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FROM BUILDING AND LOANS TO BAIL-OUTS: A HISTORY OF THE AMERICAN SAVINGS AND LOAN INDUSTRY, 1831-1989

DISSertation

Presented in Partial Fulfillment of the Requirements for
the Degree Doctor of Philosophy in the Graduate School of the Ohio State University

By

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ABSTRACT

The more than 150-year history of the American thrift industry parallels many of the broader social and economic changes of the nation as a whole. The thrift industry began in the mid-nineteenth century as a way to help working-class men and women buy homes in growing urban areas. During the Second Industrial Revolution thrifts expanded in number and controlled millions in financial assets. Despite this expansion, thrifts were not seen as an industry but as a self-help movement because they relied on systematic savings and mutual cooperation by their members to be successful. Eventually, thrift leaders formed trade associations, including the United States League, and sought government regulation, to protect and promote their shared business interests. Through these efforts thrifts became more uniform, and gained professional recognition that helped change the perception of thrifts into a true financial industry.

The most prosperous period for thrifts came after World War II when millions of American families sought homes. The demand for mortgages caused some thrifts to grow rapidly into multi-billion dollar associations, while others remained smaller and community oriented. These changes, combined with increased competition from other financial institutions, led thrift leaders and government officials to consider allowing thrifts to move away from their specialized focus on providing home finance. In the early
1980s thrifts were deregulated, a move that was criticized following the failure of hundreds of associations. An analysis of how two thrifts dealt with deregulation indicates that problems of the decade were more complex, and as such places the S&L crisis in a proper perspective.
Dedicated to Dad
PREFACE

My interest in the American savings and loan industry dates from 1993, was making a transition from a career as a corporate banker and financial analyst to that of a self-employed mortgage banking contractor. One of my first assignments was with the Resolution Trust Corporation (RTC), performing reviews on loans made by United Federal Savings Bank, a $117 million thrift located in the Atlanta suburb of Smyrna. The thrift had failed in 1992 and was in the process of liquidation by the government. Because the loans I examined were high-quality mortgages on single-family residences, I wondered how this thrift had gotten into trouble. Then I came across a number of loans made for condominiums in Duluth, another Atlanta suburb. All these mortgages were either in default or foreclosure, and had been written-down to nearly half their original amount. I estimated that these losses were sufficient to erase all of United Federal’s net worth, a situation which had probably caused it to fail.

My experience at the RTC guided me toward writing this history of the American thrift industry. While I originally expected this study to be a straightforward history of the savings and loans business, my research revealed that the story was a complex one. Like the Bailey Bros. Building and Loan in the Frank Capra movie It’s a Wonderful Life, thrifts have shaped individual lives, and have played an important role in the social and economic development of the United States.
ACKNOWLEDGMENTS

Completing this project would not have been possible without the aid and support of many individuals. While I was fortunate to have access to nearly one hundred years of trade journals and conference proceedings with regard to thrifts from dozens of libraries across the country, making sense of this material was a daunting task. It was made immeasurably easier by my advisor Mansel G. Blackford, who kept my work focused and helped me develop my ideas on the effects S&Ls had on American society. William R. Childs provided me with valuable insights into the history of government/business relations, and led me to think seriously about just when S&Ls became a true financial industry. Likewise the seminars I took under the guidance of K. Austin Kerr helped me formulate my basic approach to writing a history of this industry.

My research could not have been completed without the assistance of several talented and friendly archivists. Allen Fisher at the Lyndon B. Johnson Presidential Library provided invaluable assistance researching the collections of that impressive repository. Pat Wildenberg and Dale Mayer at the Herbert Hoover Presidential Library helped me to better understand Herbert Hoover's devotion to the needs of families and better housing. Don Shewe at the Jimmy Carter Presidential Library provided both invaluable assistance and stories about the OSU History Department faculty while he was
a graduate student in the 1960s. I also deeply appreciate the financial assistance used to complete my work from the Herbert Hoover Presidential Library and the Franklin and Eleanor Roosevelt Research Institute.

Special thanks goes to Robert Surabian who provided me with unrestricted access to the records of Medford Cooperative Bank, and Lorraine Silva who regaled me with stories of her life as a community banker. Finally, I would like to thank my mother for asking me how the dissertation was coming, and thanks to Jeff and Sandy for never bringing the subject up.
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# TABLE OF CONTENTS

Abstract ........................................................................................................................ ii

Dedication ........................................................................................................................ iv

Preface ................................................................................................................................ v

Acknowledgments .............................................................................................................. vi

Vita ........................................................................................................................................ viii

List of Tables ...................................................................................................................... xi

Chapters:

1. Scholars, Thrifts and America’s Political Economy ............................................... 1

2. A Movement Takes Shape, 1831-1899 ......................................................... 14

3. The Rise of the League, 1900-1929 ................................................................. 57

4. From State to Federal Oversight ...................................................................... 100

5. The Movement Becomes an Industry, 1930-1945 ......................................... 146

6. The Glory Years, 1946-1955 .......................................................................... 188

7. External Challenges and Internal Divisions, 1956-1966 ............................ 234

8. Lost Opportunities, 1967-1979 ..................................................................... 274

9. Deregulation and Disaster, 1979-1989 ............................................................ 313

10. Fraud, Forbearance and Failure: The Case of Empire Savings and Loan ..... 351
    Association
11. Success the Old Fashioned Way: The Case of Medford Cooperative Bank 386

12. Thrifts, Business and Politics 420

Bibliography 433
LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Number of Thrifts and Assets - 1888 to 1900</td>
<td>40</td>
</tr>
<tr>
<td>3.1.</td>
<td>Number of Thrifts and Assets - 1900 to 1920</td>
<td>76</td>
</tr>
<tr>
<td>3.2.</td>
<td>Number of Thrifts and Assets - 1920 to 1930</td>
<td>87</td>
</tr>
<tr>
<td>5.1.</td>
<td>Number of Thrifts and Assets - 1930 to 1945</td>
<td>177</td>
</tr>
<tr>
<td>6.1</td>
<td>Number of Thrifts and Assets - 1945 to 1955</td>
<td>205</td>
</tr>
<tr>
<td>7.1</td>
<td>Number of Thrifts and Assets - 1955 to 1965</td>
<td>254</td>
</tr>
<tr>
<td>8.1</td>
<td>Number of Thrifts and Assets - 1967 to 1979</td>
<td>296</td>
</tr>
<tr>
<td>9.1</td>
<td>Thrift Failures and Assets / Total Thrifts and Assets - 1980 to 1989</td>
<td>346</td>
</tr>
<tr>
<td>11.1</td>
<td>Medford Cooperative Bank, Members and Assets - 1888 to 1910</td>
<td>390</td>
</tr>
<tr>
<td>11.2</td>
<td>Medford Cooperative Bank, Members and Assets - 1915 to 1930</td>
<td>393</td>
</tr>
<tr>
<td>11.3</td>
<td>Medford Cooperative Bank, Members and Assets - 1935 to 1955</td>
<td>400</td>
</tr>
<tr>
<td>11.4</td>
<td>Medford Cooperative Bank, Members and Assets - 1960 to 1979</td>
<td>405</td>
</tr>
<tr>
<td>11.5</td>
<td>Medford Cooperative Bank, Members and Assets - 1980 to 1990</td>
<td>409</td>
</tr>
<tr>
<td>11.6</td>
<td>Medford Cooperative Bank, Members and Assets - 1990 to 1999</td>
<td>415</td>
</tr>
</tbody>
</table>
CHAPTER 1

SCHOLARS, THRIFTS AND AMERICA’S POLITICAL ECONOMY

In his movie *It’s a Wonderful Life* the director Frank Capra tells the story of George Bailey, the manager of the Bailey Bros. Building & Loan. This thrift association is in Bedford Falls, a small town where people know each other, families are stable, and personal morals are strong. Although the town also has a bank, most working-class residents belong to the building and loan, which they joined with the goal of becoming homeowners. When the banker Henry Potter accuses George of stealing from the thrift, George panics and considers suicide. To prevent this, George’s guardian angel Clarence lets him see what life in Bedford Falls would be like if he were never born, and by extension if his thrift did not exist. In a world without George and his building and loan, Potter controls the town and dominates the lives of its residents. Called Pottersville, the town is no longer peaceful and happy but a place where drinking, vice, and debauchery reign supreme. Most of the people rent apartments from Potter, have unstable families, and generally regard each other warily. The experience makes George realize how important he and his work are to the community, which causes him to keep on living and face arrest for malfeasance. In the end, no one charges George with any wrongdoing,
after the town donates money to cover the missing funds.¹

In this cinematic masterpiece, Capra's main objective was to “encourage audiences to recognize the heroism involved in merely living a helpful but ordinary life.” However, Capra also provided an accurate sketch of America's thrift industry during its heyday of the late 1940s and early 1950s. An examination of the movie from the perspective of the Bailey Bros. Building and Loan reveals that the primary goal of a thrift was to help working-class men and women become homeowners. By following the basic principles of systematic savings and mutual cooperation, thrift members could borrow money to buy their homes. The movie also revealed the widespread assumption of Americans that private homes provided the best conditions in which to raise families—that pride of owning a home generated higher personal self-esteem, solid morals, and good citizenship. Finally, because the Bailey Bros. Building and Loan was such an integral part of Bedford Falls, when events threatened to close this thrift the town fought to save it.²

Although Capra never intended It's a Wonderful Life to be an homage to the savings and loan industry, he nonetheless provided a useful snapshot of a business that to date has not received much scholarly examination. This is not to say that historians have


²Wes D. Gehring, Populism and the Capra Legacy (Westport, CT: Greenwood Press, 1995), quote 112.
ignored the study of finance in America, as evidenced by many valuable histories of investment and commercial banking. One reason for the growing number of works on these industries is that each was critical in financing big business and making America an economic super-power. Similarly, historians have closely examined the relationship between business and government, especially those actions that helped the federal government assume greater economic and social responsibilities in the twentieth century.

Finally, while scholars have explored the roles financial intermediaries have played in the growth of American cities and suburbs, the majority of works in this area have focused on federal government activities and not on those of savings and loans. Because the history of the thrift industry combines elements from all three areas into one study, “From Building and Loans to Bail-Outs” broadens our understanding of these fields and makes an important contribution to American business history.

At the end of the twentieth century, America’s 1,103 thrift institutions control more than $863 billion in assets. These thrifts provide a majority of all residential home

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mortgages and are the second-largest repositories for consumer savings in the country.\(^6\) Despite their critical importance to the financial structure of the United States, thrifts have been grossly neglected by scholars. Only five histories of this industry are available, all of them written by industry insiders.\(^7\) While numerous works are available on the history of the savings and loan crisis of the 1980s, many of them are journalistic accounts of fraud or criminal misconduct which rely on interviews and other unpublished material for their sources.\(^8\) Most authors fail to place the events of the 1980s in any historical context, and those that do try to provide an industry history typically limit it to events after the creation of federal oversight in 1932. Few use any primary source materials.\(^9\)


My work addresses these deficiencies by utilizing a broad array of primary sources to give a detailed analysis of how and why savings and loans evolved over time. Moreover, because I examine the roles the national thrift trade association and the federal government played in this process, my study contributes to the broader scholarship on government-business relations. Finally, by looking at how thrifts affected the social and cultural aspects of home ownership I broaden our understanding of how consumer finance became democratized in the twentieth century.

I have organized my work around four basic themes. The first is the creation of saving and loans as businesses: I examine the development of thrift operating procedures, such as mortgage instruments, business structures, and marketing practices. The second theme focuses on the relationship between the thrift industry and government, and in particular how their leaders interacted over time. The third theme examines how the national thrift trade association helped make savings and loans a major force in consumer finance. My final theme looks at how savings and loans promoted thrift and home ownership, and the effects this promotion had on society and culture in the United States.

The development of savings and loans as businesses involved the development of practices in a process that occurred in a series of waves, the first of which occurred between 1860 and 1890 when thrifts formalized their basic operating procedures. Although the main purpose of every nineteenth-century thrift was to help working-class men and women become homeowners and save for the future, these associations did not
all follow the same procedures. Rather, they tailored their operations to meet local needs, which resulted in a myriad of practices. While beneficial to the individual association, this independent spirit hampered the creation of a group identity and distinct image.

The second period of business innovation came during the 1920s and 1930s, when savings and loans adopted a host of standardized practices in accounting, financial reporting, real estate appraisal and loan evaluation. The most important of these was the widespread adoption of the direct reduction mortgage which savings and loans had first developed in the 1880s. While all thrift mortgages were by design long-term and fully amortizing, the direct reduction mortgage was a very consumer-friendly device, since the interest paid by the borrower fell as the loan principal balance declined. During the Great Depression, the federal government used this type of mortgage for its home relief programs, and within a matter of years virtually all home lenders followed suit.

The third wave of business change for thrifts came in the 1960s and 1970s, and focused primarily on creating new ownership structures as well as areas of lending. Traditionally, thrifts were legal not-for-profit associations owned by their members, but after World War II some industry leaders thought the mutual ownership structure was too limiting and began selling stock on the open market and forming holding companies to stimulate growth. Although this trend was limited, it still represented a major shift in the underlying work of thrifts as local institutions. When new technologies revolutionized all financial services in the 1970s, many of these same people wanted to use these tools to expand industry powers; and this sentiment helped fuel the drive to deregulate thrifts in the 1980s.
My second theme details the relationship between government and thrifts. Thrift leaders, like those in other financial industries, generally regarded government involvement in their business as both a blessing and a curse. They typically wanted government to protect and encourage industry growth, and discouraged efforts that restricted operations. As with the development of business practices, changes in industry-government relations came in a series of distinct periods, the first of which was the 1890s when thrifts actively sought regulation by state governments. The industry hoped to use laws to set standards that would limit competition among firms, increase public confidence in thrifts and create more uniform business practices.

The relationship between the thrift industry and federal government began during the Great Depression with the creation of a comprehensive system of thrift oversight. Between 1932 and 1934, the Congress created a reserve credit system, a program of deposit insurance, and a federal charter for savings and loans -- all in an effort to alleviate the economic hardships faced by home owners. As was true in the creation of state laws, thrift leaders assumed an active role in the design of the federal programs, because they believed federal oversight would protect the industry from competitors and produce greater growth. In terms of actual oversight, federal regulators maintained close positive relations with thrift leaders, so much so that some observers argued that the industry had captured their regulators.

The final major period of change in government-business relations came during the 1980s, when Congress first deregulated then re-regulated the thrift industry. The first round of deregulation gave thrifts greater powers to attract deposits, while later
legislation expanded savings and loan lending powers well beyond their traditional sphere of home finance. Designed to help thrifts escape from problems caused by inflation and high interest rates, these laws instead contributed to the worst financial disaster in American history -- one that eventually cost taxpayers over $500 billion. The level of thrift failures during the mid-1980s, combined with well-publicized instances of fraud and criminal conduct, contributed to the re-regulation of thrifts in 1989 and the creation of a temporary federal agency to clean up the savings and loan mess.

The third major theme examines the roles trade associations played in the development of the thrift industry. While savings and loans had local, state and regional trade groups to promote their business interests, a national trade association, the United States Savings and Loan League, was the most influential of all. The League was formed in 1893 to help fight against thrift competition, and over time it turned its attention to promoting and unifying the industry. In 1929 the League named Morton Bodfish as its first executive manager, and this young and highly motivated individual was crucial in making the trade group a powerful business and political organization. During the 1930s, he helped secure federal oversight and developed several new programs to make the League and the industry more respected and professional.

The League was at its height of power in the 1950s and early 1960s when the

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thrift industry emerged as an important element of consumer finance. Under the leadership of Norman Strunk, trade association efforts for thrifts to market aggressively and offer superior customer service helped the businesses become the dominant source for long-term home finance and a major repository for savings. This expansion, however, created greater friction within the industry, which made it more difficult for the League to represent the interests of all associations. As a result, by the 1970s trade association policies sometimes conflicted with statements made by its own members, which affected the level of influence the League had in its battle over deregulation.

My final major theme focuses on home ownership, and in particular how thrifts helped shape the belief that when people acquired a home they also achieved a part of the “American Dream.” This belief was especially widespread during the Second Industrial Revolution in the late-nineteenth century, when many working-class men and women found it difficult to secure financing to buy a home. Thrifts helped solve this problem by making affordable loans, but unlike other financial institutions only members of an association could receive financing, and to qualify they had to follow the principles of mutual cooperation and systematic savings. Because of these requirements, industry leaders contended that thrifts not only promoted home ownership, but also instilled proper American values and made people better citizens. These beliefs were so strong that the slogan for the national thrift trade association was “The American Home. The Safeguard of American Liberties.”

Aside from popularizing the idea that thrifts produced “good Americans,” the industry played a major role in redefining how Americans lived. A dominant trend in the
demographic history of the United States has been the migration of people from rural to urban areas and to the suburbs. Among the forces that contributed to these shifts was the home financing made available through savings and loans. Thrifts made mortgages on suburban homes as early as the 1890s, but they were especially important during the 1950s in making it possible for millions to move outside the city. This democratization of home finance was critical in helping America achieve one of the highest levels of home ownership in any industrialized nation.

In writing the history of the thrift industry, I take a chronological approach. Each chapter of my study focuses on a major period of change or innovation. Chapter 2 traces the development of thrifts during the nineteenth century and focuses on four major topics: how and why the thrift industry began, why savings and loan leaders cultivated an image of their business as a self-help movement, the role of women in encouraging industry growth, and the rise and fall of "national" thrifts and their impact on the industry. Chapter 3 covers the years 1900 to 1929, a period when the national trade association emerged as the true leader in the thrift industry. The major topics in this section include how the trade association encouraged thrifts to adopt more uniform business practices, its efforts to promote thrift development and home ownership, the rise of ethnic savings and loans, and how the prosperity of the 1920s affected the thrift industry.

Chapter 4 describes the development of federal regulation in the 1930s and the ways in which thrift leaders influenced this process, while Chapter 5 focuses on the business and organizational changes of savings and loans from 1930 to 1945. These chapters include analyses of why thrifts fared better than other financial institutions
during the Great Depression, and how the industry dealt with increased federal involvement in housing. Chapter 6 covers the first decade after World War II which was the thrift industry's "glory years." Between 1945 and 1954 millions of Americans moved to the suburbs, and the chapter analyzes how this demand for housing and home loans led to unprecedented thrift industry growth.

Chapters 7 and 8 analyze the events of the decades prior to the deregulation of savings and loans in the 1980s. While thrifts prospered during the 1960s, their industry also became increasingly torn by internal strife, especially between old-style thrift leaders and new more-opportunistic managers. At the same time, federal regulators tried to reign in thrift growth, while commercial banks increased the level of competition between the two industries. An additional concern facing the thrift industry was the persistent problems facing minority home buyers and their efforts to obtain financing. Finally, the Congress had a major impact on savings and loans when it ended their historic exemption from federal taxes and legislated that these associations face the same interest-rate controls as banks. In the 1970s, these issues combined with a stagnant economy to produce major financial problems for thrifts and resulted in the first substantive efforts to reevaluate the mission and goals of this industry in many decades.

Chapter 9 looks at the process of deregulation and ultimate re-regulation of the thrift industry in the 1980s. This chapter focuses on the passage of two key laws – the Depository Institutions Deregulation and Monetary Control Act of 1980, the Garn-St. Germain Act of 1982 – and gives a basic description of the key events of the S&L tragedy, including ways in which the industry and its trade association tried to rebuild
themselves following the crisis. The chapter ends with a critical assessment of the reasons why thrifts failed and succeeded during the decade.

