.* If the district court finds that it is without jurisdiction to hear the claim, the receivership will fail. See Fahey v. Calverley, 208 F.2d 197, 200 (9th Cir. 1953), *cert. denied*, 347 U.S. 955 (1954).

188. See NHA, *supra* note 156, § 512, 48 Stat. at 1265.

189. See Ewalt, *supra* note 36, at 26.

The fact that the peak of savings and loan mortality occurred in 1933 is noteworthy; the new Washington aids—the Federal Home Loan Bank System and the federal chartering of associations—were too new at that time to exert leadership in pulling associations out of their troubles. It was too soon for the new state laws, designed to help savings and loan institutions survive the depression, to be fully implemented . . .

Id.

190. 78 Cong. Rec. 11,191 (1934)(statement of Rep. Steagall).

191. See, e.g., 77 Cong. Rec. 4032 (1933) (statement of Rep. Fuller).

This panic, causing general bank failures, has caused the people to lose confidence in banks. The best way to restore that confidence is to examine strictly and regulate banking and guarantee the deposits of all banks sufficiently solvent to pass a rigid examination. We should make it impossible for banks to accept deposits, fail, and pay only a small percentage.

Id. See also H.R. Rep. No. 150, 73rd Cong., 1st Sess. 6 (1933)(statement of Rep. Steagall)("The public is afraid to deposit their money in the banks, and the banks are afraid to employ their deposits in the extension of bank credit for the support of trade and commerce.").

immediate needs of the economy than to the structural soundness of the S&L system.

Finally, there was a general concern that S&Ls would be unable to compete with banks, whose deposits had been insured under the Banking Act of 1933.¹⁹² Without deposit insurance for S&Ls, depositors would simply transfer funds to banks, eventually leading to the demise of the S&L industry.¹⁹³ Because S&Ls were recognized as an integral part of the housing industry,¹⁹⁴ Congress had no choice but to pass the NHA.

E. Other Legislation of Interest

1. Servicemen's Readjustment Act of 1944

The Servicemen's Readjustment Act of 1944¹⁹⁵ was enacted to help veterans obtain housing.¹⁹⁶ Under the Act, the Administrator of Veterans' Affairs was authorized to guarantee up to fifty percent of any mortgage to a veteran.¹⁹⁷ Moreover, the Administrator was directed to make the interest payments on the portion of the mortgage guaranteed under the Act.¹⁹⁸ Finally, the maximum interest rate on guaranteed loans was set at four percent.¹⁹⁹ These provisions helped achieve the Act's goals by effectively allowing smaller downpayments and longer repayment periods for veterans.²⁰⁰

2. Administrative Procedure Act of 1946

Congress had been considering a uniform procedural structure for the various government agencies for more than ten years.²⁰¹ In light of the

192. Ch. 89, 48 Stat. 162 (codified at 12 U.S.C., distributed throughout chapters 2, 3, and 6); see also Isaac, *The Role of Deposit Insurance in the Emerging Financial Services Industry*, 1 Yale J. on Reg. 195, 197 (1984).

Underlying much of the new legislation was a pervasive belief—which extended to nonfinancial fields—that excessive competition was a primary cause of the economic collapse. The new system was intended, among other things, to restrain competition, not only among financial industry groups but also within the banking industry itself.

Id. (footnote omitted).

193. See Long, Schilling, and Van Cleef, *Enhancing the Value of the Thrift Franchise: A Possible Solution for the Dilemma of the FSLIC?*, 37 Cath. U.L. Rev. 385, 392-93 (1988).

194. See generally 75 Cong. Rec. 12,607 (1932)(statement of Rep. Hancock)("There are four major sources of first-mortgage loans on small homes in this country. The largest single source is the building and loan association. . . .").

195. Ch. 268, 58 Stat. 284 (codified as amended 38 U.S.C. § 1801 et seq.).

196. See Ewalt, *supra* note 36, at 237.

197. Servicemen's Readjustment Act of 1944, ch. 268, § 500(a), 58 Stat. 284, 291.

198. See *id.* § 500(b), 58 Stat. at 291.

199. See *id.* § 500(c), 58 Stat. at 291.

200. See generally Ewalt, *supra* note 36, at 244-245 ("Over the years during which the veterans proved to be remarkably good risks, the associations came to realize they needed to reexamine many of their previous notions about loan percentages and maturities.").

201. See H.R. Rep. No. 1980, 79th Cong., 2d Sess., reprinted in 1946 U.S. Code Cong. & Admin. News 1195.

emergence of an administrative state resulting from the New Deal legislation, government bodies called for clear guidelines, so that procedure would be consistent throughout the federal administrative bodies.²⁰² This was especially true for banking regulatory agencies, because “[t]he nature of banking and of the public interest in banks shape the procedural aspects of bank supervision in forms different from those encountered in other branches of administrative regulation.”²⁰³

Congress responded to this need by enacting the Administrative Procedure Act (“APA”),²⁰⁴ which organized all federal agencies under the same set of procedural rules. First, the APA required that each agency describe its organizational and procedural structure, as well as the rules, regulations and general policies promulgated by it under the law.²⁰⁵ Second, the Act specified the procedure to be followed for administrative hearings²⁰⁶ and the circumstances under which a party might seek judicial review.²⁰⁷ Specifically, judicial review was not available where the action in question was within the agency’s discretion.²⁰⁸ If not otherwise limited by law, however, the reviewing court was given the power to compel any agency action that was withheld, and to set aside agency actions violating the Constitution or without support in fact or law.²⁰⁹

3. Reorganization Plan No. 3 of 1947

By 1947, it had become apparent that the functions of the various federal housing agencies were interrelated, and that the existing structure was “established piecemeal over a period of years.”²¹⁰ Consequently, Congress sought to consolidate the various housing-related agencies into one governmental unit. The Reorganization Plan No. 3 of 1947 (the “Plan”)²¹¹ merged the FHLBB, HOLC, the FSLIC, FHA, United States Housing Authority, Defense Homes Corporation, and United States Housing Corporation into one agency called the “Housing and Home Finance Agency.”²¹² Those entities were then abolished as independent agencies²¹³ and re-established as constituent agencies within the Housing and Home Finance Agency.²¹⁴ The Administrator of the Housing and

202. See S. Rep. No. 752, 79th Cong., 1st Sess. 298 (1945).

203. Monograph No. 13, S. Doc. No. 186, 76th Cong., 3rd Sess. 42 (1940-41).

204. Ch. 324, 60 Stat. 237 (1946) (dispersed throughout Title 5 U.S.C.). See generally Malloy, *supra* note 13, at 724-25 (examining “the hearing practices and procedures of the federal regulators in the enforcement context, under the [APA]”).