Chapters 10 and 11 present case studies of two savings and loan associations that illustrate elements of success and failure in the industry. Chapter 10 looks at the Empire Saving and Loan Association, a thrift located near Dallas, Texas, which failed in 1983 as a result of fraud. This chapter reveals that, although management fraud was critical to the collapse of Empire, an equally important factor was the inability of regulators to monitor the S&L adequately. The second case study, outlined in Chapter 11, is of Medford Cooperative Bank, near Boston, which was formed in 1887 and which successfully weathered the turmoil of deregulation. An analysis of its history reveals that an important reason for success was its commitment to making home loans to members from the local community it served and not abandoning fields that had long made the thrift industry popular with consumers.

Chapter 12 concludes my dissertation by examining the major developments of the thrift industry, federal regulation, and the national thrift trade association, and connecting these changes to the broader scholarly literature on these subjects. While this analysis indicates that the American thrift industry conforms to many of the key theories advanced by historians, it is also a unique example of how these firms used ideology and business principles to build their financial enterprises.

The contributions of my work go beyond the scholarship of business history to include academic disciplines ranging from business administration to women's studies. For economic and business historians, this work fills a critical gap in our understanding.
of American finance, and in particular the roles of small enterprises in meeting the financial needs of people. This study also contributes to the literature on government-business relations at both the state and federal levels and so will be of interest to scholars of political science. Similarly, students of consumer and home finance will find this work a valuable resource about the development of various types of lending, such as installment and mortgage loans, while business professionals will learn more about how firms evolve over time. Furthermore, this work sheds new light on how business shapes public attitudes, especially regarding home ownership. Finally, academics focused on African-American, ethnic-American, and women’s studies will find information which both expands and breaks new ground in the relationship between these groups and American business.
CHAPTER 2

A MOVEMENT TAKES SHAPE, 1831-1899

The creation and early development of a savings and loan industry in America reflected many of the broad social and economic changes that occurred during the nineteenth century. Building and loan associations (B&Ls) first appeared in 1831 as a way to help working-class men and women have the opportunity to become homeowners. This and subsequent thrifts patterned themselves on the British building societies of the late-eighteenth century. These organizations proved that people who made the commitment to save money systematically, and were willing to cooperate with each other, could successfully raise enough funds to allow them to buy homes. While the American thrift business grew slowly during the first forty years of its existence, the number of associations grew rapidly during the 1880s, when thrifts began to appear across the country. While a steady stream of innovations designed to make thrifts more efficient accounts for part of this growth, the businesses also benefitted from increased publicity by thrift leaders directed at both the working class and Progressive Era social reformers.

By portraying B&Ls as a self-help movement, thrift organizers contended their associations were an effective way to improve the lives of working-class men and women
and alleviate many of the social ills affecting industrial cities. Although these changes led to strong business expansion, their success also spawned the creation of "national" B&Ls whose primary objective was to enrich their organizers at the expense of their members. The failure of these fraudulent thrifts during the 1890s significantly tarnished the image of the thrift business, but the "nationals" crisis also led to the formation of state and national trade associations, called Leagues, as a way to promote and protect B&L business interests. Eventually, a national League would become the central force in preparing the thrift movement for the challenges of the twentieth century.

*British Traditions of Home Finance*

Although private financing of homes first began in China more than five thousand years ago, institutional lending for residential purposes originated in eighteenth-century England. The building society movement was the first effort to help people not in the upper classes become homeowners, and its creation resulted from a variety of forces. The first of these was the effort by yeoman farmers to become private land owners. Traditionally, British elites had controlled most of the arable land in the country, which they rented to farmers, but in the 1640s small groups of merchants with excess capital challenged this arrangement by forming land buyers' societies. First appearing in the English Midlands, these businesses bought large tracts of land, which they subdivided and sold outright to farmers. The upper classes, however, realized that making farmers direct land owners and not tenants reduced their power base, and tried to suppress these
groups. Despite such opposition, land-buyer societies flourished well into the eighteenth century.¹

The second development that led to the appearance of British building societies was the friendly society movement, which also appeared in the British Midlands in the late 1600s. Friendly societies were cooperatives of working-class men and women who made regular contributions to a common fund, which members could use for helping with old age, sickness or the relief of widows and children. These organizations began to spread throughout England in the 1750s when the religious revival known as the “Great Awakening” engulfed the country. This evangelical movement emphasized the need for social holiness in which men should work to help the poor, sick, and underprivileged; and the increased attention to “helping your fellow man” led to the formation of more than 7,000 friendly societies by the end of the eighteenth century. This rapid growth prompted Parliament to pass the Friendly Societies Act of 1793, which set basic standards for the organization and operation of these groups.²

The third force that aided the rise of British building societies was the growth of cities during the First Industrial Revolution. The rise of factories caused a tremendous demand for unskilled labor, and as people responded to this demand nearly every major British city experienced unprecedented growth. Between 1800 and 1850, the populations of London and Edinburgh rose by 240 percent. Glasgow experienced a 460 percent


increase, while Birmingham and Manchester more than tripled in size. One consequence of urban expansion was that housing conditions began to deteriorate, since the low wages earned by most workers forced them to live in crowded tenements. For skilled workers with higher incomes, an alternative to the tenement was home ownership, but rising real estate prices in the city made it hard for these people to save enough to buy a house outright. If they wanted to borrow from traditional mortgage lenders, they had to make substantial down payments, and often had to repay the full loan in just a few years.3

In 1781, the experience of the land buyers and friendly societies, which showed how mutual cooperation and systematic savings could achieve goals difficult for individuals, combined with the need for urban housing led to the creation of the first building society in Birmingham. As in the cases of other cooperatives, people joined by subscribing to shares in the society, which made them all part owners. Because few of these middle-class members could buy these shares at their face value, they paid for them over time in regular monthly installments. When enough money accumulated, the society held a lottery to see who would receive a loan to buy a home, but because the loan was equal to the face value of the subscribed shares, it was actually an advance on the unpaid shares. To repay these loans, members continued to make their regular monthly share payments to which was added interest for the loan. This interest, along with any fines and initiation fees, was profit for the building society which the officers distributed to the

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members as dividends. When all members had taken out and repaid their home loans, the building society terminated operations.⁴

Because building societies succeeded only if all members adhered to the ideals of mutual cooperation and systematic savings, once people joined they could not transfer or withdraw their money. Also, failure to make timely share or loan payments resulted in fines and penalties. Furthermore, anyone who joined after a society began business had to make a first payment large enough that the value invested in the new shares was the same as the total amount paid by the original shareholders. This was necessary to ensure that all members shared equally in any dividends. Given such stringent requirements, most societies had fewer than twenty-five members, but it was also common for building societies to admit men and women as members and treat them as equals. Another characteristic of these societies was that the officers usually served without pay, and meetings were held at local taverns -- all in an effort to minimize operating expenses. This last trait often resulted from behests of pub owners, who sold food and drink to the members during the meetings. As a result, many building societies named themselves after their meeting places.⁵

The growth of industrial cities gave rise to another important financial institution, the mutual savings bank. These were the first financial institutions specifically designed to help those of limited means save for the future, and their organizers were motivated to

⁴Leaver, Building Societies, 8-9; Cleary, Building Societies, 16; Price, Building Societies, 5-16. Price dates the first society to 1775 in Birmingham.

help the needy based on the moral argument that they were "deserving poor." The first mutual savings bank, called the Tottenham Benefit Bank, was organized by prominent social reformer Priscilla Wakefield in 1804. Believing that "the only true secret of assisting the poor is to make them agents in bettering their own condition," Wakefield wanted her bank to teach its members how to save and not squander their earnings. To do this, she adopted the share purchase plan used by building societies, in which members had to make regular savings contributions or face penalties. The bank placed these funds in very secure investments, and the interest earned was credited to the member accounts. Similarly, when the shares matured, the member could either withdraw the money or keep it on account. Because mutual savings banks were simple to operate, and served socially acceptable purposes, they were so popular that by the end of the nineteenth century they held more than £57 million for their 1.6 million depositors.6

By 1825, sixty-nine building societies operated in Great Britain, primarily in the industrial regions of the Midlands and the North. As more of these informal groups organized, it became necessary for the government to provide them with some type of legal definition and recognition. Initially, Parliament placed them within the jurisdiction of the Friendly Societies Act, but their more specialized operations led to the creation of the Building Society Act, passed in 1836. At the same time, societies developed standardized operating procedures, which made forming a new association

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The number of new societies multiplied to 2,050 by 1851 and to more than 3,642 by 1895. The assets of these groups also grew rapidly, rising from approximately £17 million to £54.8 million over the same period. The fact that assets growth exceeded the number of new societies is particularly interesting since the period from 1876 to 1896 was a deflationary period in Great Britain, and underlines how important these nascent financial institutions were to their members. A final consequence of this growth was that as people emigrated from England, they often took the building society ideals with them to their new homes.  

The State of Home Finance in America

In eighteenth-century America, institutional home finance was virtually nonexistent, primarily because few people needed to borrow to buy a house. Land was relatively cheap, if not free, and raw materials to build homes was abundant. These conditions began to change during the First Industrial Revolution when urban centers like Philadelphia and New York experienced rapid growth. Between 1790 and 1830, the populations of these cities rose 380 percent and 595 percent, respectively, and one consequence of this was that city housing became more expensive, often requiring some form of outside financing. Initially, private individuals with excess capital provided most of this credit; but because these were loans based on personal connections this system of

finance was not widely available, and there were many inconsistencies between lenders regarding loan terms and conditions.  

While private mortgage lending was the leading source of home finance in America well into the twentieth century, there were other institutional alternatives. One was the state-chartered commercial bank, which offered the advantages of greater availability of money for lending and more standardized loan terms than private individuals. There were, however, several drawbacks to borrowing from a bank for a mortgage. Because bank deposits could be withdrawn on demand, banks needed to make loans that were also fairly liquid. Consequently, to compensate for the low liquidity of real estate, they required home buyers to make a substantial down payment of up to 60 percent of appraised value. The structure of bank loans was also problematic, since mortgagees made interest-only payments during the life of the loan with the full principal due at maturity, a period of no more than five years. A final limitation of commercial bank finance was that only state banks could make mortgages, since national banks by law could not make real estate loans except for agricultural purposes.  

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Another institutional lender involved in residential finance was the mutual savings bank, which also came to America from England in 1819. Like the associations inspired by Priscilla Wakefield, mutual savings banks were neighborhood institutions designed to help the poor and working class save for the future. Despite the use of the term “mutual,” savings banks were not owned by their customers, but rather managed by a group of trustees who made loans on behalf of the depositors. To fulfill their mission as safe repositories, savings banks usually invested in low-risk and highly-liquid state and municipal bonds, but since these deposits were also long-term they also made home loans. While these mortgages had longer terms than commercial banks, the need to ensure safety meant that savings banks also required large down payments from borrowers. Furthermore, mutual savings banks were not national and could only be found in the Northeast.¹⁰

A third institutional source for real estate finance was the insurance company. The first modern insurance company was Lloyd’s of London, a mutually-owned British firm founded around 1688. The basic operating plan of this and other mutual insurance companies was that the members pooled their funds and agreed to provide protection to their clients against the risk of loss resulting from a variety of hazards. By the nineteenth century, insurance companies had expanded their lines of business to provide benefits if the policyholder died. While the main reason people had life insurance policies was to

provide financial security for their beneficiaries, they also used them as savings accounts since most companies paid dividends on the policies and allowed policyholders to borrow from or withdraw these funds after a certain period of time. To cover policy claims and earn a return for investors insurance companies invested their money in bonds as well as long-term commercial and residential mortgages. Like other institutional lenders, insurance companies required a large down payment from the borrower.

Creating an American Thrift Business

Although residential mortgage finance was available from a variety of private and institutional sources, the high down payments required by most lenders provided an opportunity to create an American version of the British building society; and in January 1831, forty-five men in the suburban Philadelphia town of Frankford formed the Oxford Provident Building Association, the first savings and loan in the United States. Because many of these organizers came from the English Midlands and were familiar with building societies, the operating plan of their new financial institution closely resembled its British counterparts. Members subscribed to shares in the association and paid for them in monthly installments. They received advances on these shares to buy homes through an auction in which they submitted bids indicating the loan fee and interest rate they would pay. The member/borrower then continued to make the monthly payments on the shares, as well as the loan interest and a portion of the loan fee, and the officers

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distributed these profits to the members as dividends. Finally, when the members repaid all their loans or paid for their shares in full, Oxford Provident ended business.\textsuperscript{12}

While the main purpose of this first thrift was to provide home loans, an equally important objective was to instill habits of systematic savings and mutual cooperation in members. Not only did late payments incur fines, but anyone withdrawing funds prior to maturity had to pay a substantial penalty. Similarly, the highest bidder for a loan did not automatically receive an advance. Rather, an officers' committee had to declare a person eligible to receive a loan by checking the property, which the member pledged along with the subscribed shares as security, as well as the member's "character" and ability to pay the debt. Similarly, members did not receive dividends in cash; rather the B&L officers credited these funds to the account of each member. Not only did this requirement preserve the money available for lending, but because the amount owed on the shares fell, members realized compound interest on their investments.\textsuperscript{13}

\textit{“Americanizing” the Thrift Business}

Although building and loans were an effective way for people of modest means to become homeowners, there were a number of operational problems that limited their ability to serve large groups of people. First, it was hard for anyone to join a thrift after it began business, because they had to make back payments to put them on a par with the


\textsuperscript{13}Seymour Dexter, \textit{A Treatise on Cooperative Savings and Loan Associations} (New York: D. Appleton, 1889), 66-74.
existing shareholders so that all members could share equally in thrift dividends. Another problem appeared when thrift shares neared maturity and the money received from loan repayments increased. Because this potentially meant the association would have idle funds, thrift officers would often force non-borrowing members to take advances, or require them to liquidate their shares prior to maturity. Finally, the biggest limitation to this original “terminating plan” of operations was that the association was not a permanent entity and had to end business after the members repaid their loans or paid for their shares in full.\(^\text{14}\)

To correct these structural weaknesses, B&Ls began to issue shares periodically on set dates. This minor innovation, which appeared in the 1850s and became known as the “serial plan” of organization, accomplished several goals. First, the steady issuance of shares made the thrift a perpetual entity since members could join over time. Also, by treating each issue of shares as a separate transaction, members could share equally in dividends without having to make back payments. Similarly, the steady addition of new members helped ensure a high demand for loans, which in turn caused more people to join a thrift simply to save long term. While the serial plan quickly replaced the terminating plan, this new structure also had problems. Since each series had individual dividend and payment requirements, officers needed more complex record-keeping systems to track accounts and cash management skills to pay off the series as they came

due. Also, if members wanted to keep their money in the thrift after shares matured, they had to subscribe to new shares and resume making monthly payments. Finally, in areas with rapid growth issuing shares only on set dates could unduly limit business activity.  

By the late 1870s, these shortcomings led to a new form of thrift structure, the "permanent plan," in which the B&L issued shares whenever the need arose. The permanent plan introduced a number of innovations, including passbooks in which to record deposits and dividends, and the matured share given to members who did not want to withdraw their savings after the original shares came due. The permanent plan also led to the widespread use of reserve funds to account for loan losses. Under the terminating and serial plans, each shareholder had the same amount of money invested in the thrift, which meant it was possible for the thrift to directly charge loan losses as they occurred against profits while still treating all members equally when calculating dividends. When thrifts issued shares individually, however, the share balance of each shareholder was different, and so if the thrift continued to subtract actual losses from profits newer members suffered more. To correct this inequality, thrifts set aside up to 5 percent of profits into reserve funds for potential defaults, and calculated dividends out of the

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remainder. When actual losses occurred, they were charged against the reserves and not profits.\footnote{Henry Rosenthal, Building, Loan and Savings Associations (Cincinnati: American Building Association News, 1911), 56-8; Rosenthal, Cyclopedia of Building Loan and Savings Associations, 117-8.}

A fourth form of thrift operating structure was the “Dayton plan,” which was introduced by the Mutual Home and Savings Association of Dayton, Ohio, whose president learned about it on a trip he took to England to observe the latest changes in building societies in the mid-1880s. Like the permanent plan, “Dayton plan” thrifts issued shares individually, but they also allowed members to take out loans for more than the value of their subscribed shares. In addition, these associations often accepted deposits and made loans to nonmembers, although the interest rates on these accounts were inferior to share holdings. Other innovations under the Dayton plan included allowing members to make share payments at any time and in any amount, as well as the ability to withdraw money prior to maturity without penalties. Finally, these thrifts eliminated the use of loan auctions and made mortgages at set rates determined by the officers.\footnote{Reuben M. Goldstein, Building and Loan Associations of Ohio (University of Cincinnati, unpublished B.A. thesis, 1923), 18-22; Byers, “Building and Loan Associations,” 15-6; Bodfish and Theobald, Savings and Loan Principles, 47-50.}

The most significant innovation of the Dayton plan, however, lay in how it calculated loan repayments. A typical B&L loan was repaid through the “sinking fund” method in which the loan matured when the member paid for the subscribed shares in full. One problem with this method was that the interest portion of the loan did not
change even as the principal balance fell. Also, it was hard to set a precise loan maturity
date when repayment was affected by the level of dividends paid by the association.
Dayton plan thrifts improved on this by tying loan payments to the interest rate not the
dividend rate, which meant using the outstanding principal balance to calculate the
interest portion of the loan payment. While this change allowed borrowers to know
exactly when their loans would mature, the primary benefit was that the loan accrued
lower interest charges than the “sinking fund” calculation method. These innovations
marked the birth of the modern amortizing mortgage, a consumer-friendly home loan that
was available only from thrifts for nearly forty years.18

A fifth major operating plan appeared in the late 1890s and was used primarily in
Oregon, Kansas and California. This structure, which became known as the “guarantee
stock plan,” required thrift directors to purchase non-withdrawable stock as a form of
reserve and guarantee that members would earn a specific dividend rate on deposits. If
profits exceeded the required dividend payments, the officer/stockholders received the
excess, but if profits were insufficient to meet the required payments, the balance came
from the stock fund which stockholders had to replenish. One benefit of this plan was
that the reserve fund gave members greater confidence in the overall safety of the
association. Also, since the thrift officers held this stock, management had an incentive

18H.E. Bucker, “Building and Loan Association Fundamentals and Methods: The Ohio Plan,”
Proceedings of the Thirty-Second Annual Meeting of the United States League of Local Building and Loan
Theobald, Forty-Five Years on the Up Escalator (Chicago: privately published, 1979), 245.
to operate as efficiently as possible. Finally, thrifts that used this plan could advertise dividend rates with certainty, which was a strong marketing tool to attract funds.19

**Defining the Thrift Movement**

By the late-1870s, B&Ls began to appear across the Northeast and Midwest, and this expansion led thrift leaders to try to define the nature of their business. Significantly, they described the thrift business as a “movement,” not an industry; and this deliberate choice reflected the fact that many of these leaders identified with the broader effort in America during the late nineteenth century to encourage greater political, social and economic cooperation. The most prominent of these cooperative efforts included the Knights of Labor, the Farmer’s Alliances, Populism and organized social reform campaigns – all of which formed as ways to help their members cope with the changes created by industrialization. Like the thrift movement these movements relied on grassroots organization and mutual assistance to achieve growth. Moreover, while material benefits were important, each group tried to achieve far-reaching and often idealistic social goals that would improve the nation as a whole. This combination of practical benefit and social uplift was a common trait in all these popular movements.20

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20Ellen Furlough and Carl Strikwerda, “Economics, Consumer Culture, and Gender: An Introduction to the Politics of Consumer Cooperation,” in Ellen Furlough and Carl Strikwerda, editors,
The Knights of Labor was one of the first movements to gain national attention in the nineteenth century. Founded in 1869, the Knights objected to the control that monopolies and bankers exercised over the economy and sought to emancipate workers from wage "slavery." The Knights wanted to organize all workers regardless of skill in a "great brotherhood." These wage earners would in turn pool their resources into producers' cooperatives, and use these groups to gain greater power and help them enter the capitalist class. The Knights had other goals for bettering the conditions of the working class, including an end to contract and child labor and the creation of the eight-hour day, which they argued were needed to give workers leisure time for improving their social lives. The Knights was an inclusive organization and welcomed women, immigrants and African-Americans as members, and by 1886 had more than 700,000 members. However, because the Knights became associated with the deadly Haymarket Square Riot that year, support for this movement rapidly declined and by the end of the century had vanished into obscurity.21

Another area where cooperative efforts were strong was among the farming communities of the Great Plains. Often isolated from their neighbors, farmers were at the mercy of railroads to send their crops to market and to big businesses for everyday goods. To increase their economic power, farmers formed cooperatives under the auspices of the


Grange and Farmers' Alliance which pooled the resources of growers into one entity and gave farmers greater leverage to negotiate prices with shippers. They also formed local cooperative stores to buy machines and other goods in large quantities and at lower costs. By 1890, the Farmers' Alliance claimed more than three million members, and in 1892 it expanded its activities into politics with the People's Party. Also known as the Populists, this grassroots political group advocated state ownership of railroads, a graduated income tax, lower tariffs, and easier access to money through the free coinage of silver and a "subtreasury" plan. Populism was successful at the state and local levels, and its ideas on government activism had ultimately important effects on both the Democratic and Republican parties.  

A third movement of the late-nineteenth century was the rise of organized social reform groups led by religious leaders and women. Organizations like the Young Women's Christian Association, the Woman's Christian Temperance Union and the Hull House focused on alleviating the economic and social problems experienced by the urban poor. Reformers preached a "social gospel" which maintained that in order for people to lead pure lives they had to have decent homes and opportunities to develop their talents. To create these opportunities, reformers organized vocational instruction programs, ran shelters and hospitals, and promoted physical fitness and temperance. They also advocated civil service reform, an end to child labor, and greater government regulation.

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of big business. Much of this work was coordinated locally with women taking a leading role, and while the participants in these programs realized practical benefits the organizers also emphasized the moral effects of self-improvement.23

The Knights of Labor, the Farmers' Alliances and, to a lesser extent, Populism and the social gospelers shared several important characteristics with thrifts that helped define them as movements. First, these were nonprofit groups that relied on mutual cooperation for their success. Second, they were primarily grassroots organizations that were easy to form. Third, they were often based on democratic principles, with the leaders usually coming from the membership. Fourth, these movements focused primarily on the least advantaged members of American society, and promoted self-improvement as the best way for advancement. Finally, these groups wanted to achieve broad economic and social goals for their members and the nation as a whole. It is this sense of idealism bordering on evangelism that distinguishes a movement from other forms of organization, and that helped make thrifts unique among America's financial institutions.24

The formation of popular movements by groups of Americans seeking to protect their self-interest was not unique, and in the late-nineteenth century businesses leaders and various professions also began to organize to promote their interests. One reason for


doing this was to help rationalize industries racked by increased competition resulting from changes caused by the Second Industrial Revolution. Forming trade associations gave businesses forums to discuss issues affecting their industries; and, while this helped leaders share information, it also raised problems of collusion. Professionals, like doctors and bankers, also formed organizations for many of the same reasons as businessmen, but they also wanted to use these groups to set standards for members and instill greater public confidence in their work. Thrifts ultimately followed this same course, and like other businesses, the trade association B&L leaders formed became a dominate force in shaping future growth.25

Reaching the Working Class

In order to publicize the benefits of the thrift movement, its leaders wrote books and circulated pamphlets targeted at working-class men and women. While these works emphasized the practical and economic benefits of owning a home, they also gave equal treatment to the beneficial effects home owning had on morals and character. One of the earliest of these works appeared in 1852. Its authors described in detail how B&Ls operated as well as how they were good places to invest financially. They noted how private homes were superior to tenements for families, and stressed that thrifts developed in their members the positive habits of self-restraint, respect for property, and interest in

the community. They concluded that from "both a moral and political point of view, these associations assume a position of vital importance."  

The first thrift publication to gain national prominence was *The Working-Man's Way to Wealth* by Edmund Wrigley, published in 1869. Wrigley developed two basic themes that became the basis of most early books on B&Ls. The first focused on the principles of thrift and mutual cooperation as the foundations of the successful building and loan. Wrigley provided a "how-to" guide for organizing a B&L and explained in detail how shares accrued compound interest and the ways in which loans were made and repaid. Noting this myriad of economic benefits, Wrigley concluded that "the building association is the only plan by which the working man can become his own capitalist." The second major theme of the book emphasized how developing the habits of systematic savings and mutual cooperation by joining a thrift could improve personal morals and increase self-esteem and self-sufficiency. The book was so popular that it went through six separate editions, and in 1873 Wrigley wrote the first thrift operating manual.  

Thrift leaders also relied on public addresses to reach potential members, and these speeches cited the practical and moral benefits of joining a B&L. One speaker stressed how mutual cooperation could lead to home ownership and self-improvement,

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noting that “it is very easy to help another man. It is very hard to help yourself. The chance here offered by these associations may be the cornerstone of your prosperous life. The spirit must be, first to encourage thrift; then to aid one after another to own his own home; and in and through it all a spirit of cordial cooperation.” Other speeches about the movement described B&Ls as the essence of democratic institutions, claiming that they “possess the only plan by which the working man can become his own capitalist . . . [and] create a community in which communism, socialism and anarchy will not be tolerated.”

Daily newspaper advertising, however, was the most prominent form of B&L publicity. Given the space constraints of newspapers, associations focused more on the concrete financial rewards of joining a thrift, such as good dividend earnings or safety of operations. Some advertisements also stressed how joining a B&L would help a person end the waste associated with renting a home. The copy of a typical advertisement included the following: “Young man and Woman, stop and reflect! The money you fritter away uselessly will make you independent. Today sign the magna charter of your independence and like our forefathers, in about eight years you will, in a great degree, be independent by saving only thirty-three cents each day. In that time you will realize $2,000 or have a home and be independent of the landlord.” In cities like Philadelphia, Cincinnati and Chicago associations also published cooperative weekly or monthly papers to give working-class people more complete information about the movement.

\[^{28}\text{Robert Treat Paine, Jr., } Cooperative Savings Banks or Building Associations (Boston: Tolman and White, 1880),\text{ quote 12; F. W. Bell, } Building Associations, How Operated, Advantages, Etc. Read before the Office Men’s Club, June 10, 1886,\text{ Pamphlets in American History, Cooperative Societies (s.l.:s.n., 1886), quote.}\]
While designed to promote thrifts, some of these publications also served as trade journals and over time became important business organs.²⁹

**Reaching the Social Reformers**

A second form of thrift promotion worked to gain support for the movement from social reformers and urban elites. One of the first instances of reformers examining the work of B&Ls occurred when the American Social Science Association (ASSA) conducted an extensive investigation of the movement. Founded in 1869, the mission of the ASSA was to “promote personal interaction between individuals interested in promoting educational, financial, sanitary, charitable and other social reforms and progress.” The members of this organization were primarily middle-class and upper-class men and women, including noted academics and scientists. They invited nationally-known speakers to address their conventions. The ASSA had affiliate social science associations in several Northeast and Midwest cities, as well as correspondents in several European countries.³⁰

Because one of the main concerns of the ASSA was the state of urban housing and its relation to family life, its members soon became familiar with the activities of the thrift movement. The first reports on B&Ls came from the Philadelphia Social Science Association in 1874, and six years later the ASSA Social Economy Department submitted its first report on “cooperative building associations.” This paper, which included

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information on building societies obtained from the British Social Science Association, cited the positive work thrifts were doing in helping the working-class people become home owners, and for the next twenty years the department provided annual reports on the progress of the movement. This interest led several ASSA members to become active in the movement. Among these were Robert Treat Paine, Jr., of Boston and Judge Seymour Dexter of New York, both of who became prominent thrift leaders.31

The work of the ASSA was just one example of how the movement was attracting the attention of social reformers. Another way thrift leaders attracted the attention of reformers was by writing articles in magazines like *Scribner's* and *North American Review*, which were read primarily by middle-class and upper-class men and women. Many of these works argued that because the thrift movement worked to increase home ownership among the working class it was an effective way to alleviate the problems of congested urban centers. One author argued that B&Ls would “remedy the difficulties and disabilities under which New York labors in the housing of her skilled workmen and great laboring class” and that without them the city’s future as a commercial and manufacturing center was not as strongly guaranteed. Others appealed to the ideals associated with home ownership and saw the movement as a way to “remove the youth of the nation from the terrible ever present temptations of the crowded tenement dens.”

Finally, B&Ls "encourage the development of thrift and providence among wage-earners. .. and has a social and moral value in counteracting the tendency... to a wider divergence between rich and poor, and the development of a proletariat class."

Another theme used to gain the support of social reformers focused on how thrift membership improved personal morals and strengthened community spirit. Often these writers emphasized the fact that the movement was not a charity, but was "essentially advancement of self-help. . . .There is nothing philanthropic about it. The man or woman who joins a building association and builds a house sacrifices nothing of self-respect and nothing of dignity. Indeed self-respect and dignity are increased." Philadelphia newspaper publisher Addison Burke noted that because the movement encourages self-sufficiency, a B&L "does more good for the community than the philanthropist who, in helping workmen to acquire homes through gifts of money . . . leads them to look forward with a beggar's wistful eye to means of getting money without working for it."

Furthermore, when thrifts helped people acquire their own homes, "steadiness, morality and thrift are encouraged, and lawlessness is held in check."


To convince upper-class Americans that the movement could improve citizenship and reduce social unrest, which was "the dream of the reformer," thrift leaders argued that "you cannot make a rioter out of a [homeowner]. He is a 'capitalist;' he will never be a turbulent striker." Similarly, because the movement encouraged mutual cooperation, thrifts helped produce "a community of patient, diligent, frugal and contented workers... [who instead] of wasting their hours and strength to useless opposition [and] listening to the idle talk of the demagogue, they unite, not for the purpose of overthrowing capital, but with the design of becoming in good time capitalists themselves." Given these benefits, they argued that "this movement... deserves the support and encouragement of all employers of labor as well as those devoting their energies to moral, patriotic, or philanthropic purposes."

**Gilded Age Growth**

The combination of increased promotion among both potential working-class members and reformers, improved organizational structures, refinements in lending procedures contributed to the impressive growth of the thrift movement in the late-nineteenth century as seen in Table 2.1:

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Table 2.1: Number of Thrifts and Assets - 1888 to 1900

One important trend from the early history of the thrift movement is that vast majority of all B&Ls were small, since the average thrift had under 300 members and held less than $90,000 in assets. The main reason for this was most B&Ls were local institutions that served well-defined groups of aspiring homeowners. For example, Philadelphia had more than 900 thrifts by 1890, which caused it to be known as "City of Homes," and similar concentrations of B&Ls were in Baltimore, Chicago, and Cincinnati. Furthermore, when the federal government conducted its first survey of all B&Ls in 1893, it found that these associations were helping people of limited financial means. It reported that 26.7 percent of all members were artisans, mechanics and merchants, 23.5 percent were laborers and factory workers, and 17.7 percent were housewives and housekeepers; just 2.2 percent were "capitalists." The report also found that the financial condition of most B&Ls was relatively sound, and of the more than 350,000 homes thrifts
financial only 8,400 ended in foreclosure. Ironically, the first loan ever made by an American thrift ended in foreclosure.  

A second trend not revealed by these figures was that the expansion of the thrift movement across the country was very uneven. Initially, thrifts were concentrated in Pennsylvania, New Jersey, Massachusetts New York and Maryland. As Americans moved westward, by 1866 B&Ls formed in California, Texas, and Illinois. Surprisingly, thrifts did not appear in states like Ohio, Tennessee, and Rhode Island until much later, and one reason for this spotty expansion pattern is that settlers in the West knew about thrifts while living in the East and took this idea with them. Also, the rapid growth of cities like Chicago and San Francisco made forming thrifts a logical solution. By 1880, all but five states had at least one thrift, and just ten years later B&Ls operated in every state or territory, including Hawaii.

The Role of Women in B&Ls

The 1893 federal survey of the thrift movement revealed the importance of women in helping B&Ls grow. The first thrift to admit female members was the Second Oxford Provident in 1841, and the first B&L organized and managed by women opened its doors in 1880. The government also reported that over 25 percent of all thrift

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members were women; indeed, of the 4,260 associations surveyed, only twenty-seven had no female members. Furthermore, female members held shares and borrowed money in their names, and had rights equal to those of male members. Women even served as elected delegates at League conventions. One reason why women were so involved in the movement was that thrifts were community-focused associations. Also, because most thrifts in the late-nineteenth century were small institutions that drew members from the local neighborhoods, it was common for people to learn about B&Ls by word-of-mouth or by referrals from existing members. These characteristics meshed with the strong networking skills and community support groups of women, especially among the urban working class. One female thrift manager noted that because B&Ls were well suited to women’s “rare facility of utilizing with power the small forces of life that are often regarded by men as unworthy of their attention,” they were “in conception and practical workings essentially feminine.”

Another important reason women joined thrifts arose from the close ties between home ownership and the traditional role of women as family leaders. Both men and women recognized that the primary female responsibility was to raise the family and

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reasoned that they should also be involved in social and economic pursuits that furthered this goal. One key area of this "woman's sphere" of influence lay in providing a proper home environment, and since B&Ls helped in this respect thrift leaders often considered it a duty of women to become thrift members. According to one female leader, the relationship between thrifts and women was "as close and binding as home and church." Another asked "where else do we find two great spheres into which we may class all women - the business on the one hand and the domestic on the other - coming together as closely and intimately as in the building and loan?" Male thrift leaders likewise advised associations to "encourage the securing of women as investors and borrowers, as she generally succeeds in her undertakings" to improve the home. They further noted that women tended to be thriftier than men and that they were also good credit risks.38

A second aspect of the "woman's sphere" that corresponded to the work of B&Ls was the strengthening of personal morals and character. While securing a home was the main goal of most members, thrift leaders considered developing the habit of systematic savings equally important, since thrift taught men and women "industry, frugality and patriotism." Similarly, homeowners learned values associated with pride of ownership and pride in their communities. Since women were "the teachers of thrift and helpful principles," men wanted them to help instill these ideas in others. They noted how female members often made their husbands join and become thrifty and work toward the

goal of owning a home. One of their greatest contributions as thrift members, however, was teaching these values to children. Women saw thrift as a virtue that children needed to have, and associations assisted in building this virtue by allowing minors to have accounts in their names. They also developed school savings programs, and some even maintained separate juvenile annexes.39

Women also closely identified with the self-help elements of thrift work, and some female B&L leaders connected this to the broader rise of Progressivism. As one woman suggested, promoting thrift and home ownership among the working class would "bring about a condition of affairs . . . as fruitful of perfect happiness as is pictured by Mr. Bellamy in his 'Looking Backward.'" Related to this image of thrifts as social reformers was the idea that thrift-inspired home ownership could protect traditional values such as patriotism and personal freedom. Female thrift leaders also related these ideas to the "women's sphere." One female thrift leader asked rhetorically "what is the [thrift] ideal? Surely a home. What does it signify? Safeguard of American liberty. Here Woman's Day has always been."40


Finally, women became thrift members as a way to achieve long-term financial security. Because monthly share payments were small, women of all ages, marital status and employment status could use these associations to save for the future. In Massachusetts, over 12,000 women held thrift shares valued at $11.5 million, due in part to the fact that the average monthly payment was just $1.25 per share. Most single female workers used their memberships to save for their well-being, while married women joined to have a financial cushion should their husbands lose their jobs, become disabled or die. Similarly, some women became members after their husbands borrowed from B&Ls in order to provide for new households. Several states recognized these motives and allowed married women to hold accounts as individuals with ownership rights separate from their husbands. Likewise, managers often commented on how women tried to calculate dividend payments on their own, and were eager to learn more about their accounts.41

The “Nationals” Crisis

By the late 1880s, the growth of the thrift movement contributed to the creation of a new type of B&L that applied the ideals of systematic savings and mutual cooperation

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on a national level. These new associations, which became known as "national" B&Ls, had the potential to enhance greatly the stature of the thrift business by extending the movement beyond urban centers into rural areas. Typically headquartered in a city like Minneapolis or Chicago, "nationals" were usually formed by bankers and industrialists and had on their boards prominent people like state governors and congressman. These organizers usually held capital stock in their thrifts, with the typical amount of equity invested totaling $5 million. Most "nationals" operated on the serial plan, and employed promoters who traveled the country to form local branches, the majority of which were in the Midwest and South. These member share payments were then sent back to the home office where they were pooled with other funds that members could borrow from to buy homes.42

This plan of collecting money from across the country and concentrating it into a larger loan pool was in principle an ideal way to bring the benefits of B&Ls to areas too sparsely populated to have their own associations. Unfortunately, there were negative aspects of the "nationals" that prevented these thrifts from meeting their objectives. First, "national" B&Ls were for-profit businesses in which the organizers expected to make a return on their investment separate from regular dividend payments. Second, the organizers, officers, and promoters all earned hefty salaries, and the typical "national" spent from 6 to 11 percent of revenues on operating expenses. By contrast, the rate for

traditional B&Ls was just 1 to 2 percent of revenues. Finally, the “nationals” reduced the money available for home loans by segregating member payments into insurance funds, to pay the par value of the shares to the heirs of any deceased member and also to support expense funds to cover operating costs. After making these deductions, only 80 to 85 percent of the total members’ payments was available for loans. In contrast, virtually all member dues at a traditional B&L were lent as mortgages.43

Despite these drawbacks, the “nationals” were extremely successful and spread quickly across the country. By 1893, over 290 such associations were in business, a figure that rose to 361 three years later. Some “nationals” were among the largest financial institutions in the country, with assets in the millions and membership in the tens of thousands. In contrast, the typical “local” had on average $100,000 in assets. At their height, the “nationals” controlled over $139 million in assets, and branches of these associations could be found in every state. While most people joined the “nationals” to become homeowners, another equally important reason was that “nationals” seemed to offer a way to get rich quick, since their advertised dividend rates were three to four times as high as those available from any other financial institution.44


While the "nationals" did not actually guarantee investors would earn high returns on savings, these rates were implied because these associations did guarantee that their shares would mature after a set number of monthly payments. The "nationals" maintained this was possible because they were high-volume lenders that would generate large amounts of interest income. Traditional thrift leaders, however, conducted a close examination of the "national" business practices and found that interest income was just one source of total revenues. The "nationals" actually charged members up to fourteen different types of fees and fines, many of which were quite exorbitant. Furthermore, their mortgage agreements had strict payment requirements that increased the potential of foreclosure by the lender. Finally, members faced severe restrictions on premature withdrawals, and "nationals" commonly required deposits be held with the thrift for a minimum number of years to avoid penalties. Some also operated under a "tontine" arrangement in which withdrawals or any late payments resulted in the complete forfeiture of member savings.45

The leaders of traditional thrifts were incensed by the "nationals," and in an effort to distinguish themselves to the public they began to refer to their B&Ls as the "locals." They also tried to discredit the "nationals" through articles that highlighted the inherent problems of these associations, one of which was having all branch loan requests

approved by the home office. Since the officers in the home office rarely were familiar
with the real estate conditions where their branches operated, it was common for them to
make loans based on overvalued appraisals or inadequate security. Also, since branch
agents were paid according to the number of new members they attracted and not the
quality of the loans, borrower-credit risks were unusually high. The “locals” contended
such operational problems virtually guaranteed a loan portfolio of such low quality that
the safety of the entire institution would be at risk, a problem they said they rarely faced
since their loans were approved by directors who came from the local community.46

Another line of attack on the “nationals” exposed the contradictory promises they
made for high returns on savings and easy availability of loans at low interest rates.
According to the critics, “these magic workers think nothing of promising that the
borrower shall pay only six percent for his money, six to eight percent shall be deducted
for expenses, and yet the depositor will realize from seventeen to fifty percent on his
investment.” By showing how these B&Ls imposed many restrictions on member
savings, the “locals” graphically demonstrated that a person would have to hold money in
a “national” up to four years to avoid losing money, while earning a paltry 1.5 percent
return. As the “nationals” began to post unfavorable financial results, the problems
predicted by the “locals” gained credibility, and one critic wondered how a “national”

46See How It Works,” FRABAN 14 (March, 1895), 3; J. H. Westover, “The Difference Between
National and Local Building Associations,” FRABAN 16 (May, 1897), 5; “National Installment Loan
Companies,” ABAN 43 (June, 1923), 254-7; “National Installment Loan Companies,” ABAN 43 (July,
1923), 311-13; D. A. Emery, “The National Building Associations of Twenty Years Ago,” Proceedings of
the Thirty-Second Annual Meeting of the United States League of Local Building and Loan Associations
with annual management expenses of nearly 10 percent of total income "can keep going and pay even a small percentage of interest. Yet this particular St. Paul company offers 24 percent interest. Comment is hardly needed here. It is plain to see that somebody is going to be greatly disappointed."  