205. See Administrative Procedure Act, *supra* note 204, § 3, 60 Stat. at 238.

206. See *id.* §§ 7, 8, 60 Stat. at 241-42.

207. See *id.* § 10, 60 Stat. at 243.

208. See *id.*

209. See *id.* § 10(e), 60 Stat. at 243.

210. 1947 U.S. Code Cong. & Admin. News 1839, 1840 (President Truman’s letter to Congress).

211. 61 Stat. 954 (1947)(codified at 5 U.S.C. §§ 133y-133y-16).

212. See Reorganization Plan No. 3 of 1947, § 1, 61 Stat. 954.

213. See *id.* § 9, 61 Stat. at 956.

214. See *id.* § 1, 61 Stat. at 954.

Home Finance Agency was charged with organizing and coordinating the functions of these constituent agencies.²¹⁵ In addition, the Plan created the National Housing Council to promote consistency among the various agencies.²¹⁶

Under the Plan, the structure of the "constituent" Board (the Home Loan Bank Board) was also altered. It now consisted of only three members, who were appointed by the President subject to Senate approval.²¹⁷ The Plan then transferred to the Board the functions of the the FHLBB, the Board of Directors of the HOLC and the Board of Trustees of the FSLIC.²¹⁸ However, this reorganization understandably caused confusion among both the courts and financial institutions, and yielded a few unintended results.²¹⁹ Eventually, the FHLBB (and thus the FSLIC)²²⁰ regained autonomy in 1955, when the FHLBB was re-established as an independent government agency.²²¹

III. 1950-1959

During the 1950s, the government continued the policy of "easy money" begun in the late 1940s.²²² Consequently, although the economy experienced inflation and a few relatively minor recessions,²²³ the decade was characterized by a great increase in productivity: During the 1950s, personal income, consumption expenditures and personal savings expanded with few exceptions.²²⁴ In this favorable atmosphere, where economic conditions no longer threatened the existence of the S&L industry, individual S&Ls were able to challenge the provisions of the regulatory legislation that had arisen under the New Deal.

A. *The Mallonee Litigation*

The *Mallonee* litigation involved a series of cases centered around Long Beach Federal Savings and Loan Association ("Long Beach"),²²⁵

215. *See id.* § 5(b), 61 Stat. at 955.

216. *See* Administrative Procedure Act, *supra* note 204, § 6, 60 Stat. at 240.

217. *See id.* § 2(a), 61 Stat. at 954.

218. *Id.* § 2(c), 61 Stat. at 954.

219. *See* Howard v. United States, 195 F.2d 974, 975-76 (9th Cir. 1952)(S&L president could not be convicted of filing a false report with the FHLBB because at the time the report was made, the FHLBB had been technically abolished under the Plan).

220. The board of trustees of the FSLIC was composed of the members of the FHLBB. *See* NHA, *supra* note 156, § 402(a), 48 Stat. at 1256.

221. Housing Amendments of 1955, ch. 783, § 109(b), 69 Stat. 635, 640 (codified as amended in 12 U.S.C. § 1437(B)); *see also* H.R. Rep. No. 913, 84th Cong., 1st Sess. (1955), *reprinted in* 1955 U.S. Code Cong. & Admin. News 2902, 2926 (because the Board was originally created as an independent agency, and because it remained "self-supporting," it was restored to independent status).

222. *See* 4 Documentary History of Banking and Currency in the United States 324-25 (H. Krooss ed. 1983).

223. *See id.* at 326.

224. *See* United State Savings & Loan League, Savings and Loan Fact Book 1960, at 11.

225. Long Beach was chartered as a federal mutual S&L on July 10, 1934. Federal

the FHLBB and the legislation granting the FHLBB its various regulatory powers. In May 1946, the FHLBB, without notice or a hearing, placed Long Beach under conservatorship,²²⁶ apparently because it felt that the association was engaging in unsound practices.²²⁷ In response, the association commenced a class action suit in the name of Mallonee (a shareholder) against Fahey (chairman of the FHLBB) and Ammann (the conservator), among others.²²⁸ The principal claims of the suits concerned the constitutionality of Section 5(d) of HOLA,²²⁹ which authorized conservatorships, the propriety of the FHLBB's appointment of Ammann as conservator, and the district court's jurisdiction to review the FHLBB's decisions.²³⁰ The decisions issued in the *Mallonee* litigation left unanswered several questions that were later addressed in the Housing Act of 1954,²³¹ but it did help solidify the various powers granted to the FHLBB under the extant S&L regulatory legislation.

In *Fahey v. Mallonee*,²³² the Supreme Court upheld the constitutionality of Section 5(d) of HOLA²³³ on three grounds. First, the Court ex-

Home Loan Bank Bd. v. Elliott, 386 F.2d 42, 44 (9th Cir. 1967), *cert. denied*, 390 U.S. 1011 (1968).

226. See *Fahey v. Mallonee*, 332 U.S. 245, 247 (1947). The FHLBB was given the authority to place an unsound S&L under conservatorship in HOLA, *supra* note 130, § 5(d), 48 Stat. at 133.

Ironically, Long Beach Federal was again placed under conservatorship in 1960. See *Federal Home Loan Bank Bd. v. Elliott*, 386 F.2d 42, 44-45 (9th Cir. 1967), *cert. denied*, 390 U.S. 1011 (1968). Consequently, there was a run on deposits and Long Beach lost \$37 million in withdrawals in the first four or five weeks of the takeover. See H.R. Rep. No. 2083, 86th Cong., 2d Sess. 7 (1960). Long Beach was eventually allowed to convert to a state charter despite protest from the FHLBB. See *id.* at 14.

227. See *Fahey v. Mallonee*, 332 U.S. 245, 247 (1947).

Generally speaking, an 'unsafe or unsound practice' embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

112 Cong. Rec. 26,474 (1966).

228. See *Mallonee v. Fahey*, 68 F. Supp. 418 (S.D. Cal. 1946), *rev'd*, 332 U.S. 245 (1947).

229. See *supra* notes 145-147 and accompanying text.

230. The litigation lasted almost ten years, involving over 50 interpleaders and generating over 100 hearings. See *Home Loan Bank Bd. v. Mallonee*, 196 F.2d 336, 369 (9th Cir. 1952), *cert. denied*, 345 U.S. 952 (1953).

231. See *infra* notes 248-273 and accompanying text.

232. 332 U.S. 245 (1947); see also *Home Loan Bank Bd. v. Mallonee*, 196 F.2d 336, 355 (9th Cir. 1952)(summarizing the Court's seventeen holdings in *Fahey v. Mallonee*), *cert. denied*, 345 U.S. 952 (1953).

233. Ch. 64, § 5(d), 48 Stat. 128, 133 (1933). Section 5(d) provides:

The Board shall have full power to provide in the rules and regulations herein authorized for the reorganization, consolidation, merger, or liquidation of such associations, including the power to appoint a conservator or a receiver to take charge of the affairs of any such association, and to require an equitable readjustment of the capital structure of the same; and to release any such association from such control and permit its further operation.

plained that HOLA was clearly a regulatory, and not a penal, statute.²³⁴ In this vein, the Court stated that "discretion to make regulations to guide supervisory action in such matters may be constitutionally permissible while it might not be allowable to authorize creation of new crimes in uncharted fields."²³⁵

Second, the Court recognized the unique nature of the S&L industry, and therefore gave due deference to already-established practices for conservatorships.²³⁶ The Court noted that "the delicate nature of the institution and the impossibility of preserving credit during an investigation has made it an almost invariable custom to apply supervisory authority in this summary manner."²³⁷

Finally, the court stressed the "elementary rule" of constitutional jurisprudence that one may not obtain benefits from a law while attacking the constitutionality of a key provision.²³⁸ Consequently, Long Beach could not obtain a federal charter under HOLA and then avoid its regulatory provisions. The Court reasoned that "[i]t would be intolerable that the Congress should endow an association with the right to conduct a public banking business on certain limitations and that the Court at the behest of those who took advantage from the privilege should remove the limitations intended for public protection."²³⁹

The Supreme Court's decision, however, did not end the litigation, and the Long Beach plaintiffs continued to contest the conservator's appointment. The Supreme Court had reversed the lower court's decision and remanded the case.²⁴⁰ The lower court, however, read *Fahey v. Mallonee* as allowing the plaintiffs to attack the conservatorship if they alleged fraud by the FHLBB; the court allowed the plaintiffs to amend their complaint accordingly, and the litigation continued. By contrast, *Home Loan Bank Board v. Mallonee*²⁴¹ interpreted *Fahey v. Mallonee* as requiring the exhaustion of administrative proceedings²⁴² available within the FHLB system. Only after all such avenues were exhausted could a party seek judicial review in the district courts. Because the plaintiffs had not exhausted the proceedings available to them, the court found that it lacked jurisdiction to hear the merits of the claims.²⁴³

The litigation, however, would not die, and surfaced again in *Fahey v.*

234. See *Fahey v. Mallonee*, 332 U.S. at 250.

235. *Id.*

236. See *id.* at 253-54.

237. *Id.*

238. *Id.* at 255 (citing *United States v. San Francisco*, 310 U.S. 16, 29 (1924)).

239. *Id.* at 256.

240. See *id.* at 248, 258.

241. 196 F.2d 336 (9th Cir. 1952), *cert. denied*, 345 U.S. 952 (1953).

242. "The doctrine of exhaustion of administrative remedies requires not merely the initiation of prescribed administrative procedures; it requires pursuing them to their appropriate conclusion and awaiting their final outcome before seeking judicial intervention." *Id.* at 381.

243. See *id.*

O'Melveny & Myers.²⁴⁴ There, the plaintiffs appealed the award of interim attorneys fees to the FHLBB. The Ninth Circuit, however, used the case as an opportunity to define the nature of the S&L system created by the New Deal legislation. The court reasoned that FHLBs do not have "any sort of 'vested right' in [their own] *continued existence or status*," and that "Congress, and not the courts, may continue or end the [FHLB] System or any part of it; that Congress and not the courts may direct *how, where and when* a Home Loan Bank is to function."²⁴⁵ Because the FHLB Act did not provide for a federal-court hearing on the question of the dissolution of any FHLB, the lower court lacked subject matter jurisdiction and *in personam* jurisdiction over indispensable parties.²⁴⁶ The circuit court therefore remanded the case to the lower court with instructions to dismiss the action.

The *Mallonee* Litigation thus helped define the nature of the newly created S&L system. The Ninth Circuit was able to dismiss many claims on procedural grounds, however, and thus they never addressed some questions that the case raised.²⁴⁷ Congress responded to those issues in subsequent legislation.

B. *Housing Act of 1954*

1. Purpose

The Housing Act of 1954²⁴⁸ was enacted to achieve three specific goals. First, the Act sought to amend the National Housing Act of 1934,²⁴⁹ correcting "certain deficiencies and numerous obsolete and unnecessary provisions."²⁵⁰ Second, Congress wanted to advance its traditional goals of improving housing conditions and fostering home ownership.²⁵¹ Congress' focus, however, shifted from avoiding foreclosures, as in the 1930s, to preventing "the spread of blight into good areas of the community" and rehabilitating "salvable" areas.²⁵² Finally, the Act sought to spur the economy by combatting the effects of "no-building war years and . . . the sharp increase in families enlarged by the baby boom."²⁵³

2. Structure and Powers

The Housing Act of 1954 contains three areas of particular interest:

244. 200 F.2d 420 (9th Cir.), *cert. denied*, 345 U.S. 952 (1953).

245. *Id.* at 444 (emphasis in original).

246. *See id.* at 459 (emphasis added).

247. Specifically, the courts did not address the questions of personal jurisdiction over Fahey or the propriety of appointing Ammann as conservator. *See Home Loan Bank Bd. v. Mallonee*, 196 F.2d 336, 381 (9th Cir. 1952), *cert. denied*, 345 U.S. 952 (1953).

248. Ch. 649, 68 Stat. 590 (dispersed throughout Title 12 of the U.S.C.).

249. Ch. 847, 48 Stat. 1246 (1934)(codified as amended at 12 U.S.C. §§ 1701 et seq.).

250. 100 Cong. Rec. 738 (1954)(President Eisenhower's letter to Congress).

251. *See id.*

252. *Id.* at 737.

253. 100 Cong. Rec. 739 (1954)(statement of Rep. Bolling).