The "nationals" defended their work, contending they were not in competition with the "locals" but instead complemented these thrifts by distributing funds more equitably between areas of high and low loan demand. Furthermore, because most "nationals" were wholesale lenders, they needed paid agents to "expand the usefulness" of their work. In terms of their expense accounts, these leaders countered that unlike most "locals" managers, "national" organizers were full-time employees and needed to be paid accordingly. They also contended that their thrifts were safer than traditional B&Ls, since they limited their mortgages to just 50 percent of appraised value, unlike the "locals" which lent up to two-thirds of the value. Given this, they argued that the "nationals" combined the best practices of traditional thrifts, such as the encouragement of systematic savings and mutual cooperation, with the conservativeness of banks and insurance companies. Finally, the "nationals" cited the 1893 survey of B&Ls by the

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federal government, which concluded that these associations were "conducting business with the same integrity as the locals."^48

As leaders of both "nationals" and "locals" fought each other, they began for the first time to press actively state legislators to enact laws governing all B&Ls. Although "national" leaders scored some modest victories, the "locals" were more effective and secured a number of anti-"national" restrictions. These included prohibiting "foreign" associations from opening branches in a state, capping officers' salaries as well as fines and fees, and even banning the use of the word "national" in the name of an association. These efforts occurred throughout the country, and in states such as Illinois, Indiana, West Virginia, and Missouri, local thrift leaders essentially drafted the laws passed by their legislatures. Most laws were not simply designed to limit the "nationals," but were an attempt to promote the "local" movement by producing better business standards. In Ohio, the thrift trade group secured the adoption of a "model building association code," and by 1900 nearly every state passed some form of thrift law.^49

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While legislation did hinder the "nationals" business, what ultimately caused these thrifts to disappear was a deflation and collapse in real estate prices during the Depression of 1893. Problems began when these B&Ls could no longer attract new members and borrowers. Because the "nationals" relied heavily on membership and loan fees, which in some cases accounted for over 25 percent of total income, the lack of new members meant they had trouble covering both their hefty expenses and large dividend payments. Another detrimental factor was the general collapse in real estate values. During the late 1880s, real estate prices rose to such an extent that even if borrowers defaulted on their loans, the lenders who acquired these properties could still resell them and make a profit. In the period of deflation, however, the properties "nationals" acquired through foreclosure were worth just a fraction of their original value.50

By 1897, the number of prominent nationals that went out of business began to skyrocket, and in their wake thousands of working-class members were left penniless. The most shocking aspect of these failures, however, was that they revealed the magnitude of these thrifts' self-dealing practices. One Minneapolis association, with branches throughout the Midwest and assets of over $2.1 million, had spent $1.2 million for expenses during its seven years of operation. Another "national" with only $170,000 in assets spent nearly $40,000 annually on operating expenses. By 1897, "local" thrift leaders estimated that over half of all "nationals" had failed in the previous four years.

costing investors a quarter a billion dollars. The death knell for the “nationals” came when the largest, the Southern Building and Loan Association of Knoxville, Tennessee, with $5 million in assets collapsed. This thrift had a broad network of branches across the South and its failure sparked a number of banking scares that fueled a general loss of confidence in all “nationals.” By the end of the century only a handful of “nationals” still remained, and all were be gone by 1910. Such a rapid rise and fall of thrifts that generated profits for their owners at the expense of the members would, unfortunately, occur again during the 1980s.51

The Legacy of the “Nationals”

The rise and fall of the “national” B&Ls had important consequences for the thrift movement. One negative effect was that the wholesale failure of the “nationals” sparked a general loss of public confidence in all B&Ls. This situation was especially true in the South, and in states like Tennessee, where in 1893 sixty-one “local” and seventeen “national” B&Ls existed, a total of just fifteen thrifts were in business by 1910. In Georgia, which had thirty-one “locals” and twelve “nationals” in the 1890s, one thrift was still in business by 1900. The crisis also tarnished the reputation of the thrift movement and undid much of the effort to position B&Ls as friends of the working class. Because

the “nationals” were so similar to the “locals” in terms of operations and nomenclature, it was hard to convince people that any building and loan was still safe. As one thrift leader commented, “it will be years before it will be possible to establish a genuine building and loan association in a community after the name of building associations has been besmirched and prostituted, and brought into grave disrepute through the action of schemers who have run these bogus concerns.”52

Among the positive consequences was the realization by movement leaders of the importance of having state laws to regulate B&L operations. While many of these laws were intended to drive the “nationals” out of business, thrift leaders also wanted them to limit the potential for future competition and promote the movement by restoring public confidence in legitimate B&Ls. The movement also pressed legislators to update these laws periodically and frequently took the lead in drafting desired legislation. A second important positive consequence was that B&L managers realized the importance of reserves as a way to reduce the possibility of failure when real estate values fell, and by the early twentieth century most thrifts began voluntarily to create loan loss reserve funds. Finally, the “nationals” experience directly led to the creation of the guarantee stock plan, which required thrift directors to create and maintain a permanent capital fund and guarantee their dividend rates.53


The most significant consequence of the “nationals” crisis was that it showed thrift leaders the importance of greater internal organization through trade associations. As early as the 1870s, B&Ls began to form state trade associations called “leagues,” and by 1890 twelve were in operation. As the “nationals” crisis grew, these leaders formed the United States League of Local Building and Loan Associations in 1892 to provide a forum for state leagues. Although some thrift leaders saw the national League as a temporary body limited to defeating the “nationals,” its founders had long-range plans for this organization. As outlined by its first president, Seymour Dexter, the League would “magnify the movement we represent not for our own welfare, save as citizens, but for the welfare of the Republic.” The primary way to do this was to popularize the positive benefits of thrift and home ownership, the importance of which was evident in the League motto “The American Home. The Safe-Guard of American Liberties.” During the next thirty years, the League became an important force that promoted the thrift movement, created uniform business practices, and encouraged the passage of favorable legislation.54

Conclusions

From the appearance of the first thrift in Philadelphia the 1830s, American B&Ls had, by the end of the nineteenth century, spread from coast to coast. One reason for the

rapid growth of these B&Ls, which helped working-class men and women save for the future and acquire homes affordably, was that they were mutually owned and used different plans of organization that made them easy to form and operate. Another factor was that thrift leaders aggressively promoted their businesses and the benefits of thrift and home ownership to not only the working class but also socially-conscious reformers. By the late 1880s, the success of the thrift movement combined with economic prosperity gave birth to a new type of B&L called the “national.” The prolonged depression of the 1890s led to the wholesale collapse of the “nationals,” and by 1900 they had virtually disappeared. The “nationals” crisis represented the first major challenge the thrift movement faced in its brief history, and the experience had a number of important consequences. One of the most long-lasting was the realization by thrift leaders of the need for greater internal organization. In 1892, these leaders formed the United States League of Local Building and Loan Associations as a national trade association to promote the principles of thrift and home ownership as well as the political and economic interests of the thrift movement. As the League entered the twentieth century, its dual role of encouraging the basic tenets of the thrift movement and shaping the direction of the thrift business would help repair the image of B&Ls and help them assume a greater role in residential and consumer finance.
CHAPTER 3

THE RISE OF THE LEAGUE, 1900-1929

By the turn of the twentieth century, the "nationals" crisis was over and the thrift movement faced the challenge of restoring its image and returning to prosperity. At the forefront of these efforts was the movement's trade association, the United States League of Local Building and Loan Associations. The League focused on three major objectives. The first was to repair the damage caused by the "nationals" controversy was to reemphasize the ties between B&Ls and the ideals of thrift and home ownership. Elements of Progressive Era reform movements partially aided these efforts as B&L leaders cited how home ownership could help in meeting the goals of these reformers. A second objective focused on generating greater advertising and publicity. The League advised associations on useful advertising methods, encouraged their participation in national promotions of thrift and home ownership, and took steps to build better relations with housing-related industries. The final objective of the League involved encouraging uniform business practices and creating professional standards -- including designing formal education classes for thrift managers, modernizing the physical appearance of B&Ls, and adopting standardized lending systems.
These efforts, combined with economic prosperity and increased consumerism in the 1920s, helped the B&L movement recover fully and emerge as an important source of consumer finance. The success of the movement did not go unnoticed by others, however, and the result was greater competition from banks as well as increased public scrutiny into how thrifts conducted their work. Despite these developments, the experience of the first two decades of the twentieth century helped the League mature as a trade association and gave it the capacity to aid the movement once the nation sank into the Great Depression of the 1930s.

*Progressivism and the Thrift Movement*

The major focus of the League at the turn of the century was to restore and strengthen the tarnished public image of the B&L movement following the “nationals” debacle. While the actual damage in terms of failed associations during the 1890s was nominal, thrift leaders were still concerned that legitimate B&Ls had been smeared by the episode. To rebuild public trust and confidence in these institutions, the League resumed its efforts to promote how B&Ls helped their members acquire the habit of thrift and the benefits of home ownership. These themes had been critical in helping the movement grow in the 1880s, and in the early twentieth century the League hoped they would attract the favorable attention of the Progressives who were also trying to improve housing conditions for the working class. Despite such similar goals, these reformers did not always consider the creation of B&Ls as a way to solve the nation’s problems.¹

The rise of Progressive reform movements in the early 1900s resulted in part as a way to address the social changes caused by the Second Industrial Revolution. One aspect of the work of reformers lay in improving the substandard and overcrowded living conditions of the urban lower classes. Although reformers began addressing this problem as early as the 1860s, it was only after muckraking journalists brought greater attention to the evils of the infamous “dumbbell” tenements that substantive changes were made. In 1900, New York Governor Theodore Roosevelt formed the first state housing commission that issued substantive tenement reform laws, and similar government bodies appeared in other industrial cities. Eventually, the mission of improving tenements became a national movement when urban reformers founded the National Housing Association (NHA) in 1911. The NHA, like other Progressive organizations, approached the housing problem scientifically and collected data on the problems, educated the public on the need for change, and secured corrective legislation that could be enforced.2

While the NHA believed that teaching the public how to live better was an important part of housing reform, it did not try to encourage these people to join thrifts and become home owners. One reason for not doing so was a matter of priorities. As NHA leader Lawrence Veillor noted, “any effort toward considering more interesting and

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attractive forms of housing had to wait” until tenement conditions were improved. He saw the immediate conditions as the more “serious social menace which threatens to overwhelm American institutions.” Nor was Veillor entirely convinced that home ownership would produce lasting reforms. He claimed that “in cities where the workingman owns his own home . . . sanitary authorities have the greatest difficulty meeting health needs, securing adequate appropriations, and enforcing higher standards.”

A final reason why the NHA may not have seen B&Ls as a viable solution was that its focus was on helping the poorest elements of society who did not have the financial capacity to join thrifts. As Robert Treat Paine, Jr., a thrift leader and president of Boston’s Associated Charities, noted, tenement reformers aimed to help “the class who have sunk to the very bottom and propose to stay there.” Thrifts, however, wanted as members “the classes above the lowest” because these people had more stable incomes. This requirement that members had steadier incomes was important because systematic savings were critical to the success of any B&L.3

Although few Progressives advocated organizing B&Ls as an immediate solution to urban housing problems, they did agree that teaching the habit of thrift would help solve another tenement problem, that of loan sharks and pawnbrokers who preyed on immigrants. Urban reformers supported the creation of remedial banks and employee cooperative savings banks to provide personal finance at reasonable terms and conditions.

These mutual banks were not charities, but rather self-help organizations that operated much like B&Ls by issuing shares to members who paid for them over time. The only real difference was that remedial bank loans were small and used for household needs. Given such similarities, it is likely that when lower-working-class borrowers advanced into higher wage positions, they would already have the financial habits needed to join a B&L and make a final exit from life in the tenements. Consequently, it may be best to view such NHA reforms as a stepping stone to the ultimate goal of home ownership through a building and loan association.4

Another goal of Progressive reformers was to bring immigrants into the American mainstream. Achieving this objective took a variety of forms, including “social hygiene,” settlement house, health education, and temperance movements. Because this work involved making immigrants “better” citizens, thrift leaders felt this was an area they could play a role in. Since the 1870s, B&L movement leaders had maintained that increasing home ownership would reduce the threats of socialism and labor unrest, since owning a home “adds dignity and earnestness to life.” Also, home owners, they claimed, took a greater interest in government and would “demand as a matter of right purer water, better sanitation, better schools and better moral surroundings.” Finally, developing the habit of thrift in immigrants would reduce “wasteful” spending on socially harmful goods

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like cigarettes, gum, and alcohol. Initially, however, most Progressives continued not to see the creation of thrifts as part of their work.\(^5\)

By the mid-1910s, the rise of “good citizenship” and “Americanization” movements finally caused reformers to recognize the potential of thrifts to improve personal morals and character. Because the majority of the estimated 9.3 million immigrants who came to America between 1873 and 1910 were from southern and eastern Europe, some “traditional” Americans saw these people as a threat to the American way of life and value system. One business leader even contended that “the greatest danger . . . upon our country’s future prosperity is the emigration to our shores of thousands upon thousands of the ignorant lower classes of the old world.” To address this perceived problem reformers tried to “Americanize” immigrants by forming national organizations like the YMCA, and local bodies like settlement houses. The League recognized the potential benefits of participating in these movements, and encouraged thrift managers to make “special efforts . . . to secure the foreign element as members,” since “every time you make a home you make a citizen.”\(^6\)


As this work to encourage immigrants to join thrifts grew, people associated with the Americanization effort began to give greater recognition to the B&L movement. The president of the Kalamazoo Chamber of Commerce said that the best way to Americanize aliens was to form B&Ls for them so that they could learn how to manage their own finances and own their own homes. Governor Woodrow Wilson of New Jersey noted that the real significance of B&Ls was its “moral influence on members. It is a movement for the conservation of the character of citizenship.” New Jersey Chamber of Commerce President George Viehmann spoke for many when he said there was "no greater force for the Americanization of the immigrant than is being exerted by the building and loan association.” He also noted that immigrant home owners "take a taxpayer's interest in good government and politics." One reason why good citizenship groups used thrifts to promote Americanization while housing reformers were generally averse to the idea was that “Americanizers” often had more diverse social backgrounds and were not drawn simply from urban elites.7

A third aspect of Progressivism that shared a similar goal with the B&L movement was the effort to promote thrift by reducing personal and national wastefulness. To do this, however, efficiency advocates had to convince people that thrift was not a negative trait associated with parsimony and miserliness. This task became

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much easier during World War I because victory required all Americans to make financial sacrifices. One example of this was the need to raise money to finance the war effort, since 77 percent of all war expenditures were covered by issuing federal debt. Significantly, much of this debt was sold to individual Americans in the form of small denomination Liberty Loans and War Savings Stamps. The idea to involve the general public in financing the war came from Treasury Secretary William MacAdoo who created campaigns which made buying government bonds as the patriotic duty of all citizens. The result was overwhelming national participation, and by the end of the war 22 million people held more than $17.8 billion in government debt, up from the $1 billion held by 200,000 people in 1914.8

Such broad popular support for Liberty Loans encouraged reformers to continue their work of encouraging thrift after the war and to change what the Cleveland Plain Dealer described as a national motto of “easy come; easy go.” One reason that reformers felt it was possible to sustain these efforts was that the war experience had created a new concept of thrift in which people “realized for the first time it was a matter of life and death whether they wasted or whether they consumed.” Consequently, while the government ended most wartime conservation programs in 1918, the Treasury

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Department continued to sell savings stamps to help perpetuate the habit of thrift. Similarly, academic and civic leaders tried to promote the idea of a “New American Thrift” by designing standardized budgets that would achieve the “proper use” of resources, and creating classes to teach children the benefits of thrift. 

The high point of this renewal of thrift came in 1919 when the Treasury Department urged the YMCA and other national civic organizations to create a nationwide celebration of financial awareness called National Thrift Week. Designed to increase public education about the benefits of sound financial planning, each day of Thrift Week had a specific theme, such as “National Thrift Day,” “Share with Others Day,” and “Pay Your Bills Promptly Day.” To give this celebration added importance, it occurred around the January 17 birthday of Benjamin Franklin, whose Poor Richard’s Almanac contained many well-known stories on the advantages of thrift. Since the goals of National Thrift Week and the B&L movement dovetailed, the League strongly endorsed the event and urged associations to sponsor speakers, produce literature, and create advertisements highlighting the messages of each day. Although the initial Thrift Week celebrations were successful, interest in the movement waned during the consumer-oriented 1920s, and the League eventually assumed responsibility for the annual event.

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The League established an affiliate organization, the nonprofit National Thrift Week Committee, to coordinate these activities. Another related national celebration the B&L movement took an active role in was Better Homes Week. Commerce Secretary Herbert Hoover developed the idea of Better Homes Week in 1922 as a way to encourage home ownership among people of lesser incomes, as well as to promote better housing design and more efficient construction methods. Hoover wanted this promotion to be community focused, and to support related efforts he had the Commerce Department systematize building standards across the country. Although Better Homes Week was not a government program, Hoover was the honorary president of the volunteer organization called Better Homes of America, whose more than 30,000 mostly female members coordinated the activities. Each year the League encouraged associations to get involved in these promotions not by publicizing their own business, but by focusing on the benefits of home ownership to the public. While this work brought greater attention to the thrift movement, Better Homes Week also created the opportunity for greater interaction with other housing industries.

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The Rise of Thrift Movement Advertising and Promotion

A second major focus of the League in the early twentieth century involved getting more B&Ls to advertise and promote their associations broadly to the general public. In the late-nineteenth century, most thrift managers relied primarily on the traditional word-of-mouth advertising to promote their associations. Some also tried to build ties to the community by allowing civic groups to meet in thrift offices and by sponsoring public lectures. By the 1910s, the use of window displays by associations with ground-floor windows gained in popularity. These advertisements usually were dioramas based on the themes of thrift and home ownership. This form of publicity became so popular and effective that the League began an annual contest for the best-designed window advertising. During this same period, a growing number of B&Ls advertised in newspapers as well as circulars. While early print advertisements focused on the self-help virtues of thrift membership, by World War I the dominant trend had shifted to an emphasis on interest rates for deposits and loans.\(^\text{12}\)

While the League approved of the increase in advertising, it also wanted B&Ls to produce more polished publicity efforts. In 1899, the League’s trade journal began to run a regular column on effective thrift advertising, and by the 1920s its editors invited

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advertising experts to write articles on how to design more effective types of promotions. Significantly, the League did not want managers to lose sight of the spirit of self-improvement that was central to the thrift movement. J. R. Moorehead, a leader of both the thrift and lumber trade associations, compared the mission of B&L officers to that of religious crusaders, and he exhorted them to “spread the gospel of savings and home ownership.” He insisted managers had an obligation to “sell the building and loan association to all people for their own good,” and urged “the apostles of thrift and home ownership [to] send out men to preach the gospel you profess to believe.”

Another way to increase thrift publicity was to build cooperative alliances with other housing-related industries to promote home ownership. In 1927, thrift leaders launched the Better Relations campaign to increase interactions between the lumber and real estate trade associations and coordinate joint promotions. In 1929, local chapters of these various trade groups sponsored advertising campaigns that often stressed the importance of using experts in real estate, construction and finance when buying a home. Finally, thrifts also benefitted from the number of “how-to” articles that appeared in popular press magazines during the 1920s, many of which were targeted at female

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readers. Like the “how-to” books of the nineteenth century, these works advised home
buyers on the strengths and weaknesses of different types of home financing, and
highlighted how B&L mortgages offered the most consumer-friendly terms.  

Making the Thrift Movement More Professional

A third major objective of the League in the early twentieth century was to
enhance the status of the movement as a profession and to better standardize business
operations. The Progressive Era drive to professionalize the image of everything from
industrial occupations to the sciences was done in part to increase public respect for the
specialized nature of different lines of work. For the League, a key reason to make B&Ls
appear more professional was to give the movement the same status people gave to other
financial institutions. To do this, the League wanted managers to become knowledgeable
with the latest developments in finance, an area in which bankers had a decided edge. An
important reason for this advantage was that the American Bankers Association formed
the American Bankers Institute in 1900 to design formal financial education classes. As
consumer finance increased in complexity during the 1920s, the lack of a similar program

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for B&L executives led one League leader to conclude that "the next generation of
building and loan executives will surely need an education in keeping with the times."\(^ {15} \)

In 1922, representatives from the thrift, lumber and real estate trade associations
organized the American Savings, Building and Loan Institute (ASBLI) to improve
manager education. The ASBLI designed courses in savings and loan business
principles, salesmanship and advertising, and accounting and property appraisals -- all of
which were made available through local ASBLI chapters or home study. Each course
took about sixteen weeks to complete, and students received a diploma certifying their
accreditation as B&L professionals. The ASBLI curriculum used a college-level text,
which was also the first standard manual for thrift operations, and the ASBLI even helped
colleges design their own courses in building and loan methods. In 1924, the Institute
graduated its first class of twenty men and seven women, and by the end of the decade it
had a national network of chapters educating hundreds of B&L managers. Initially, the
ASBLI was an independent organization run by the Kansas City Building and Loan
League and the Southern Lumbermen’s Association, but in 1930 it became an official
affiliate of the League.\(^ {16} \)

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"American Bankers Association," *ABAN* 19 (December, 1900), 1; R. Holby Meyers, "Education for Building
and Loan Service," *ABAN* 41 (December, 1921), 514-5, quote 514; Frank A. Chase, "Educational
Development, Part I: Organization of the American Savings, Building and Loan Institute," in Bodfish, editor,
*History of Building and Loan*, 253-7; "Get Behind the American Savings, Building and Loan Institute," *ABAN*
43 (May, 1923), 196-8.

\(^ {16} \) The first college course on B&L practices appeared at The Ohio State University. See "The
American Savings, Building and Loan Institute," *ABAN* 42 (December, 1922), 533-6; Franklin Stevens,
"Building and Loan Education," *Proceedings of the Thirty-Second Annual Meeting of the United States
League of Local Building and Loan Associations* (Chicago: American Building Association News Publishing
While creating a formal thrift-manager education program was a major success in the campaign to professionalize the movement’s image, other initiatives were less successful. One of these was the effort to encourage managers to improve the physical appearance of their offices. Although few B&Ls held meetings in taverns as in the old days, it was equally true that most did not own their own offices. Most thrifts, in fact, rented upper-floor space in bank buildings. Furthermore, few associations were open every business day, since most transactions like share payments and making loans occurred only on certain days of the month. The League wanted managers who could afford the expense to acquire separate office buildings or at the least rent ground-floor space. It also wanted thrift offices to look like banks by using classical architecture styles, marble and brass fixtures, and the ubiquitous “teller’s cage” as a way to convey financial strength. Despite these urgings, few managers wanted to spend money in this manner, and as a result by 1930 less than half of all thrifts owned their offices.17

Another partial failure in this campaign to professionalize the B&L movement was the effort to convince managers to adopt standardized business procedures. The

magnitude of this problem became clear when the 1893 federal government survey of B&Ls showed that thrifts calculated dividends, loan premiums, and fees by dozens of different methods. Most associations also used rudimentary accounting systems that primarily tracked just the receipt and disbursement of cash, and which were inadequate for complex tasks like calculating multiple-share dividends and amortization schedules. Furthermore, financial statements used terms like “installments” and “dues,” or “gains” and “profits” interchangeably, which the League saw as needlessly confusing to outsiders. One thrift leader charged that such inconsistency in thrift practices not only “places obstacles in the way of a [B&L’s] effectiveness,” but was also a reason why “we do not have the definite strong standing before the public.” During the 1920s, state league-sponsored legislation requiring greater uniformity did reduce some of these problems, but resistance to change was so strong that substantive alterations came only during the economic crisis of the Great Depression.  

Another standardization effort that failed was having the movement use a common name to describe their business. From the beginning of the thrift movement, B&Ls deliberately chose very descriptive names for their businesses, names that often  

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described the ethnic or occupational background of the members. Also, thrifts used the words "building," "loan," "savings," and "investment" seemingly at random. These practices were so pervasive that by 1925 thrifts used more than 140 forms of corporate titles. Adding to this confusion was the fact that B&Ls went by different names depending on where they were located. Thrifts in Massachusetts were called "cooperative banks," while in Louisiana thrifts were known as "homestead associations." In New York the most common title for a B&L was "savings and loan association." A related problem lay in how the movement should describe its occupation. Thrift employees were not in the strict sense bankers, given their different functions, and most managers were loathe to use the term.19

League members failed to agree on how to solve these problems. Despite pleas to adopt "some sort of standardization, so a man dealing with an association in California will, upon moving to Texas, feel a sense of security with an association in Houston," thrifts typically refused to give up what they considered to be their own unique identities. The effort to describe the B&L occupation also produced a wide range of terms. In 1922, the League sponsored a contest and encouraged "anyone who can put 'building-loan-savings-investment-association-company-homestead-cooperative-bank' into a melting pot and produce a simple term that will be readily understood everywhere" to enter. The most popular suggestions included "Co-operative Banker," "Savings-Loaner," "B-Lator" (a take-off on "Realtor"), "Thriftor" and "Frugalator." The League eventually decided

not to pick a single term, leaving the issue of what to call the thrift professional to local preference.20

New League Strategy, New League Structure

As the League expanded the range of services available to the B&L movement, its leaders realized they also had to improve the level of communication they had with their members. In 1899, the League combined the two major thrift publications into one monthly journal, which became the official trade association organ. It also refined its content to make it more informative and useful to managers. In the past, thrift journals had consisted of speeches by movement leaders and stories on thrift and home ownership that gave them distinctly home-spun qualities. The new journal contained more articles written specifically on business issues affecting thrifts, and by 1909 it switched from a newspaper format to that of a professionally-edited magazine. The League also began to include inserts with articles important to a particular area written by local thrift leaders to help customize the journal for state leagues. Finally, the League published more general thrift texts and manuals which were written by experts and frequently updated.21


Another change that helped the League keep more closely in touch with the B&L movement was the 1924 decision to let individual thrifts become members. Although some executives objected to this change because of fears that the trade group would become dominated by large B&Ls, it was necessary to improve the ailing financial condition of the League. This situation was so severe that during most of the 1910s the League was virtually bankrupt. A final organizational change came in 1929 when the League hired a full-time executive manager to be responsible for day-to-day operations. This step was necessary because most elected officials were still managers at their local institutions and could work for the League only part-time, a situation that made it difficult for them to tend to the widening scope of trade association activities. Creating the position of executive manager was also important because it reflected how the League had become a truly professional organization, and like other trade associations, needed a staff dedicated to this work.22

**Progressive Era Recovery**

As the “nationals” crisis of the 1890s faded from memory and the League worked to revitalize the movement, the thrift business experienced slow recovery through the 1910s, followed by substantial growth by the end of World War I as seen in Table 3.1:

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<table>
<thead>
<tr>
<th>Year</th>
<th>No. B&amp;L</th>
<th>Chg/Yr</th>
<th>Assets (000)</th>
<th>Chg/Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900</td>
<td>5,356</td>
<td>---</td>
<td>$571,367</td>
<td>---</td>
</tr>
<tr>
<td>1907</td>
<td>5,424</td>
<td>0.2%</td>
<td>$731,508</td>
<td>3.6%</td>
</tr>
<tr>
<td>1914</td>
<td>6,616</td>
<td>2.9%</td>
<td>$1,357,708</td>
<td>9.2%</td>
</tr>
<tr>
<td>1920</td>
<td>8,633</td>
<td>4.5%</td>
<td>$2,519,915</td>
<td>10.8%</td>
</tr>
</tbody>
</table>


Table 3.1: Number of Thrifts and Assets - 1900 to 1920

This expansion reveals a number of trends in the development of the movement during the early twentieth century. First, as total asset growth exceeded the increase in the number of associations, individual B&Ls were larger than ever before. The assets of the average thrift rose from just $106,000 in 1900 to nearly $292,000 twenty years later.

Second, the B&L movement proved to be fairly resilient to short-term economic crises like the Panic of 1907, which caused dozens of banks to fail, but which barely affected thrifts. While one reason for this was that many B&Ls were literally not open when the crisis swept through their areas, the key factor was that B&Ls had a different legal relationship with their members than that between banks and their customers. Commercial bank customers were legally considered creditors, which gave them the right to demand immediate withdrawal of deposits. B&L members, however, owned their thrift and could not legally demand immediate payouts. They instead had to submit withdrawal requests, which the thrift had to honor within thirty days. This delay helped
diffuse potential problems associated with deposit runs and permitted more effective cash management.23

During World War I, the main problem for the thrift movement was finding ways to invest the surge in new deposits they received from members working in the defense industries. Even though most thrifts only financed existing homes, government controls on all types of home construction and repair meant that deposit growth exceeded loan demand. To prevent the accumulation of idle funds, thrift managers invested in government debt, like Liberty Loans. While these securities earned lower interest rates than what could be earned from making home loans, associations saw this work as a way to show their patriotism and support of the war effort. When the war ended, the major increase in the demand for homes helped boost the share of all residential mortgages provided by thrifts from 15 percent in 1915 to 20 percent by 1922. Furthermore, this market share remained steady during the 1920s.24

The Rise of Ethnic Thrifts

One of the main reasons for the expansion of the thrift business during the early twentieth century was that ethnic groups became very active in the movement. Beginning

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in the late-nineteenth century millions of immigrants began to settle in America's industrial cities, and in order to acquire better homes they created B&Ls to serve specific ethnic communities. By 1894, more than 550 ethnic thrifts were in business serving German, Irish, Scottish, Polish, Hungarian, Serbian, Croatian, Yugoslavian, Italian, Lithuanian, Estonian, Latvian, and Russian communities. Some thrifts even served specific religious groups. The League approved of these developments, and encouraged greater involvement by ethnic groups, noting that thrifts are "being rapidly carried forward among the foreign element which is truly for the good of the local community."\(^{25}\)

There are several reasons why thrifts appealed to these ethnic groups, one of which was that thrifts were traditionally small organizations. The average thrift had just 300 members, and it was common for a single city to have more than 200 associations. Given this small size, the primary way people learned about a B&L was by word-of-mouth advertising, a trait ideally suited to the tight-knit nature of ethnic communities. This circumstance, however, did not mean ethnic thrifts were small financially. In Chicago, one Bohemian association with more than $5 million in assets drew all its members from a neighborhood four miles long and one mile wide, and did so without any outside advertising. Also, because states often allowed thrifts to conduct business from almost any location, some ethnic associations operated out of local taverns that were

often the center of neighborhood social activity. Finally, these B&Ls were not
"clannish," but often attracted members from a variety of ethnic groups.26

The most important business characteristic that endeared thrifts to ethnic-
Americans was their reliance on mutual cooperation for success. Since most thrift
members knew each other and had open access to management, immigrants usually
trusted ethnic associations. Also, because these thrifts conducted meetings and printed
documents in their members' native languages, immigrants felt less like "strangers in a
strange land." According to one Polish thrift executive, "the work of the [thrift] is more
on the line of a social organization. Perhaps it is the fact that the members know
personally their own officers which they have chosen . . . that gives them so much
confidence in the [association]." This need for trust was important, since unscrupulous
businessmen often preyed upon financially-ignorant immigrants to fleece them of their
savings. In contrast, officers in ethnic associations worked to make sure their members
understood how the association worked, and even tried to avoid foreclosing on a home if
immigrant borrowers fell on hard times.27

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26Wright, Ninth Annual Report, 291; "Monthly Dues," ABAN 22 (November, 1903), 244; "Loan
Associations for Store Workers," ABAN 31 (September, 1911), 391; Sundheim, Law of Building and Loan, 33-9;
"Irish-American of Buffalo," ABAN 29 (March, 1909), 127; "Tavern Societies," ABAN 29 (April, 1909), 149;
John Novak, "The Bohemian People and Their Building and Loan Associations in the United
States," Proceedings of the Thirty-Sixth Annual Meeting of the Building Association League of Illinois

27Albert Wachowski, "Polish United Building and Loan Associations," ABAN 31 (December, 1911),
492-3; H. S. Rosenthal, "Possibilities of Building and Loan Movement," Proceedings of the Thirty-Sixth
Annual Meeting of the Building Association League of Illinois, 105-8; Upton Sinclair, The Jungle (New York:
Another reason that there were close connections between immigrants and thrifts was that similar savings associations operated throughout Europe in the early 1900s. In Poland, the "People's Banks" were a very popular form of mutual-aid cooperative, and in the Province of Posen more than 141,000 working-class Poles entrusted $87.7 million in assets with these banks. Germany also had a very strong history of cooperative finance that included the Housewives Societies (hausfrauen vereins) and Friendly Societies for Building (Baughenossenschaften). The friendly societies were so popular with the German working class that by 1914 over 1,400 were in operation throughout the country. Similar examples of cooperative home financing existed in other countries such as France, Denmark, and Sweden. Finally, because many of these foreign associations used the home finance system developed in England, immigrants were often familiar with the business practices of American thrifts.28

A third reason why ethnic-Americans joined B&Ls was that they saw membership as a way to help them assimilate into society and become better citizens. This factor became especially important by the 1910s when Americanization movements swept the nation. One German thrift leader noted that the ethnic B&Ls in Cincinnati encourage "not only the assimilation of the immigrant population, but inculcate anew the spirit which prompted the early pioneers of America in the pride of the home." Ethnic thrift leaders also stressed that they developed in immigrants habits like systematic savings that helped instill proper "American" values and morals. A Polish thrift officer noted that

“our organizations help to make better citizens, and greatly add to the wealth and prosperity of our nation,” while another called attention to the homes financed by ethnic B&Ls and “erected by the foreign speaking element who became citizens by adoption.” During World War I, these thrift members reinforced their standing as “good Americans” by participating in Liberty Bond drives as a way to prove that “we do our bit.”

Although nearly every major industrial city had ethnic thrifts, Chicago had the most diverse mix of associations. The city had over 120 thrifts that served Bohemian residents, fifty-two with primarily Polish members, and overall four different trade groups based on nationality. Bohemians were particularly active in forming thrifts, and their ethnic leaders attributed this not only to their “natural thriftiness,” but also to the fact that “we Bohemians believe home owning is the highest test of citizenship.” A leader of the Polish B&L trade association also noted that “Poles see in the building and loan the foundation of everything that is democratic and free.” The commonality of these attitudes led one state league official to claim that thrifts have “contributed in no small measure to Americanize the thousands of aliens who have come from different parts of

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81

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the world to make Chicago their home.” Minneapolis also had a diverse collection of
ethnic thrifts, including one restricted to Catholic members. A student of these B&Ls
noted that “their social and moral value is in counteracting the tendency to wider
divergence between rich and poor, and to the development of a proletarian class.”

*Thrifts in the Decade of Consumerism*

The 1920s was an economically prosperous time for most Americans, and one
characteristic of this decade was the increased consumption of goods intended to last
more than two or three years, items commonly called “consumer durables.” An
important factor in the rise of consumer-durable purchases was the development of
installment credit, which allowed people to buy goods immediately and not wait until
they had saved the full purchase price. Under this arrangement, a seller allowed a buyer
to purchase a product by paying only a portion of the price in cash at the time of sale,
with the balance paid in installments over time. Initially, many Americans were uneasy
about buying anything other than a house with credit because of the social stigma of
being in debt. This attitude, however, changed as advertisers urged people to consume
and take on more personal debt. Not only would such consumption improve the material

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30 Albert Wachowski, “The Polish Nationality and Their Building and Loan Associations,” *ABAN* 29
(January, 1909), 24-5, quote 24; Albert Wachowski, “The Democratic Spirit of the Polish People and Its

82
lives of people, but the need to repay these loans meant that debt was good because it helped instilled a stronger work ethic. The resulting increase in consumer credit was so great that by the mid-1920s some people described the nation as "installment mad." \(^{31}\)

While increased consumer durables sales were one sign of the prosperity of the 1920s, another economic sector to benefit was the housing industry. Because of the severe postwar housing shortage, new home construction soared, significantly nearly 80 percent of all houses built between 1923 and 1928 were in urban areas. Another aspect of these new homes was they incorporated more uniform designs, in part because of increased standardization in building materials, and plumbing, and ventilation systems. These changes, combined with the eventual saturation of the housing market, caused the average price of a house to actually fall 8 percent between 1925 and 1929. For consumers with significant installment debt, however, these changes did not mean that it was easier to buy a home in the 1920s. One reason for this was that most lenders still required a down payment of between 33 and 60 percent of the purchase price in order to obtain a mortgage. \(^{32}\)


83
To obtain this equity, home buyers often took out second mortgages, which like installment credit grew in popularity during the 1920s. There were drawbacks, however, with this type of financing. Because second mortgage lenders held a second lien on the property, if borrowers defaulted they did not get repaid until the first mortgage was paid off. Also, because of the higher level of debt on the property, if property values fell there was a risk that the second mortgage would no longer be covered by the underlying security. To compensate for these risks, second mortgage lenders collected from their borrowers up-front fees up to 20 percent of the loan amount and charged an average interest rate twice as high as rates on first mortgages. Finally, second mortgages usually matured within three years, and often required additional fees for their renewal.33

While most states prohibited B&Ls from making second mortgages, associations in Philadelphia found a way to provide this service that was both profitable and relatively low-risk. This arrangement required a home buyer to take out a short-term, non-amortizing first mortgage from any lender, and a long-term amortizing second mortgage from a B&L. The borrower then paid off the second in installments while paying interest only on the first mortgage, and renewing the first each time it came due. This plan saved borrowers money because the loan renewal fees for a first mortgage were far less than for a second. Also, the borrowers built up equity in their homes as the B&L second mortgage was repaid. Like all second mortgage lenders, thrifts charged higher rates for this service, but they also developed more precise loan approval and appraisal processes.

that significantly reduced these risks. Consequently, over 85 percent of all Philadelphia thrifts used second mortgage financing with very favorable loan losses.34

Another way thrifts helped home buyers was by making it easier for them to qualify for mortgages. Between 1900 and 1930, the average thrift mortgage term rose from eight to twelve years, which significantly reduced monthly payments for borrowers. This term was more than twice as long as commercial bank mortgages, and was close to the fifteen-year maturity most homeowners preferred. B&Ls also replaced the older loan auction method of determining loan rates with a set interest rate to which was added a premium that was negotiated by the lender and the borrower. Furthermore, more thrifts used escrow accounts to pay property taxes and insurance, and sold credit life insurance as a way to protect both the borrower and lender. Finally, more thrifts began using commercially-prepared credit reports and credit-scoring systems that incorporated ratio analysis, which made lending decisions more precise and "scientific." These changes also allowed managers to correlate loan risks and returns better.35


Thriffs also tried to make it easier to buy a new house by consolidating the different forms of construction finance into simpler packages. Prior to the 1920s, new homes were usually built to order, and financing was a multi-step process. The home buyer first had to acquire the land outright, then use a short-term bank loan to pay for the construction. This interim loan was then refinanced with a permanent mortgage. Such an awkward system was needed because few lenders were willing to finance the entire process given the variety of lending risks. After World War I, the demand for new houses was so strong that developers began building multi-home projects in which they controlled everything from raw land acquisition to final home sales. Because this arrangement made it easier to measure financial risks, some B&Ls were eager to make larger loans to these developers; some thrifts provided home buyers with design and construction supervision services.36

Although most of the prominent B&L innovations in the 1920s improved lending services, thrifts also broadened their savings options for members. One of these was the creation of juvenile annexes to attract more children as members and teach them the value of thrift. While accounts for minors had long been a part of most B&L activities, these new services made children feel more responsible for their accounts by giving them their own passbooks to record deposits and withdrawals. While the League noted this work

was typical of "uplifting organizations" like thrifts, encouraging child members helped build relations with B&Ls that lasted into adulthood. Another popular savings option was the fully-paid share issued to members who wanted to make one initial lump-sum deposit to pay for the share completely. Most managers liked using these shares because they earned lower dividends than regular shares, and thus were cheaper sources of funds.