Title I, which amends the insurance powers created in the NHA; Title II, which adds new provisions to the NHA; and Title V, which deals specifically with the FHLBB.

Title I of the Act prospectively limited the insurance coverage on mortgages established under the NHA²⁵⁴ to ninety percent of total assets.²⁵⁵ In addition, Title I declared that the Commissioner of the FHA could extend loans only to those projects that protected or improved the livability of properties.²⁵⁶ Title I of the Act also modified some aspects of the Mutual Mortgage Insurance Fund created under the NHA.²⁵⁷

Title II added new provisions to the NHA that dealt largely with slum clearance and the housing shortage. Specifically, the Act supplemented the mortgage insurance available through the MMIF for home improvement and construction loans in low income areas.²⁵⁸ In addition, the Commissioner was granted discretion to release parts of the mortgaged property from the lien.²⁵⁹ To accomplish the goals of Title II, the Act created a revolving fund of one million dollars.²⁶⁰

Title V promulgated new provisions and amendments relating to the FHLBB.²⁶¹ First, the Act addressed the issue of personal jurisdiction for both the FHLBB²⁶² and the FSLIC²⁶³ by clarifying the process-serving mechanism.²⁶⁴ The Act also limited the authority of courts to hear claims involving FSLIC insurance payments:

No action against the Corporation to enforce a claim for payment of

254. See NHA, *supra* note 156, § 2, 48 Stat. 1246.

255. See Housing Act of 1954, *supra* note 248, § 101(a)(1), 68 Stat. 590.

256. See *id.* § 101(a)(2), 68 Stat. 590. Section 221(d) sets forth the specific eligibility requirements for a home improvement loan. See *id.* § 221(d), 68 Stat. at 600-01.

257. See Housing Act of 1954, *supra* note 248, § 111, 68 Stat. at 593.

258. See *id.* § 220(d)(1), 68 Stat. at 597.

259. See *id.* § 220(e), 68 Stat. at 597.

260. See *id.* § 220(g), 68 Stat. at 599.

261. The Committee on Banking and Currency noted that

[t]he Board presently has no means, except through the appointment of a conservator or receiver, to enforce the laws and regulations under which Federal savings and loan associations operate. The bill would provide a method for the enforcement of law and regulations without the necessity of the appointment of a conservator or receiver, and would also establish standards and procedures for the appointment of conservators and receivers.

S. Rep. No. 1472, 83d Cong., 2d Sess. 43 (1954). Title V of the Act was thus intended to provide the FHLBB with the additional, less drastic tools for handling unsound S&Ls. See *infra* text accompanying notes 269-272 for a description of the additional procedures created for unsound S&Ls.

262. See Housing Act of 1954, *supra* note 248, § 503(2), 68 Stat. at 634-35. See also *Home Loan Bank Bd. v. Mallonee*, 196 F.2d 336, 365 (9th Cir. 1952) (acknowledging, but failing to resolve, the question of personal jurisdiction over Fahey), *cert. denied*, 345 U.S. 952 (1953); *Fahey v. O'Melveny & Myers*, 200 F.2d 420, 459 (9th Cir. 1952) (holding that the court lacked *in personam* jurisdiction over several indispensable parties, including Fahey), *cert. denied*, 345 U.S. 952 (1953).

263. See Housing Act of 1954, *supra* note 248, § 501(1), 68 Stat. at 633.

264. Process could be effected by serving any agent of the FHLBB or the FSLIC and mailing a copy of such process to the offices of the FHLBB or the FSLIC in Washington, D.C. See *id.*

insurance upon an insured account of an insured institution in default shall be brought after the expiration of three years from the date of default unless, within such three-year period, the conservator, receiver, or other legal custodian of the insured institution shall have recognized such insured account as a valid claim against the insured institution and the claim for payment of insurance shall have been presented to the Corporation and its validity denied, in which event the action may be brought within two years from the date of such denial.²⁶⁵

In addition, the Act also limited the FHLBB's power over state-chartered S&Ls. Where the FHLBB determined that a state-chartered S&L was unsound, the Act directed that it notify the responsible state authority, which then had 120 days to correct the situation. If the authority failed to do so, or if no such authority existed, the FHLBB then had the power to terminate the S&L's insurance.²⁶⁶ This provision also required that the FHLBB hold a hearing on the matter (in accordance with the APA),²⁶⁷ and make a written report of its findings.²⁶⁸

If the S&L failed to correct its unsound condition even under the threat of termination of the FSLIC coverage, the FHLBB still had the power to appoint a conservator or receiver, but was required to appoint the FSLIC for any federal S&L.²⁶⁹ The Act clearly stated, however, that "no such appointment . . . shall be made except pursuant to a formal resolution of the [FHLBB] stating the grounds therefor . . ."²⁷⁰ The S&L simply had to be notified of a time and place for a hearing on the proposed appointment.²⁷¹ If the administrative procedures were exhausted, the FHLBB was subject to suit in a federal court on the question of the appointment,²⁷² thus addressing the issue of subject matter

265. *Id.* § 501(2), 68 Stat. at 633 (amending § 405 of the NHA).

266. *See id.* § 501(3), 68 Stat. at 633-34.

267. *See supra* notes 201-209 and accompanying text.

268. *See* Housing Act of 1954, *supra* note 248, § 501(3), 68 Stat. at 633-34; *see also* Home Loan Bank Bd. v. Mallonee, 196 F.2d 336, 341 n.2 & 350 (9th Cir. 1952)(the FHLBB's order placing Long Beach under conservatorship did not state the reasons for the decision; plaintiffs claimed they were entitled to hearing before an impartial tribunal before action was taken), *cert. denied*, 345 U.S. 952 (1953).

269. *See* Housing Act of 1954, *supra* note 248, § 503(2), 68 Stat. at 634-36 (amending § 5(d) of HOLA). The Act of 1954 also set forth the grounds for appointing a conservator or receiver: insolvency, violation of law or regulation, concealment of its books or the refusal to submit the books for inspection, and unsafe or unsound operation. *See id.*

270. *Id.* at 636. Section 503(2) also provided for a review of the appointment under the process set forth in the APA. *Id.*

271. *See id.* § 503(2), 68 Stat. at 634-35. If the FHLBB determined that an emergency existed, however, it was empowered to appoint a "Supervisory Representative" pending the outcome of the hearing on the appointment of the conservator or receiver. *See id.* at 635. The Supervisory Representative was authorized to oversee the affairs of the S&L for six months, or until sixty days after the end of litigation on the matter, whichever was longer. *See id.* at 636.