In addition, despite concerns that these shareholders would withdraw their money whenever rates changed, these accounts attracted stable and long-term investors.\(^{37}\)

**Post War Prosperity**

Although the thrift movement recovered fully from the "nationals" crisis by the end of World War I, during the 1920s it truly blossomed, as seen in Table 3.2:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. B&amp;L</th>
<th>Chg./Yr.</th>
<th>Assets (000)</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1920</td>
<td>8,633</td>
<td>---</td>
<td>$2,519,915</td>
<td>---</td>
</tr>
<tr>
<td>1924</td>
<td>11,844</td>
<td>7.4%</td>
<td>$4,765,937</td>
<td>17.2%</td>
</tr>
<tr>
<td>1927</td>
<td>12,804</td>
<td>2.6%</td>
<td>$7,178,562</td>
<td>14.7%</td>
</tr>
<tr>
<td>1930</td>
<td>11,777</td>
<td>(2.7)%</td>
<td>$8,828,612</td>
<td>7.1%</td>
</tr>
</tbody>
</table>

Source: Ewalt, *A Business Reborn*, 391

Table 3.2: Number of Thrifts and Assets - 1920 to 1930

\(^{37}\)"Little Savings Banks for Public Schools," *ABAN* 22 (May, 1903); 22; "Juvenile Saver Annex," *ABAN* 23 (June, 1904), 23; Edwin M. Einstein, "School Savings," *ABAN* 47 (October, 1927), 54-5; H. Morton Bodfish, *Historical Balance Sheet Analysis of Ohio Building*, Bureau of Business Research, College of Commerce and Administration (Columbus, The Ohio State University Press, 1928); 28-30; Charles Elliott, "Full Paid Stock," *ABAN* 26 (November, 1907); 212; "Fitting the Investment to the Investor" *The Magazine of Wall Street* 45 (November 29, 1930); 171; Bodfish and Theobald, *Savings and Loan Principles*, 140-6
An analysis of this expansion reveals several important trends. First, because assets continued to grow faster than the number of associations, individual B&Ls became still larger, with the average thrift in 1929 controlling $704,000 in assets, up from $205,000 in 1914. Furthermore, one hundred thrifts had over $10 million in assets each, with the largest association exceeding $52 million. Second, this expansion was not uniform, but rather followed the national population trend of higher population growth in the West. While states like Pennsylvania and Ohio experienced average annual asset growth of 35 percent between 1914 and 1929, in California thrifts saw their assets double annually. This growth was so fast that by the end of the decade California accounted for 6 percent of all B&Ls and assets, up from less than 1 percent in 1914. A third trend was that the percentage of people who belonged to B&Ls rose steadily, until by 1929 one in ten of all Americans were thrift members, up from 4 percent in 1919 and just 2.5 percent in 1900. These changes combined to make thrifts one of the leading institutional home lenders in the country, providing 22 percent of all mortgages and an estimated one thousand loans a day by 1930.\(^{38}\)

One important change for the movement during the 1920s lay in the type of
people who were joining these associations. For nearly one hundred years, thrift
members had come almost exclusively from the working class, with many associations
serving specific occupations or ethnic groups. By the 1920s, the increased use of fully-
paid shares and services like deposit by mail attracted upper-class and upper-middle-class
men and women with more disposable income. While many of these new members used
B&Ls to acquire homes, others joined to invest money safely and earn good returns. By
1925, *The Magazine of Wall Street*, a leading personal finance and investment weekly,
was carrying regular stories on thrifts in its “Building Your Future Income” column. It
recommended thrift shares to young professionals as an ideal way to balance their stock
and bond investment portfolio risks. Such favorable exposure to people who would not
otherwise have come in contact with the B&L movement was critical in broadening the
appeal of thrifts and generating growth.39

Women Move to the Fore

Another factor in the success of the B&L movement during the early twentieth
century was the increased role of women in local and national affairs. The League
boasted that thrifts had more female managers and directors than other financial
industries and encouraged their involvement noting, “if they can induce more of their

39“Small Investors Money for Home Building,” *World’s Work* 26 (May, 1913), 31-3; Theis, “If You
are Thinking of Building A Home,” 108; J. Lloyd McMaster, “The B&L Plan as First Aid for the Home-
Maker,” *The Magazine of Wall Street* 43 (April 7, 1928), 1049; Stephen Valiant “Weighed in the Balance!”
*The Magazine of Wall Street* 44 (March 23, 1929), 959; Milton M. Schayer, “Paid-Up’ Building and Loan
Certificates Attractive for Investment” *The Magazine of Wall Street* 44 (August 24, 1929): 770-1; “Rating
Building & Loan Investments by States,” *The Magazine of Wall Street* 41 (October 9, 1926), 1128, 1179;

89
sisters to emulate their example, the movement will be better for it.” One sign of this change was the effort by thrifts in the 1920s to broaden their appeal to working women with services like “women’s departments” to provide specialized financial planning and advice for female customers. Another example of greater female involvement in the movement was the appearance of thrifts organized and managed by women. One of the most successful of these associations was the Women’s Building and Loan of Cleveland, formed in 1922. The only difference between the Women’s B&L and one managed by men, according to one observer, was the absence of cigar smoke in the boardroom. This B&L was so successful that in its first nine years of business it reportedly had to foreclose on only one loan.40

Women also became more active in thrift trade organizations, and in the 1920s several states formed women’s auxiliaries to address issues affecting female thrift officers. While several women achieved prominence as the leaders of state trade associations, few had the same degree of success as Ann Rae. Rae began her thrift career in the late 1900s at the Niagara Permanent Savings and Loan Association in Niagara, New York. In 1917, she became thrift president, and when she retired in 1930 her association was one of the largest in the nation with over $16 million in assets. Rae was also involved in both state and national trade association work. In 1921, she became

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40”Then and Now,” ABAN 41 (June, 1921), quote, 296; “Women in Building Associations,” ABAN 46 (June, 1926), 257; Bessie Q. Mott, “Why Building and Loan Shares Appeal to Women,” ABAN 49 (May, 1929), 268-8; McMaster, “The B&L Plan as First Aid for the Home-Maker,” 1049; Susan Bozung, "Are Building and Loan Associations Keeping in Step with the Times?" ABAN 49 (December, 1929), 714-5; Anna Caldwell, "A Woman's Building and Loan Association," ABAN 20 (January, 1900), 6; Nina Donberg, "Are Women Good Financiers?" ABAN 51 (June, 1931), 273, 292-4

90
president of the New York state trade group, and two years later she was elected
unanimously as the first female president of national League, a selection that was "not a
function of gallantry or even courtesy, but was the logical choice." As president, Rae
spoke across the country to thrift and housing industry groups, and urged ways to
improve movement. She remained involved in the League after her term, and in 1931
was the American delegate to the International Thrift Convention. Rae died in 1932, and
the movement recognized her passing with a full-page tribute in its trade journal.41

The Consequences of Growth

The rapid expansion of the thrift movement in the 1910s and 1920s was noticed
by other financial groups, especially commercial banks, which for the first time saw
B&Ls as a real competitive threat. Traditionally, banks had not regarded thrifts as
competitors, in part because each offered different financial products. Banks made
primarily short-term loans funded by demand deposits, while thrifts made long-term
mortgages using less liquid savings. The main interaction between the two was that
banks provided thrifts with liquidity loans and depository services. Both financial
institutions benefitted from this symbiotic relationship, in that thrifts could use the loans
to meet unanticipated mortgage demands, while banks gained low-risk loans and fees
from ancillary business like title and trust work. Given this dependency and the

41Lydia Cellarius, "Women and the Home," Proceedings of the Thirty-Sixth Annual Meeting of the
"Women's Auxiliary in Ohio," ABAN (September, 1921), 391; "A Woman Elected President," ABAN 37
(March, 1917), 104; ABAN 50 (January, 1930), 114; "Then and Now," 296; "First Woman President of the U.S.
League," ABAN 43 (August, 1923), quote 341; "Tireless Work of the League President," ABAN 43 (November,
1923), n. p.; "Woman's Auxiliary of the U.S. League to be Organized at the Cleveland Meeting," ABAN 44
(February, 1924), 59; "Death of Miss Ann E. Rae," ABAN 52 (November, 1932), 486.

91
from ancillary business like title and trust work. Given this dependency and the
prominence of commercial banks in the American financial system, it was generally
acknowledged that “in relation to banks building and loans have always occupied a
subordinate position.”

By the mid-1920s, however, the expansion of the thrift business caused tensions
between these two groups to become more strained, as bankers began to complain that
thrifts had unfair advantages over their institutions. Bankers contended that activities like
making unsecured share loans and issuing fully-paid shares made thrifts less like mutual
organizations and more like ordinary for-profit stock corporations. They also disliked
that thrifts were attracting a greater share of consumer deposits, as in the 1920s the
percentage of consumer savings held by thrifts rose from 10 percent to 16 percent. While
bankers realized the main reason for this increase was that the dividend rates paid by
thrifts were up to three times higher than those paid by banks, they alleged that B&Ls
also used misleading advertising and even used house-to-house solicitors to lure savings
from banks. Finally, bankers maintained that thrifts should be prohibited from the
common practice of allowing share withdrawals without advance notice. By doing this,

42 Thomas B. Fulmer, “Trust Companies and Building and Loan Associations,” *ABAN* 24 (December,
1905), 246; I. H. C. Royse, “The Legitimate Sphere of the Building and Loan Associations Considered in Its
Relation to Banks and Trust Companies,” *ABAN* 23 (October, 1904), 209-11; “Associations Have a Field of
Their Own,” *ABAN* 29 (November, 1909), 502-3; James M. McKay “The Building and Loan Movement in the
United States,” *Proceedings of the Annual Convention of the American Bankers Association* (New York:
American Banker’s Association, 1910), 539-40; Samuel McK. Perry, “The Financial Relationship Between
B&Ls were essentially offering demand deposit accounts, and so should be placed under the same rules as banks.\footnote{C.F. Schwenker, "Building and Loan Competition with Banks," \textit{American Banking Association Journal} 21 (August, 1928), 129-31; H.L. Standeven, "To Stop Unfair Competition" \textit{American Bankers Association Journal} 22 (May, 1929), 1110, 1156-7; Reuben A. Lewis, Jr., "A Growing Competitor for Savings," \textit{American Banking Association Journal} 20 (February, 1927), 561-2; W. S. Webb "An Invasion of Savings Banking" \textit{American Banking Association Journal} 20 (July, 1927), 7-8; Bodfish and Theobald, Savings and Loan Principles, 59.}

To counter thrift competition, commercial bankers followed several strategies. They filed complaints with state regulators to stop improper B&L advertising, and launched consumer education campaigns that detailed what services banks and thrifts could legally offer. Bankers also lobbied for laws to require thrifts to hold reserves if they were going to continue to make unsecured share loans and pay deposits on demand. Forcing thrifts to set aside a portion of earnings as reserves also reduced the amount of dividends they could pay. Finally, national banks wanted the right to make residential mortgage loans, something they were prohibited by law from doing. This effort to “level the playing field” contributed to the inclusion of language in the McFadden Act in 1927 allowing national banks to lend up to one-half of their savings deposits on real estate mortgages. Despite the increased hostility toward B&Ls, bankers were never intent on destroying these businesses and readily admitted that thrifts served a useful role in American finance.\footnote{Standeven, "To Stop Unfair Competition," 1156; James E. Clark, "A Way to Meet Unfair Building and Loan Competition," \textit{American Banking Association Journal} 23 (June, 1930), 1108-1109, 1095; "Banks Up in Armes," \textit{Kansas League Section of the American Building Association News} 46 (November, 1926), iii; "National Banks May Enter Real Estate Loan Field." \textit{American Banking Association Journal} 20 (February, 1927), 617; Peter G. Cameron, “Regulating the Building and Loan Associations,” \textit{American Bankers Association Journal} 18 (February, 1926), 82-3, 111-2.}
While thrift leaders grudgingly admitted some criticism was warranted, they insisted the practices bankers objected to represented only isolated cases of abuse. While the League publically opposed any efforts to require B&Ls to establish large reserves, citing the historically low rate of loan losses for the movement as a whole, it privately encouraged thrifts to build reserves voluntarily to blunt further attacks. Interestingly, some bankers agreed with the League that the criticism was extreme, and instead felt the real reason for the competition was that conservative bank practices allowed thrifts to steal customers. They also accused bankers of hypocrisy by "condemning all building and loans to [their] official family at the very moment [they] send salesmen down-state to see if they can't knock off a few more of 'those good building and loan accounts.'" The debate over the financial roles of thrifts and banks would continue for the next fifty years. Over time, the leaders in each group insisted on gaining powers that were other group's strengths: banks wanted greater ability to make mortgages, while thrifts sought the right to make consumer and personal loans. The debate would finally end when deregulation in the 1980s removed most barriers separating thrifts and banks.45

Aside from increased criticism from bankers, thrifts faced other competitive challenges in the 1920s. One of these was the rise of nonbank firms like mortgage brokers and mortgage companies, which provided alternative sources for finance for potential home buyers. Mortgage brokers specialized in connecting home lenders from different areas with borrowers, and collected a fee for this service. In contrast, mortgage companies made direct loans using funds from the sale of stock or mortgage-backed securities. Mortgage companies were also generally unregulated, and since most focused on providing high-rate second mortgages they were also very profitable. As a result, from being an insignificant source of finance prior to 1910, mortgage companies accounted for 5 percent of all residential mortgages by 1929. Unfortunately, these firms also lacked substantial reserves and equity capital, so that when the Great Depression began losses from foreclosed properties forced hundreds of mortgage companies into bankruptcy. One important consequence was that the second mortgage market virtually disappeared.46

Another new source of mortgage competition came from the federal government, which in the 1910s entered the farm mortgage field in order to ease a severe credit crunch. The main reason for the lack of credit from private sources was that the prices for farm land more than doubled in the first decade of the twentieth century, and this

demand had absorbed almost all available funds from traditional lenders. In 1916, Congress passed the Federal Farm Loan Act, which created a system of federal land banks to increase liquidity for agricultural lenders. Patterned after the Federal Reserve banks, the land banks made loans to commercial banks, pledging existing farm mortgages as collateral. One provision of this law was that farm loans had to be long-term and be amortized in monthly installments. While the League was pleased the land banks were using the repayment system pioneered by the movement, its members also feared this was the first step toward government involvement in residential finance. As one thrift leader stated, “it will be but a short time before the city housing problem will be included in its operations. . . . [T]his chain of land banks is designed to, and is capable of, taking over our place in the financial world.” As a result, thrift leaders worked to ensure this program remained narrowly defined.47

Aside from legitimate forms of competition, thrifts had to contend with fraudulent home finance businesses throughout this period. One of the most serious came after World War I when “Three Percent” Loan Companies spread rapidly in the South and Midwest. Members signed a contract that required them to pay $10 per month to the lender, and at maturity they could withdraw the accumulated savings, which earned no

interest, plus an amount equal to $1,000; the borrower then paid 3 percent interest on the additional funds. Several states outlawed these companies because they were essentially lotteries that relied on steady membership growth to make them work. Members received loans based on when they signed their contracts, which matured based on how quickly money accumulated. This meant that the only way for people who joined late to receive a loan was after they made close to $1,000 in payments to the lender. While such shady lending operations were not unique to the 1920s, the fact that dishonest financiers could still attract business was a sign the nation needed a more systematic and available system of home finance, an issue that would be addressed by the thrift movement and the federal government in the 1930s.\footnote{T. J. Fitzmorris, “Cooperative Home Finance Companies,” \textit{Proceedings of the Tenth Annual Meeting of The United States League of Local Building and Loan Associations} (Chicago: The Press of the American Building Association News Press, 1902), 108-12; Morris Mechanic, \textit{The Development of the Building and Loan Associations} (unpublished M. A. thesis, Johns Hopkins University, 1921), 21-3; “Promoters in the Insurance and Building and Loan Fields,” \textit{Worlds Work} 44 (July, 1922), 247-8; L. E. Roush, “The Impossible Three Per Cent Loan Contract,” \textit{Proceedings of the Thirtieth Annual Meeting of the United States League of Local Building and Loan Associations}, 128-40; Maco Stewart, “Contract Loan Companies -- Frauds and Lotteries,” \textit{Proceedings of the Thirty-First Annual Meeting of the United States League of Local Building and Loan Associations}, 179-90; “Three Percent Concerns Under Fire,” \textit{ABAN} 42 (September, 1922), 393; W. G. Akers, “Inside View of 3 Per Cent Contract Loan Companies,” \textit{ABAN} 43 (January, 1923), 14-16.}

While the majority of all thrifts were honest operations, when signs of fraud did occur they often drew close public scrutiny. The largest and most publicized instance occurred in 1925 when Pennsylvania regulators closed seventeen Philadelphia thrifts for unethical banking practices. Each B&L was controlled by interlocking directorates, which allowed a small group of investors to manipulate the lending processes for their own personal gain. Among the illegal activities they engaged in were approving loans for more than what a property was worth and accepting kickbacks from developers. While
most of the accused officers contended they were acting out of ignorance and not criminal intent, several were convicted of defalcation. One consequence of this incident was that the League, like many businesses of the 1920s, adopted a code of ethics for all officers to follow. Still, despite such problems, the overall record of thrift failures during the 1920s was superior to the record for banks. During the decade, just 2.3 percent of all thrifts failed, while 21.3 percent of all banks, most of which were small and rural, went out of business. In 1924 alone over 700 bank failures cost depositors $182 million, while the eighteen B&L failures that occurred during the year resulted in less than $398,500. This record of financial strength, however, would change once the nation entered the Great Depression.49