272. *See* Home Loan Bank Bd. v. Mallonee, 196 F.2d 336, 355-56 (9th Cir. 1952)(interpreting *Fahey v. Mallonee*, 332 U.S. 245 (1947), as requiring exhaustion of administrative proceedings before suit in federal court is proper), *cert. denied*, 345 U.S. 952 (1953).

jurisdiction raised in the *Mallonee* litigation.²⁷³

3. Reactive Theory

One Congressman admitted that the impetus for the passing the Act of 1954 was the *Mallonee* litigation:

[T]he 1954 legislation was designed specifically with the Long Beach Federal controversy in mind and in order to provide for administrative procedures short of seizure action, so that solvent associations need not bear such drastic penalties. . . . [W]e ha[d] the authority to go in and appoint a conservator, and that seems to be a foolish thing to do if the institution is solvent, and is merely guilty of violating the law or some of the rules of the [FHLBB], and this will give us a practical means of discussing and arbitrating and settling such disputes.²⁷⁴

Therefore, the Housing Act of 1954, like its predecessors, was a reactive measure, relating to a past occurrence rather than to the future security of the S&L industry.²⁷⁵

IV. 1960-1969

From 1960 to 1965, the economy continued to exhibit strength and stability, growing at an average of \$9.7 billion each quarter from 1960 to 1965. Output grew in real terms by more than twenty three percent and unemployment fell to 4.5% by July of 1965.²⁷⁶ By 1966, however, serious problems had emerged in the S&L industry.²⁷⁷ Commercial banks began actively competing with S&Ls by offering high rates on certificates of deposit, thereby diverting funds from S&Ls.²⁷⁸ As a result, there was a "sharp curtailment of mortgage lending by the thrift institutions, which in turn dragged down new housing starts."²⁷⁹

The Federal Reserve, the FDIC and the FHLBB consequently coordinated interest-rate ceilings on time deposits, thus decreasing competition among the various components of the industry.²⁸⁰ By this time, how-

273. See *supra* note 246 and accompanying text.

274. H.R. Rep. No. 2083, 86th Cong., 2d Sess. 24 (1960)(statement of Rep. McAllister) (footnote omitted).

275. The Long Beach plaintiffs tried to use the provisions of the Housing Act of 1954 to bolster their claims that the administrative proceedings under which Long Beach was taken were inadequate. See *Federal Home Loan Bank of San Francisco v. Hall*, 225 F.2d 349, 360 (9th Cir. 1955), *cert. denied*, 350 U.S. 968 (1956). Ironically, the Ninth Circuit refused to apply the provisions of the Act—designed with the *Mallonee* litigation in mind—because it interpreted the Act as having a prospective application only. See *id.* at 373-74.

276. See Fowler, *Monetary and Fiscal Policy Coordination*, in 1966 Savings and Loan Annals 11-12.

277. *Id.* at 14.

278. See *id.* at 16.

279. *Id.*

280. See Interest Rate Adjustment Act of 1966, Pub. L. No. 89-597, 80 Stat. 823 (codified at various sections of 12 U.S.C.)(giving the FHLBB the authority to confer with the Federal Reserve Board and the FDIC in setting the interest rate on time deposits);

ever, inflationary pressures were mounting,²⁸¹ and a string of S&L failures ensued.²⁸² The focus on the activities of financial institutions was soon diverted, however. As the Hon. J.L. Robertson noted in his address to Congress:

We are in the midst of . . . such important issues as the war in Vietnam, a soaring crime rate, the behavior of alienated young people, and active dissatisfaction on the part of many Negro citizens. While we face some difficult and complex problems in the area of bank supervision, they lack the drama inherent in these other issues.²⁸³

Consequently, S&L regulatory legislation during the 1960s was sparse.

A. *Financial Institutions Supervisory Act of 1966*

1. Purpose

The Financial Institutions Supervisory Act of 1966 ("FISA")²⁸⁴ had five goals. First, FISA sought to create an intermediate step between determination of unsound practice in an S&L and the "drastic" steps of either appointing a conservator or receiver or of terminating the FSLIC coverage.²⁸⁵ FISA thus provided the FHLBB with the supplemental tool of cease-and-desist orders ("CDOs") to protect and regulate the S&L industry.²⁸⁶ Second, Congress wanted to foster public confidence and safeguard deposits by curtailing the FHLBB's ability to terminate FSLIC coverage as a means of forcing compliance with FHLBB regulations.²⁸⁷ Third, in order to decrease the potential for abuse of power, Congress enacted FISA to strictly limit the ability to take over an association or remove a director.²⁸⁸ Fourth, Congress enacted FISA to correct the lack of uniformity of supervision between the state and federal S&L systems.²⁸⁹ One Congressman noted the danger of giving exclusive supervisory power over state-chartered S&Ls to state agencies: a string of failures in even a couple of states could drain the FSLIC and increase the premiums assessed against other member institutions.²⁹⁰ Finally, FISA was passed to prevent groups of people from creating different combinations of joint bank accounts, thereby obtaining more FSLIC coverage

W. Woerheide, *The Savings and Loan Industry 139-144* (1984)(discussing the consequences of interest-rate ceilings).

281. See F. Mishkin, *The Economics of Money, Banking, and Financial Markets* 216-17 (1986).

282. See Bartell, *An Analysis of Illinois Savings and Loan Associations Which Failed in the Period 1963-1968*, in *Study of the Savings and Loan Industry* 345-436 (Federal Home Loan Bank Board 1969).

283. 114 Cong. Rec. 29,210 (1968).

284. Pub. L. No. 89-695, 80 Stat. 1028 (codified at various sections of 12 U.S.C.).

285. See S. Rep. No. 1482, 89th Cong., 2d Sess. (1966), *reprinted in* 1966 U.S. Code Cong. & Admin. News 3532, 3537.

286. See *id.* at 3541.

287. See 112 Cong. Rec. 24,983-84 (1966) (statement of Rep. Patman).

288. See *id.* at 25,524.

289. See *id.* at 24,984 (statement of Rep. Patman).

290. See *id.*

than was actually granted by law.²⁹¹

2. Structure and Powers

FISA provided that if the FHLBB found an S&L to be engaging in unsound practices likely to result in "insolvency . . . or substantial dissipation of assets . . . or . . . to otherwise seriously prejudice the interests of its savings account holders, the [FHLBB] may issue a temporary order requiring the association to cease and desist any such violation or practice."²⁹² The temporary CDO was effective upon service and lasted until the FHLBB had made a final ruling on the charges.²⁹³ The FHLBB could apply to a federal district court to force the S&L to comply with the temporary CDO.²⁹⁴

Additionally, once the FHLBB determined at a hearing that the S&L was engaging in unsound practices, FISA authorized the FHLBB to issue a permanent CDO.²⁹⁵ Moreover, FISA authorized the FHLBB to serve notice of its intention to suspend any officer(s) who violated a CDO, engaged in unsound practices or were considered personally dishonest.²⁹⁶ The suspension was effective upon notice and remained effective pending the outcome of an administrative proceeding on the subject.²⁹⁷ Furthermore, any officer charged with a felony could be suspended or prohibited from any further S&L management; even if the officer was acquitted, the FHLBB could still institute proceedings for removal.²⁹⁸

If the S&L failed to comply with the terms of the CDO, FISA allowed the FHLBB to appoint a conservator or receiver *ex parte*.²⁹⁹ The S&L then had thirty days to bring an action in federal district court to request the removal of the conservator or receiver. FISA directed the courts to give priority to these cases and to expedite matters as much as possible.³⁰⁰ If the conservator or receiver was validly appointed, the court lacked authority to constrain his powers to act as a director for the

291. *See id.* at 26,472 (statement of Rep. Robertson).

292. Financial Institutions Supervisory Act of 1966 [hereinafter FISA], Pub. L. No. 89-695, § 101(a), 80 Stat 1028-30 (adding § 5(d)(3)(A) to HOLA).

293. *See id.*

294. *See id.* (adding § 5(d)(3)(C) to HOLA).

295. *See id.* (adding § 5(d)(2)(A) & (B) to HOLA). "[T]he new cease and desist authority in title I is entirely adequate to deal with any liquidity, reserves, conflict of interest, or other serious supervisory problem that might arise." 112 Cong. Rec. 24,985 (1966)(statement of Rep. Patman).

296. *See FISA, supra* note 292, § 101(a), 80 Stat. at 1030-31 (adding § 5(d)(4)(A)-(D) to HOLA).

297. *See id.*

298. *See id.* (adding § 5(d)(5)(A) to HOLA).

299. *See id.* (adding § 5(d)(6)(A) to HOLA). The grounds listed for appointment of a conservator or receiver were insolvency, substantial dissipation of assets, unsound condition, willful violation of a CDO or concealment of books. *See id.*

300. *See FISA, supra* note 292, § 101(a), 80 Stat. at 1032-33 (adding § 5(d)(6)(A) to HOLA).

S&L.³⁰¹ Moreover, FISA amended the NHA to grant CDO powers to the FSLIC that were similar to those described above.³⁰²

Title IV of FISA provided that the Act was effective only until June 30, 1972.³⁰³ The time limit was included because—in light of the new rules for federal and state S&L receiverships and conservatorships—FISA would have a major impact on both federal regulators and individual S&Ls.³⁰⁴ The expiration date would thus give Congress a chance to “work out any kinks” in the system that might surface after FISA was put into widespread effect.³⁰⁵

3. Reactive Theory

FISA also conforms to the reactive nature of the S&L regulatory legislation. The Act was first developed to satisfy S&L trade associations and regulators³⁰⁶ who demanded legislation that would “deal with the *handful* of financial institutions whose conduct might reflect unfavorably on the vast majority of the soundly operated savings and loan associations.”³⁰⁷ FISA was therefore enacted specifically because of the difficulty the FHLBB had experienced in obtaining the obedience of only a few delinquent S&Ls.³⁰⁸ FISA thus overhauled the disciplinary structure created under HOLA and NHA, partially because the regulators could not effectively control isolated incidents.³⁰⁹

B. *Savings and Loan Holding Company Amendments of 1967*

1. Purpose

The Savings and Loan Holding Company Amendments of 1967³¹⁰

301. *See id.* (adding § 5(d)(6)(C) and (D) to HOLA).

302. *See id.* § 102, 80 Stat. at 1036-37 (amending § 407 of the NHA).

303. *See id.* § 401, 80 Stat. at 1056.

304. *See* 112 Cong. Rec. 25,524 (1966) (statement of Sen. Robertson).

305. *Id.* at 24,985 (statement of Rep. Patman).

306. *See id.* at 20,078 (statement of Rep. Proxmire).

307. *Id.* at 20,079 (letter to Sen. Proxmire) (emphasis added).

308. *See* Baxter, *Life in the Administrative Track: Administrative Adjudication of Claims Against Savings Institution Receiverships*, 1988 Duke L. J. 422, 484 (1988).

309. *See* 112 Cong. Rec. 20,078 (1966) (statement of Sen. Proxmire).

310. Pub. L. No. 90-255, 82 Stat. 5 (codified as amended at 12 U.S.C. § 1730a). Holding companies are “corporations which own more than 25 percent of the stock of two or more [institutions].” 113 Cong. Rec. 6609 (1967) (statement of Rep. Mills).

Congress enacted the original S&L Holding Company Act in 1959, adding Section 408 to the NHA to regulate the activities of holding companies. *See* Pub. L. No. 86-374, 73 Stat. 691 (1959). Under the Act, a company had “control” over an S&L if it owned more than 10% of the institution’s stock. *See id.* § 408 (a)(3), 73 Stat. 691-92. The Act required the FSLIC to reject any insurance application if the applicant was controlled by a holding company, if such company already controlled an insured S&L. *See id.* § 408 (b)(1), 73 Stat. at 692. Moreover, if the FSLIC discovered that an institution was controlled by a holding company, it had the authority to terminate insurance coverage or to order a sale of stock to bring ownership below the 10% limit. *See id.* § 408(b)(2)(A)&(B), 73 Stat. at 692. If a holding company refused to divest itself of its holdings, the FSLIC could enforce divestiture through the federal district courts. *See id.* § 408(e), 73 Stat. at

were enacted to achieve three main goals. First, the Act sought to create a comprehensive regulatory scheme for S&L holding companies where those companies held federally insured S&Ls.³¹¹ Congress thus hoped to foster the responsible use of holding companies as a financing device.³¹² Second, the Act sought to curtail the opportunity for abuse while simultaneously maintaining enough freedom to foster normal business transactions between the holding companies and their subsidiaries.³¹³ Third, bank holding company debt had been structured to pressure the insured subsidiary associations "to maximize earnings and dividends to meet the parent's debt service."³¹⁴ That, in turn, induced the subsidiaries to make risky investments, which endangered both the FSLIC and member associations. Congress enacted the Amendments to prevent this "top-heavy" debt structure.³¹⁵

2. Structure and Powers

The Amendments of 1967 revised the NHA to encompass bank holding companies,³¹⁶ requiring that each company register with the FHLBB, maintain books and records in accordance with the FSLIC regulations, and agree to periodic examinations.³¹⁷ In addition, the Amendments listed those activities forbidden to bank holding companies and subsidiary S&Ls.