Conclusions

Following the failure of the “national” building and loan associations, thrifts faced the task of rebuilding their public image, and during the first three decades of the twentieth century their national trade association, the United States League of Building and Loan Associations initiated many of these improvement efforts. One initiative involved reemphasizing the ties between B&Ls and ideals of thrift and home ownership, a campaign that seemed to be well-suited to the rising spirit of Progressivism sweeping

the nation. Two other main initiatives of the League designed to improve the public
image and professional standing of the thrift movement focused on greater B&L
advertising and increased standardization of thrift business practices. Despite the only
partial gains in these areas, the League did mature as a trade association and helped
oversee what was a period of exceptional growth for the movement. By the end of the
1920s, the thrift movement had not only recovered fully from the crisis of the 1890s, but
had also become a leading force in consumer finance. One reason for this growth was the
role of ethnic Americans in forming new associations as a way to both improve the
material condition of their lives and to show their desire to become good citizens in their
new country. Women also helped bolster the movement in the early twentieth century, as
evidenced by their increased participation in various trade association activities as well as
in the organization of female-managed associations. Like other financial institutions,
B&Ls benefitted from the booming consumer-oriented economy in the 1920s, and by
designing more affordable mortgages products and savings options thrifts attracted
members from broader segments of society. By 1929, the League had, thus, implemented
organizational changes that allowed it to improve its level of service and leadership,
attributes that would be tested during the Great Depression.
CHAPTER 4
FROM STATE TO FEDERAL OVERSIGHT

By the end of the 1920s, the thrift movement was larger and stronger than at any time in its previous history, but despite the best efforts of the United States Building and Loan League it still was not completely unified. One way to change this situation was to promote government oversight, since comprehensive regulation might result in greater public respect and recognition for B&Ls, protection from competition, and increased standardization within the movement. Government oversight of thrifts had begun at the state level in the 1860s, and by 1900 nearly every state had passed some form of thrift regulation, much of which was done at the behest of thrift leaders with relatively little public input. The fact that these laws were not uniform and often lacked detail led the League to consider federal regulation as a way to correct these inconsistencies. The movement, however, was not fully supportive of federal oversight, as was seen during the first attempt to create a mortgage credit bank after World War I. This attitude changed when the Great Depression caused massive economic turmoil, and between 1930 and 1934 Congress created a comprehensive set of thrift regulations, including a reserve banking system, federally-chartered institutions, and deposit insurance. The process of securing these laws was difficult, however, since thrift leaders had to overcome
considerable opposition from legislators, other financial institutions, and dissent within their own movement. Despite such obstacles, intense lobbying by League leaders helped ensure the passage of new legislation favorable to the thrift business. Securing these laws represented a milestone that proved to be instrumental in finally creating a group identity for thrifts, as well as providing a base for their continued growth in the decades that followed.

*The Struggle Over State Regulation*

When the thrift movement first appeared in the 1830s, there was little need to have government supervision for these associations, since most B&Ls were temporary organizations. By the 1860s, the movement had expanded to such an extent that some thrift leaders began seeking greater state oversight. Their arguments focused on three basic objectives. First, regulation would promote safe operations that would check poor business practices, which could lead to losses and would prevent dishonest people from using their positions of trust for personal gain. Second, regulation would lead to greater standardization, which would help increase public confidence in all associations. Finally, state supervision could be used to protect thrifts from competition by giving B&Ls favorable treatment and preferences. Given these potential benefits, movement leaders felt that government oversight would both improve the integrity of the thrift business and represent a state “seal of approval” for well-managed associations.¹

One of the earliest thrift leaders to elucidate these reasons for state oversight was League founder Judge Seymour Dexter. Dexter, who was a thrift president and author of many New York B&L laws, advocated that all states pass laws that were not only consistent with those for other financial institutions, but would also promote the mission of thrifts in advancing the condition of the wage-earning working classes. He also wanted states to limit the territory in which thrifts could operate and prohibit the creation of branches, restrictions intended to help preserve the local nature of thrift business and encourage the formation of hundreds of new B&Ls. The goal, according to Dexter was that a thrift would be located in "every business center of the state having a population of 500, all operating under one law requiring uniformity in the essential methods and elements of safety."

Despite the potential benefits of state supervision, the process of securing legislation was initially limited to states where B&Ls were numerous and active. Ohio, Pennsylvania, and Illinois were the first states to enact comprehensive codes to regulate thrift formation and operation, all of which aided B&L growth in those states. In 1875, New York became the first state to require that thrifts file annual reports with the banking

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commissioner, and twelve years later it was the first to require state examinations. The progress in securing state regulation increased dramatically during the "nationals" crisis of the 1890s. The scandals associated with these for-profit businesses led to dozens of new thrift laws, many of which state league leaders drafted for the legislators. By 1900, nearly every state had some form of thrift code, and state leagues continued to work with legislators to ensure these laws were enforced and updated. Such work led one League leader to later claim "it would be difficult to find any other business which is so anxious to restrict itself in the interests of the public welfare."

Although this initial wave of thrift regulation was an important accomplishment for the movement, the process was not a complete success since many of these laws were confusing, incomplete and not uniform. By the 1920s, thirty-six of the forty-eight states directly supervised thrifts, while ten states included these associations in their "blue-sky" laws that required certain financial disclosures; only Maryland and South Carolina had no B&L-specific rules. Four states maintained separate building and loan commissions, with the majority of the other states giving their banking or insurance commissions responsibility for B&L oversight. While nearly every state mandated that thrifts file annual reports, in twelve states the laws did not indicate how to meet this requirement. Furthermore, while thrift supervisors in some states could prohibit "unnecessary or

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unsatisfactory associations” from entering business, other states granted charters to anyone who applied. Finally, having a law did not guarantee adequate supervision since some states refused to fund their regulatory agencies.4

The haphazard development of state laws was frustrating for thrift leaders as well as potential members. Although thrifts were receiving greater and more favorable publicity from the financial press by the 1920s, publications like the *Magazine of Wall Street* counseled investors to use caution before opening accounts, in part because of the vagaries of state laws. In 1926, this magazine rated the quality of state laws governing thrifts and found that only twenty-seven states provided high or reasonable degrees of safety, while fourteen had only minimal depositor safeguards. For seven states with particularly weak thrift laws it recommended that only residents should open B&L accounts. The amazement and disbelief at the inconsistencies of the state laws governing thrifts was best summarized by two Wharton School of Business professors who stated that “not only do important subjects frequently go without legislation, but where regulations exist they are so dispersed as to make mental grasp thereof difficult, and oversight easy.”5

Another factor complicating the passage of uniform codes was that not everyone in the movement agreed on the need for state supervision. Many smaller associations

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objected to the expense of examinations and increased paperwork associated with these regulations. These managers also considered state supervision an infringement on individual rights and an unwarranted extension of government power into business. When government increased its oversight of railroads, banks and insurance companies during the Progressive Era, some B&L leaders still contended they should not be regulated because those industries performed “public functions” that thrifts did not. Finally, opponents to regulation insisted that the individual member and not the state was best suited to judge a thrift’s condition and any effort to change this smacked of socialism. Such differences in opinion invariably affected the level of individual state oversight during the early twentieth century.6

As more associations operated under state oversight, thrift leaders realized that active supervision often resulted in official efforts to promote the movement. As North Carolina Commissioner Stacy Wade stated, “the supervising official’s attitude should be one of never-failing interest and enthusiasm... If there is need of a building and loan association anywhere, and I can help to get it going, I let nothing short of a serious illness stand between me and active participation in the movement.” The League encouraged associations to advertise that they were under state supervision as a sign of their safety, since such supervision represented to the layman “a sort of Pure Food Law of Building and Loan Associations.” Over time, the relationship between the movement and thrift

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regulators grew so close that when state supervisors formed a national organization in 1920, they held their annual meetings in conjunction with the League "to share information and cooperate with building and loan leaders for the furtherance of the best interests of the movement."

The evolution of state thrift laws reveals important trends that would reappear during the effort to secure federal regulation in the 1930s. First, movement leaders were often responsible for initiating thrift supervision, a pattern that was common in the late-nineteenth century government-business relations. While these leaders cited public interest concerns in support of regulation, little public input went into the design of these laws; rather, state trade associations often dictated their wording and their passage. Second, these regulations were specific to the businesses, and there was little uniformity among the states, characteristics that were typical of early Progressive Era efforts to reform business. Finally, the level of internal support for oversight varied widely, with states that had active thrift leaders passing the most complete laws and states with smaller and more rural associations having the least comprehensive codes.

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The development of regulation initially at the state level and the creation of supportive relationships with regulators, was not unique to thrifts, but was true for firms in capital-intensive industries like railroads. In the late nineteenth century, officials in several states enacted laws designed to rationalize the increasingly competitive railroad industry, and the leaders of these firms realized that such supervision had many benefits for their business. First, uniform standards for rates, timetables, and operations not only improved public confidence and safety, but helped reduce cut-throat competition. The result was that these businesses were able to grow profitably, while at the same time providing more efficient service. The development of closer government-business relations spread from the state to the federal level in 1888 with the creation of the Interstate Commerce Commission. Like state railroad commissions, this federal agency encouraged more uniform business practices, often with the cooperation of the firms they regulated.9

The League and the Federal Government

While several League leaders encouraged state regulation, such was not the case for federal involvement in the movement. The first evidence of recalcitrance appeared in 1894 when Congress tried to include thrifts in a proposed national tax on corporations. To prevent this, the League used a variety of arguments. First, it contended that B&Ls

should not pay federal taxes because B&Ls were not for-profit businesses, but
cooperatives that distributed all earnings back to their members. Second, because thrifts
helped members of the working class improve their lives through home ownership, the
League contended they should be treated like other tax-exempt charitable organizations.
Finally, they saw the proposed federal tax as an “injustice to the workingman,” since a
national levy would represent double taxation for those who paid state real estate taxes.
By positioning thrifts as semi-charitable organizations that constituted a movement and
not as for-profit businesses that were part of an industry, the League secured exemptions
from Congress for all federal tariffs and revenue acts and income taxes, a status thrifts
enjoyed until 1952.10

By the mid-1910s, League officers had realized that federal involvement in the
movement could be beneficial, especially as they saw how government activity in other
banking fields produced positive results. In particular, the creation of the Federal
Reserve system in 1913 and the Federal Land Banks in 1916 gave commercial banks
increased availability to low-cost funds. These two credit reserve systems made loans to
the member banks which pledged a portion of their existing loan assets as collateral, a
process known as “rediscounting.” In addition to giving banks access to low-cost funds,

FRABAN 13 (January, 1894), 1; “The Tax Question in New York,” FRABAN 15 (December, 1896), 1; Joseph
H. Sundheim, Law of Building and Loan Associations (Chicago: Callaghan & Co., 1933), 7, 216-20; Julius
Stern, “The Necessity for, and Justification of, the Exemption From Taxation of Local Building and Loan
Associations,” FRABAN 13 (September, 1894), 219; “Victory in Sight!” FRABAN 13 (June, 1894), 1; Thomas
F. Larkin, “Taxation and its Effect on Individual Home Owning,” FRABAN 18 (October 20, 1899), 295;
the government also established uniform rules for the members of the Federal Reserve, such as minimum standards for reserves, lending guidelines and depository services. Even though small banks objected to this intrusion by government into their business, during the 1930s the ability of these reserve systems to increase liquidity proved their effectiveness in easing tight credit conditions.¹¹

These successes caused thrift leaders to think about a federal credit reserve bank for their associations, and in 1919 the League saw the opportunity to create such a system as a way to help end the severe post-World War I housing shortage. The widespread demand for materials needed to support the war effort caused a virtual cessation of new home construction, and this halt in turn meant that only a fraction of the 600,000 new homes the nation required annually were built during the conflict. Consequently, when the war ended the nation needed an estimated two million new homes, including one million units in urban areas. Unfortunately, full-scale rebuilding was delayed by a postwar labor unrest caused by low wages and inflation, and shortages of construction material. Another factor in the housing shortage was that the demand for peacetime conversion loans led to a lack of money available for home mortgages.¹²


To ease this crisis, in January 1919 the White House called housing industry leaders to Washington for a housing and home finance conference. Because one objective of this meeting was to find ways to extend federal aid to B&Ls, League leaders came prepared with a proposal to organize a federal credit reserve bank for thrifts. The League plan was to create a national network of up to twelve banks to be owned by individual thrifts. These banks would make loans to members, which would pledge a portion of their mortgage assets as collateral. To fund these loans, the League wanted the bank to sell tax-exempt bonds to the public, a requirement that was in keeping with the tax-exempt status of B&Ls. The White House endorsed the League plan, and worked with its leaders to draft a bill for Congress. In July, long-time B&L supporter Sen. William Calder (R-NY) and Rep. John Nolan (R-CA) co-sponsored the Federal Building Loan Bank Act, more commonly called the Calder-Nolan Bill. Both the House and Senate then held hearings on the bill in October.13


Although the League helped create the Federal Building Loan Bank Act, the movement was not united in support of the measure. A Department of Labor poll conducted after the bill was introduced showed that only 45 percent of thrift executives favored creating a central bank, while 9 percent were opposed and 46 percent were undecided. One reason for the indecision was that more than 60 percent of all B&Ls, most of which were smaller associations, felt they had ample funds in hand to meet existing loan demand. Similarly, an increase in funds might lead some managers to take greater lending risks that might harm association safety. Also, the traditional wariness of thrifts regarding political involvement in their affairs led to fears that such a system would lead to socialism in housing. To counter this internal opposition, the League emphasized that a reserve bank would increase the prestige of the movement, which could be irreparably damaged if B&Ls did not meet the overwhelming demand for new homes.\(^1^4\)

For legislators, however, concerns over the bill focused on two issues. Some Congressmen questioned the creation of a new federal agency, which they saw as duplicating existing government functions, while others disliked using tax-exempt debt to fund the bank. Few lawmakers opposed the basic intent of the federal building and loan bank, and, in fact, favored a thrift reserve system in principle. However, because the proposal came at a time when the government was trying to dismantle wartime agencies

and reduce spending, backers could not muster enough support and the Calder-Nolan Bill died in committee. This failure, however, did not deter the League, and throughout the 1920s it lobbied Congress to reintroduce a mortgage credit bank measure. Political opposition to using tax-exempt funds combined with B&L apathy to prevent substantive actions. As the housing shortage began to disappear after 1922, enthusiasm for the idea declined further, and finally in 1928 the League formally withdrew its support of a home loan bank.  

Interest in forming a home loan bank reappeared two years later as a way to help thrifts and other home lenders contend with the financial crises of the Great Depression. One of the biggest problems these institutions faced was meeting the growing demand for withdrawal of consumer savings. Initially, B&Ls honored these requests immediately, but as these requests mounted some associations invoked their rules requiring members to wait up to thirty days to receive their funds. They were able to do this because B&L members were the legal owners of the thrift, and unlike bank customers they could not demand immediate withdrawal of deposits. This helped insulate B&Ls from "runs" that had forced many commercial banks to close, with the result that in the year following the

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October 1929 stock market crash more than 6 percent of all banks failed, as compared to just 1 percent of all thrifts. In fact, thrift assets in some states grew as investors saw B&Ls as a safer place to hold money.16

Beginning in 1931, however, the financial situation for thrifts worsened considerably. Not only did withdrawal requests continue to rise, but deposits also fell off since members lacked the ability to make their loan and share payments. While these conditions were serious, even worse problems began when more correspondent commercial banks used by B&Ls went under. Traditionally, thrifts relied on commercial banks to provide them with a variety of depository services and checking accounts. As a result, when these institutions closed their doors, the B&Ls, like other customers, usually lost all their money. Moreover, because most B&Ls had credit lines with these banks that were typically payable on demand, when these lenders called in their thrift loans most associations lacked the funds to make immediate repayment and were forced into bankruptcy. Combined, these factors produced a significant increase in the number of bank and thrift failures, and between 1931 and 1932 almost 20 percent of all banks went out of business while over 2 percent of all thrifts met a similar fate.17


Herbert Hoover and the Home Loan Bank

While the deepening financial crisis of the early 1930s was important in generating support for a home loan bank, another important reason plans moved forward was that Herbert Hoover occupied the White House. An engineer by training, Hoover gained national prominence after World War I when he led famine relief efforts in Belgium. Hoover embraced many of the ideals first developed by the Progressives, and among these was a belief that a proper living environment had a salutary effect on individual morals and improved personal character. In the 1920s, Hoover was the secretary of commerce in both the Harding and Coolidge Administrations, and he expanded the role of government in promoting home ownership in two major respects. First, he organized the Better Homes campaign as a way to standardize housing conditions, and second he formed the Division of Building and Housing in the Bureau of Standards to improve construction efficiency, housing availability, home finance availability.18

Another way Commerce Secretary Hoover promoted the growth of home ownership was through his policy of "associationalism," in which government

Savings and Loan Associations, 654.

encouraged businesses to cooperate in the public interest. He organized a series of conferences that brought together representatives from the housing and financial sectors to share information on ways to improve the state of housing in America. These conferences not only received a positive reception from the media and trade groups, but also brought Hoover into contact with the thrift movement and its leaders. Although he did not maintain close ties with the League, Hoover did voice his support of the movement, noting “the Department of Commerce has been in thorough sympathy with the work you have been carrying on, and is at least an agency of government that believes the results which you attain are of the most fundamental to our American people.”

As early as 1921 Hoover expressed an interest in creating a home loan bank as a way to extend home ownership and end the problems associated with using second mortgages to buy houses. While the commerce secretary believed that “the government has no notion whatever of going into the housing business either directly or indirectly,” he did feel it had a responsibility to improve the flow of housing credit. Consequently, Hoover followed the postwar efforts to form a rediscount bank, and over the years he corresponded with League and housing industry leaders on this subject. Although Hoover pledged to the League he would sponsor Congressional legislation to create a

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home loan bank if he became president, it was only when the crisis facing home owners
and lenders became truly serious that he appeared ready to use a home loan bank as one
way to alleviate problems faced by home owners and revive residential construction.20

In early 1931, the White House announced plans to organize a conference to study
all aspects of the national housing problem and provide recommendations for ways to
increase home building and home ownership. To provide the conferees with the
necessary information to create these plans, the White House formed several committees
made up of government and business leaders to gather facts and study the housing
question from a variety of perspectives, including housing design and construction,
residential planning, urban renewal, and the availability of homes in rural areas and for
minorities. One of the central issues the conference would address was finding ways to
improve the availability of home mortgages, which was an area Hoover felt was “not as
soundly organized as other branches of credit.” To assist in this effort, in November
Hoover met privately with banking, insurance, real estate, and thrift leaders to discuss
preliminary ideas on these and other related issues.21

20 "Address before the National Association of Real Estate Boards, Chicago, Ill.," 15 July 1921, 6-9,
quote 6; The Bible #164; HHPL; Memorandum from F. T. Miller to Secretary Hoover, 20 June 1921; Miller,
F. T. June-August, 1921 and undated; Building and Housing, Home Finance 1921-1929; Commerce Papers;
HHPL; Letter from Herbert Hoover to Wilber Walling, 5 March 1925; Kingsley, William H.; Home Financing;
Building and Housing, Home Finance 1921-1929; Commerce Papers; HHPL; The Herbert Hoover Presidential
Library has dozens of letters from home owners to the president requesting something be done to help them
renew their mortgages or pay their taxes to avoid foreclosure. See handwritten memorandum from Arthur
Mertzke to Dr. Gries and Mr. Ellington with attachments, 21 April 1932; Circular Letter, Finance Committee,
Reduction of Foreclosure Plans; White House Conference on Home Building and Home Ownership
(WHCHBHO); HHPL.