First, the Amendments prohibited holding companies from conducting any activities that would evade restrictions placed on a subsidiary S&L.³¹⁸ The Amendments restricted S&L holding companies to only the following activities: participating in the management of S&Ls, conducting an insurance business, managing or liquidating assets or properties, acting as a trustee, or engaging in any other service that the FSLIC determined was appropriate.³¹⁹ Second, the Amendments proscribed the following activities by subsidiary S&Ls: investing in an affiliate; purchasing securities from an affiliate; making loans to an affiliate; making loans secured by the property of an affiliate; making loans with knowledge that the proceeds will be paid to the affiliate; and guaranteeing a loan of an

692. Finally, the Act required a study on the nature and growth of the holding company industry, as well as a comment on the prospects for the future of the industry. *See id.* § 408(g)(2), 73 Stat. at 693.

311. *See* H.R. Rep. No. 997, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. Code Cong. & Admin. News 1601, 1603.

312. *See id.*, *reprinted in* 1968 U.S. Code Cong. & Admin. News, at 1617.

313. *See id.*, *reprinted in* 1968 U.S. Code Cong. & Admin. News, at 1603.

314. *Id.*, *reprinted in* 1968 U.S. Code Cong. & Admin. News, at 1604.

315. *See id.*

316. *See* Savings and Loan Holding Company Amendments of 1967, *supra* note 310, § 2, 82 Stat. 5.

317. *See id.* (amending § 408(b) of the NHA).

318. *See id.* (amending § 408(c)(1) of the NHA).

319. *See id.*

affiliate.³²⁰

The Amendments also placed general restrictions on individuals and corporations that participated in the bank holding company business. The Amendments made it unlawful for one to acquire an interest in a bank holding company or an S&L where he would thereby gain complete or virtually complete control in the enterprise, unless he had obtained approval from the FSLIC.³²¹ Furthermore, the Amendments made it illegal to establish an interstate bank holding company, or for existing companies to acquire or establish headquarters and subsidiary S&Ls in different states.³²²

Finally, the Amendments granted additional powers to the FSLIC to issue rules and regulations governing the bank holding company business.³²³ First, the FSLIC was authorized to prohibit any acquisition that tended to create a monopoly or decrease competition in the industry, regardless of the size of the acquisition.³²⁴ Second, the Amendments empowered the FSLIC to conduct any investigation it deemed necessary to ascertain compliance with the Amendments and its own rules and regulations.³²⁵ Where the FSLIC found a violation, it was authorized to bring an action in federal district court to enjoin the violation of the provisions, rules or regulations.³²⁶ Finally, individuals who willfully violated the provisions of the Amendments were subject to fines, imprisonment or both.³²⁷

3. Reactive Theory

True to form, Congress continued its reactive policymaking in 1967. First, through the Amendments, Congress responded to the demands of trade groups such as the United States League of Savings Associations. Since 1965, the League had been proposing changes in the holding company laws, and virtually all of their suggestions can be found in the 1967 Amendments.³²⁸

320. See Savings and Loan Holding Company Amendments of 1967, *supra* note 310, § 2, 82 Stat. at 8-12 (amending § 408(d) of the NHA).

321. See *id.* (amending § 408(e)(1)(A)(ii) of the NHA).

322. See *id.* (amending § 408(e)(3) of the NHA). This section provided an exception for S&Ls acquired through pledge or hypothecation. See *id.*

323. See *id.* (amending § 408(h)(1) of the NHA).

324. See *id.* (amending § 408(e)(2)(A) of the NHA).

325. See Savings and Loan Holding Company Amendments of 1967, *supra* note 310, § 2, 82 Stat. at 12-15 (amending § 408(h)(2) of the NHA).

326. See *id.* (amending § 408(h)(4) of the NHA). The Amendments also allowed the parties to appeal any such order to the federal Circuit Court. See *id.* (amending § 408(k) of the NHA).

327. See *id.* (amending § 408(j)(2) & (3) of the NHA).

328. See United States League of Savings Associations, 1965 Savings and Loan Annals 361. The League stated that

careful consideration should be given to assure inclusion of the following features in such legislation: (1) Provision for the regulation and examination of holding companies and their affiliates, to preclude them from activities which are prohibited to insured institutions which they control. (2) Prohibition from

Second, the S&L industry's competition with banks sparked the realization that S&Ls were no longer an isolated industry, but rather, a responsive part of the money market.³²⁹ Consequently, "the *real* question this legislation raised . . . was not one of merely extending Home Loan Bank Board jurisdiction over the activities of the savings and loan holding companies, but the broader and more important question of what competitive devices are needed and will be needed to strengthen the thrift industry."³³⁰ In short, this legislation was the vehicle for S&Ls to return to the competitive market of 1967 to 1968 after the hard times of 1966.

C. Bank Protection Act of 1968

1. Purpose

By 1968, Congress had finally realized that past S&L legislation had created the "*accidental and irrational system* of bank regulation and supervision [with which] this country has been *saddled* . . ."³³¹ It is fitting, then, that the last piece of S&L legislation examined in this Note, the Bank Protection Act of 1968,³³² was intended to correct some of the system's existing deficiencies.

First, in response to the divergent policies of state and federal regulatory agencies, this Act sought to consolidate the actions of state and federal agencies regarding receiverships and liquidations.³³³ Furthermore, the Act limited the overlap of the various federal agencies that exercised receivership and liquidation powers.³³⁴ Additionally, the Act responded

acquiring or retaining the control of insured institutions in more than one state. (3) Restriction of business dealings of holding companies and their affiliates with the insured institutions which they control. . . (5) Prohibition of an officer, director or owner of substantial interest in a holding company from acquiring or retaining for more than three years the control of any insured institution which is not otherwise controlled by the holding company.

Id.; see also United States League of Savings Associations, 1966 Savings and Loan Annals 295 (reiterating the suggestions for the Holding Company Amendments).

329. See H.R. Rep. No. 997, 90th Cong., 2d Sess., reprinted in 1968 U.S. Code Cong. & Admin. News 1601, 1616 (supplemental views of Rep. Hanna); see also 113 Cong. Rec. 17,369 (1967) (statement of Sen. Sparkman)(of the associations in financial difficulty, 63% of the assets were held by bank holding companies even though they constituted only 12% of the industry in 1966).

330. H.R. Rep. No. 997, 90th Cong., 2d Sess., reprinted in 1968 U.S. Code Cong. & Admin. News at 1616-17 (emphasis added).

331. 114 Cong. Rec. 29,209 (1968)(address by Hon. J.L. Robertson)(emphases added).

332. Pub. L. No. 90-389, 82 Stat. 294 (codified as amended in 12 U.S.C. § 1729).

333. The Act "was effected against a background of obstruction on the part of the Illinois authorities, who had refused to appoint the FSLIC as receiver in four cases even though the FSLIC was the insurer of deposits in those thrifts and by far the major creditor." Baxter, *supra* note 308, at 486. See also 114 Cong. Rec. 29,208 (1968)(statement of Rep. Patman)(the fact that federal and state agencies "have not always been in step with each other has been a source of considerable concern both to the regulators and to those regulated. For a time it became the focus of attention, virtually to the exclusion of everything else.").

334. See 114 Cong. Rec. 29,209 (1968) (statement of Rep. Patman) ("During the past five years the delicate balance of the banking industry has been upset, the dual banking

to an increase in bank robberies in the mid-1960s by mandating increased protective measures.³³⁵

2. Structure and Powers

The Bank Protection Act mandated the appointment of the FSLIC as the sole receiver or conservator of any insured, state-chartered S&L where (1) appointment by the state authority had been outstanding for fifteen consecutive days or where the S&L had been closed under the laws of the state;³³⁶ or (2) one of the grounds enumerated in HOLA³³⁷ for the appointment of a receiver or conservator existed.³³⁸

Once the FSLIC was appointed, the Act gave the FSLIC the same powers it exercised over federal S&Ls under receivership or conservatorship.³³⁹ Moreover, the Act gave the FSLIC the power to liquidate an insured, state-chartered institution where it deemed the action necessary.³⁴⁰ Finally, the Act gave the federal supervisory agencies discretion in the area of bank protection. Congress simply directed the Comptroller of the Currency, the Federal Reserve Board, the FDIC and the FHLBB to issue rules outlining the steps financial institutions must take with respect to the installation and operation of security devices and procedures.³⁴¹

By the end of 1969, unemployment was at 3.5%³⁴² and the economy

system endangered, and the development of banking on sound lines impeded by the divergent policies, procedures and interpretations emanating from the three federal supervisory agencies.”).

335. *See id.* at 11,804 (statement of Rep. Patman)(“[R]obberies of banks have increased 154 percent over the level of 1960 Between 1963 and 1967, violations of the Federal bank robbery statute rose from 1,548 to an all-time high of 2,551”); *id.* at 11,806 (letter of Byron Dunn)(discussing the deaths of law enforcement officers and bankers); *id.* at 11,808 (statement of Rep. Fascell)(noting “a tendency in bank architecture that places more value on comfort and convenience than on safety. Concomitant with these trends, we find a serious deficiency of protective equipment in a great number of our banking institutions.”).

336. *See* Bank Protection Act of 1968, *supra* note 332, § 6, 82 Stat. at 295 (amending § 406(c)(2)(A) of the NHA).

337. *See supra* note 302 (FISA’s amendments to HOLA enumerating these grounds).

338. *See* Bank Protection Act of 1968, *supra* note 332, § 6, 82 Stat. at 295 (amending § 406(c)(2)(B) of the NHA). In *Biscayne Fed. Sav. & Loan Ass’n v. Fed. Home Loan Bank Bd.*, 720 F.2d 1499, 1505 (11th Cir. 1983), *cert. denied*, 467 U.S. 1215 (1984), the court held that the FHLBB need only have a reasonable belief that a statutory ground for receivership or conservatorship (outlined in HOLA) exists. Once a court determines that the FHLBB acted reasonably, the court may not second-guess the FHLBB’s judgment, since the discretion to appoint a receiver or conservator has been delegated by statute to the FHLBB. *See id.* at 1503, 1505. Using the same reasoning, the court also rejected the plaintiffs’ request for a “less drastic” remedy under the Bank Protection Act. *See id.* at 1505.

339. *See* Bank Protection Act of 1968, *supra* note 332, § 6, 82 Stat. at 295-96 (amending § 406(c)(3)(A) of the NHA).

340. *See id.* (amending § 406(c)(3)(B) of the NHA).

341. *See id.* § 3(a), 82 Stat. at 295.

342. *See* United States Bureau of the Census, Statistical Abstract of the United States 216 (1970).

had grown by 2.8%.³⁴³ The Gross National Product was \$932.3 billion,³⁴⁴ national income was \$771.2 billion³⁴⁵ and personal savings were \$37.6 billion.³⁴⁶ The nation's S&L industry, armed with the regulations described above, entered the 1970s unaware of the troubles that lay ahead.

CONCLUSION

The S&L regulatory legislation has generally been reactive, and while it helped develop the industry, it did so at a staggered pace. Congress continued to amend S&L legislation—even amending amendments—almost always in response to immediate conditions. Consequently, the S&L regulations, as they developed up to 1969, lacked the consonance required for a stable and strong S&L industry. FIRREA is certainly a comprehensive piece of legislation, but it is nonetheless built on the foundation created from the 1930s to the 1960s. Moreover, it is a reaction to the string of S&L failures experienced during the latter half of the 1980s. Does that mean that the “bailout bill” is doomed? Is a collapse of the commercial banking industry on the horizon? While no one can predict the future, the Little Dutch Boy was a courageous figure, and he was still no match for the crumbling dam and the floodwaters that lay behind it.

Lucia J. Mandarino

343. *See id.* at 313.

344. *See id.* at 311.

345. *See id.* at 315.

346. *See id.* at 313.