21 "The Chance for Civilized Housing," The New Republic, 17 September 1930, 115-7; Housing
Objectives and Programs, President's Conference on Home Building and Home Ownership, (Washington,
D.C.: USGPO, 1933), 1-20; "Money for Homes," American Builder 52 (December, 1931), 30; Confidential
One of the participants at the White House meetings with the League was the trade group’s executive manager, H. Morton Bodfish. Although just twenty-nine years old, Bodfish was already a recognized authority on the movement. He had attended The Ohio State University where he wrote extensively on B&L operations, and after graduation he had become an instructor in real estate at Northwestern University and a consultant for the national real estate trade association. Once he joined the League, Bodfish established himself as a strong and effective leader; and, while some associates described him as arrogant and opinionated, he was above all else passionate about the B&L business. This commitment, combined with an innate ability to influence people, proved very useful when Bodfish began to represent the League on Capitol Hill. To keep thrifts informed of his work he began a League members-only Confidential Bulletin, which proved to be an important tool in rallying support for federal thrift laws.22

During its meeting with Hoover, the League leadership presented its plan to ease the problems facing home lenders. Like Hoover, they agreed that providing a stable source of liquidity was an important part of the solution, and they wanted to let thrifts become members in the Federal Reserve and use its funds to make home loans. They

reasoned that because the crisis demanded quick action including B&Ls in an existing rediscounting system was more expedient that creating a new reserve bank; it would also enhance the prestige of the movement. Hoover, however, suspected that Congress would strongly resist tampering with the Federal Reserve and quickly rejected the idea. He instead commented on a proposal outlined at the annual meeting of the National Association of Real Estate Boards in May 1931 to create a central mortgage reserve bank. Hoover then pulled from his desk a detailed plan for such a mortgage reserve bank that he intended to give to Congress and wanted the League to review.\textsuperscript{23}

Shocked by this revelation, the League leaders initially tried to rally support for their ideas with legislators, but they soon learned that Hoover’s concerns were accurate. Given this situation, the League fell in line with Hoover, and worked to ensure that any mortgage bank would serve the interests of the movement, since, as Bodfish noted, “we must do something, or something may be done to us.” Consequently, thrift leaders served on the Finance Committee of the housing conference, which met in April to discuss how to increase home finance. During the next five months, however, it became apparent that the main concern of the committee was not increasing the availability of mortgages but rather reducing the need for high-risk second mortgages. One reason for this was that the committee was chaired by an insurance company executive and dominated by banking

\textsuperscript{23}Confidential Bulletin 1 (October 26, 1931), 2, 8-11; Confidential Bulletin 2 (November 10, 1931), 2-4; Confidential Bulletin 4 (December 23, 1931), 7; Mortgage Bankers Association, “Central Residential Mortgage Bank,” Letter to Members 40 (June 30, 1931), 1-2; Letter from Herbert Hoover to Roy A. Young, 30 March 1930, 1-2, Letter from Roy Young to Herbert Hoover, 28 March 1930, and Memorandum from E. A. Goldwater to Roy Young, 11 April 1930, 1-6; Federal Home Loan Bank Board Correspondence, 1930; Presidential Papers - Subject File; HHPL;
and insurance representatives who likely had little interest in bolstering the status of the thrift movement. Furthermore, many of these people not only questioned the basic premise of a funding shortage, they did not want federal government directly involved in the mortgage business and insisted that any program created to help lenders be temporary in order to “meet the present emergency.”

While the Finance Committee was compiling housing data and evaluating various alternatives, on November 13 Hoover announced his proposal to create a federal home loan bank capable of advancing up to $2 billion to home lenders. Patterned on the organization and operational structure of the Federal Reserve, this new reserve banking system would consist of twelve banks owned by B&Ls and other institutions that joined by subscribing to bank stock. These members could receive liquidity loans from the banks by pledging a portion of their mortgage assets as collateral. The reserve bank would issue bonds to investors to fund these loans, but initial funding would come directly from the government. Furthermore, Hoover insisted that this home loan bank become a permanent addition to the nation’s financial system to “further the promotion of

24The committee received dozens of suggestions from businessmen and homeowners for solving the home finance problem, including the creation of a limited number of large, urban federally-chartered savings and loans that would loans directly to individuals. Memorandum from James Taylor to Mr. Baker with attachment, 19 September 1930, Finance Committee, 1930, WHCHBHO, HHPL; Notes on First Meeting of the Committee of Finance of the President’s Conference on Home Building and Home Ownership, 23 April 1931, 1-4, and Addendum to Notes on Second Meeting of the Committee of Finance of the President’s Conference on Home Building and Home Ownership, 29 May 1931, 1-2; Home Financing, 1931, April-May; WHCHBHO; HHPL; Notes on First Meeting of Division on Mortgage Structure of the Committee of Finance of the President’s Conference, etc., June 29, 1931, 1-4, quote 4 and Handwritten notes of Division on Mortgage Structure meeting, 29 June 1931, 1-6; Home Financing, 1931, June-July; WHCHBHO; HHPL; Handwritten notes of Division on Mortgage Structure meeting, 22 September 1931, 1-5; Home Financing, 1931, August-September; WHCHBHO; HHPL; Confidential Bulletin 2 (November 10, 1931), 1-6.
home ownership, particularly through the financial strength thus made available to building and loan associations."\textsuperscript{25}

The announcement of the new home loan bank plan received a very cool reception from the Finance Committee and the entire home building and home ownership conference when it met in December. The main objections came from banking and insurance interests who disliked creating a permanent organization, and one that was so narrowly defined. Furthermore, they considered the large size of the bank as an extreme response to a temporary emergency, especially because B&Ls could gain access to funds through existing federal agencies like the Reconstruction Finance Corporation (RFC). Supporters countered that because the maximum term for RFC loans was only one year, it was ill-suited for long-term mortgage lenders; and, in fact, of the $2 billion lent by the RFC through 1933 only $125 million went to thrfts. Despite this overall negative reaction, the conference wanted to be supportive of the president and in its final report gave his plan a mild endorsement. Hoover was undeterred by this tepid response, and in his opening message to the new session of Congress on December 8, 1931 he called for legislators to establish a permanent home loan bank.\textsuperscript{26}


In January 1932, representatives from the Commerce Department, the Federal Reserve, and League met to draft the Federal Home Loan Bank Act, which Rep. Robert Luce (R-MA) and Sen. James Watson (R-IN) co-sponsored in Congress. While the basic outline of the final draft matched the Hoover plan, it also contained elements of the original Calder-Nolan bill, including a restriction on bank membership to only B&Ls and a provision allowing the government to use tax-exempt bonds to fund the bank. The bill had the backing of the League, the National Association of Real Estate Boards, home building trades, and consumer groups; and in their testimony to legislators representatives of these groups argued that increased home financing through the home loan banks would create new jobs and ease the national economic crisis. The home loan bank would also complement the federal credit reserve systems for banks and agricultural lenders, and thus place B&Ls on a par with these financial institutions.  

35; Confidential Bulletin 5 (January 30, 1932), 2-8; Confidential Bulletin 6 (March 25, 1932), 6; "Building Loan Groups Get Help from RFC," Business Week, 4 May 1932, 26; Letter from Edward Bertram to James Taylor, 21 June 1932 and Letter from James Taylor to Edward Bertram, 6 July 1932; Personal Experiences and Finance Plans, 1931; Finance Committee; WHCHBHO; HHPL James S. Olson, Herbert Hoover and the Reconstruction Finance Corporation, 1931-1933 (Ames, IA: Iowa State University Press, 1977), 14, 60-61; Article by Joseph Day, "More and Better Mortgages," n.p., n.d.; References to Finance Committee Reports; Finance Committee; WHCHBHO; HHPL; Handwritten comments by James S. Taylor, References to Finance Committee Reports; Finance Committee; WHCHBHO; HHPL; Memorandum from James S. Taylor to Secretary Lamont, 24 November 1931; Correspondence and Memoranda. Home Finance Report and Recommendations of the Committee on Home Finance; WHCHBHO; HHPL; Kreutz, The Way It Happened, 10-15.

Bankers and insurance companies were the main opponents to the bill, and they raised objections first used to defeat the Calder-Nolan bill in 1920. They opposed limiting bank membership to just thrifts, and alleged that using government bonds to fund the bank would lead to inflation. They also feared that increasing the availability of home loans would lead to “another wild spree in real estate” with overbuilding resulting in lower home values. Given these criticisms, the House Banking and Commerce Committee dropped the Luce-Watson measure and substituted a new bill drafted by Rep. Michael Reilly (D-WI) as a way to broaden support, especially because House Speaker Jake Garner (D-TX) wanted to “make short work of getting a home loan bill passed. . . .” The Reilly bill allowed virtually any mortgage lender to join the home loan bank, which made the new bank appear to be less a special interest for thrifts but also resulted in strong criticism from both the League and White House officials.28

The Reilly Bill was reported to the full House on June 10, and during five days of lackluster hearings representatives raised only two substantive objections, the first of which involved a general disapproval of creating “another army of federal officers, agents and employees” to handle what some saw as a short-term problem. The other more

122

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contentious issue was using tax-exempt bonds to fund the banks, since legislators feared this would increase the national debt. Despite these concerns, the majority of representatives voted in favor of the bill, and sent the measure to the Senate on June 16. When the Senate Committee on Banking and Currency reported it to the full body after only four days of hearings, the White House was so confident it would pass that officials began making plans for putting the home loan bank into operation. Their optimism quickly ended, however, as debate in the Senate dragged on for almost a month. As Congress neared the end of its session, officials feared the bill would not pass and would have to be reintroduced in the next session in December.29

The main reason for the delay was that several influential senators, including Carter Glass (D-VA), William Borah (R-ID), and James Couzens (R-MI), strongly opposed the measure. While Glass and Borah expressed concerns similar to those raised in the House debate, Couzens felt the purpose of the bill was misdirected. Instead of making loans to mortgage lenders, Couzens wanted the home loan bank to make loans directly to individual homeowners. He argued that if government were to become involved in home finance, any system it created had to provide direct relief to those who

29Bridewell, The Federal Home Loan Bank, 73-89, quote 78; Confidential Bulletin M9 (July 12, 1932), 1; “New Laws and Legislative Matters,” Building and Loan Annals, 1932, 666-70; Memorandum from John M. Gries to Secretary Lamont, 15(? ) January 1932; Federal Home Loan Bank Legislation, 1931-1932; Presidential Papers - Subject File; HHPL; Telegram from Ohio Bankers Association to Herbert Hoover, 29 January 1932; Federal Home Loan Bank Board Correspondence, January, 1932; Presidential Papers - Subject File; HHPL; Letter from Herbert Nelson to Walter Newton, 1 February 1932; Federal Home Loan Bank Board Correspondence, February, 1932; Presidential Papers - Subject File; HHPL; Memorandum from the United States Building and Loan League to Herbert Hoover, n.d.; Federal Home Loan Bank Board Correspondence, March-May, 1932; Presidential Papers - Subject File; HHPL; Letter from Clarence Seaman to Herbert Hoover, 17 May 1932; Federal Home Loan Bank Board Correspondence, March-May, 1932; Presidential Papers - Subject File; HHPL.
needed it the most. Given this formidable opposition, the Senate approved the bill only
after Couzens amended it to permit the bank to make direct loans to home owners who
could not get money from a B&L or bank. On July 12, just nine days before Congress
was scheduled to adjourn, House and Senate members met in a joint conference
committee to iron out their differences over the much-amended bill.30

By July 16, the House had accepted the Couzens Amendment, and had agreed on
all other issues except for an amendment inserted by Glass, designed in part to defeat the
bill, to expand the currency. For the next five days, final approval of the home loan bank
bill hinged on this one provision, until finally on the last day of the session the House
agreed to accept the amendment to ensure passage. Opponents to the bill, however, could
still nullify it by not authorizing money to fund bank operations. Because Senate rules
required an appropriation bill to lie over for one day before it could be considered, it
appeared as if the home loan bank would in fact be a dead letter law. Then, just minutes
before adjournment, Sen. Wesley Jones (R-WA), using an obscure parliamentary
maneuver, attached the appropriation to another pending bill, which allowed the Senate to

30Bridewell, *The Federal Home Loan Bank*, 93-111; Robert Luce, "The Federal Program and Building
"Couzens Gets Shift in Home Loan Bill," *The New York Times*, 7 July 1932, 12; Phone Message from Secretary
Lamont to Herbert Hoover, 5 February 1932; Federal Home Loan Bank Board Correspondence, February,
1932; Presidential Papers - Subject File; HHPL; Letter from Secretary Lamont to Secretary Newton with
attachment, 24 June 1932; Federal Home Loan Bank Board Correspondence, June, 1932; Presidential Papers -
Subject File; HHPL; Memorandum from Lawrence Ritchie to Herbert Hoover with attached letter from Wilson
W. Mills to Lawrence Ritchie, 6 January 1932; Federal Home Loan Bank Correspondence, January 1932;
Presidential Papers - Subject File; HHPL; "Senate Approves Home Loan Bill," *The New York Times*, 13 July
States Building and Loan League, 1934), 23-5; The Legislative History of the Bill H. R. 12280; Federal Home
Loan Bank Board; Federal Home Loan Bank Legislation, 1931-1932; Presidential Papers - Subject File; HHPL.
vote on the funding immediately. Caught off guard, Couzens protested this legislative “sleight of hand” to no avail, and by voice vote the appropriation passed, followed by a motion to adjourn. On July 22, 1932, President Hoover signed the Federal Home Loan Bank Act into law.\textsuperscript{31}

The creation of a federal home loan bank culminated a twelve-year effort to give thrifts a liquidity reserve system, and passage of the law reflected the differences between the 1930s and the 1920s. First, the crisis of the 1930s was clearly more severe than that of a decade earlier, and the need to give homeowners some form of relief was an important concern for legislators. Also, opponents to the home loan bank did not wage a coordinated attack to defeat the bill, as both the Mortgage Bankers Association and the American Bankers Association put up only nominal resistance. In the final analysis, passage benefitted from much stronger support from within the thrift movement which overwhelmingly believed the bank would improve their financial condition. This factor, combined with intense lobbying by League leaders, caused Reilly to later compliment the League saying, “the reason why you have a Federal Home Loan Bank Bill . . . is because of the efforts put forth by this organization.”\textsuperscript{32}


\textsuperscript{32}Confidential Bulletin 7 (May 21, 1932), 2; Confidential Bulletin M9 (July 12, 1932), 1; "Lamont Will Urge Home Loan Banks," The New York Times, 6 February 1932, 2; "Get Behind the Home Loan Bank Bill," ABAN 52 (March, 1932), 100; Railroad Cooperative Building and Loan Association, Financing Home Ownership, 3-4; Martin, George A.; Finance Committee, Correspondence; White House Conference
In August 1932, Hoover appointed the first Federal Home Loan Bank Board (FHLBB) to put the home loan bank into operation. Its members were Commerce Department housing advisor John Greis, banker Nathan Adams, League president William Best, League manager Morton Bodfish, and banker Franklin Fort as chairman. The first task of the Board was to divide the country into districts for each Federal Home Loan Bank; and, although it could have used the existing Federal Reserve districts, the members deliberately chose different boundaries and headquarter cities to combine states that had adequate mortgage financing with those that had severe shortages. Next, the Board got states to pass laws that would allow thrifts to pledge their mortgages as collateral for bank loans, something most prohibited because during the "nationals" era thrifts had used these assets for speculative purposes.33

In October 1932, the Board announced the federal home loan bank system was fully operational and ready to make loans to its members. The bank had total capital of $134 million, consisting of $122 million from the government and $12 million from the bank members. Although the bank was open to all types of residential lenders, all of the

first members were thrifts, a trend that continued throughout the life of the home loan bank. Within a few months, the Board approved $98.8 million in loans to members and had an additional $53.4 million in pending applications. By March 1933, lending volume exceeded $5 million per day, and, while the additional liquidity did not dramatically improve conditions, it did help. Thrift managers reported to the League that they experienced a decline in withdrawal requests following their joining the home loan bank, and in some instances people opened new accounts reflecting greater public confidence that B&Ls had money to lend.34

Despite such overall progress, the Board did have major trouble in meeting the objective of making direct loans to home owners as required by the Couzens Amendment. Because the home loan bank was, like the Federal Reserve, a wholesale lender to other financial institutions, it did not have the manpower to effectively operate a retail lending system as envisioned by Couzens. The lack of personnel was so acute that the Board had difficulty just responding to the avalanche of requests it received from mortgagees seeking relief. Another problem was that Congress did not specify what lending criteria the Board should use to evaluate individual loan requests. Because of this omission, the Board was forced to treat applications from home owners by the same standards it used to

34Press Release, Federal Home Loan Bank Board, 14 October 1932, 1-3; Federal Home Loan Bank Board; Federal Home Loan Bank Legislation, 1931-1932; Presidential Papers - Subject File; HHPL; H. Morton Bodfish, "The Home Loan Bank System," ABAN 52 (October, 1932), 454-5; Confidential Bulletin M11 (November 18, 1932), 3-4; Confidential Bulletin M18 (December 22, 1932), 1-3; "Members of the Home Loan Bank," ABAN 53 (May, 1933), 75; Address of Horace Russell, General Counsel, Federal Home Loan Bank Board before the Carolina Lumber and Building Material Dealers’ Association, 8 February 1933, 1-4; Federal Home Loan Bank Board; Federal Home Loan Bank Legislation, 1931-1932; Presidential Papers, Subject File; HHPL.
approve loan requests from private lenders. This meant that small loans had to have a minimum loan-to-value ratio of between 60 and 70 percent, which, given the steady erosion of property values, was virtually impossible to meet. The result was that of the more than 41,000 home owner requests for direct loans received by the Board through March 1933, only three were approved.35

These problems in meeting the direct loan provision ultimately led to public criticism of the Board. Since several newspapers followed the progress of organizing the regional banks on an almost daily basis, the public had heightened expectations that the home loan bank would provide immediate assistance. This attitude was reinforced by the constant attention given to the Couzens Amendment. The Board, however, stressed that its primary role was as a source of liquidity for home lenders. Consequently, it would take time for these institutions to use this money to make mortgages, and the Board urged the public to be patient and have faith that things would improve. Despite such pleas, the rising tide of foreclosures combined with the virtual absence of direct loans caused a steady rise in criticism. Attitudes were so negative, that the “failure” of the home loan

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bank to help suffering home owners became a Democratic party campaign issue in the 1932 presidential election.\textsuperscript{36}

Nor did Congress like this lack of direct lending to homeowners, and some congressmen thought the Board was purposely avoiding the mandate legislators had given it. Among them was Sen. Borah who accused the Board of operating the home loan bank as a self-serving institution to help only B&Ls. He introduced bills to abolish the bank in December 1932 and March 1933. The Board defended its record by citing the problems it had in interpreting and implementing the law. It also noted how the bank was steadily increasing its membership and its success in meeting the demand for loans. Although neither of Borah's bills was reported to the full Senate, the debate over the value of a home loan bank highlighted the need to find a more effective way to provide homeowners with direct relief from their delinquent mortgage debts. This issue, along with rescuing the nation's rapidly faltering banking system, would be one of the top priorities of the new president, Franklin D. Roosevelt.\textsuperscript{37}


Roosevelt Takes Command

By the time Franklin D. Roosevelt took the oath of office on March 4, 1933, the problems facing homeowners were reaching epidemic proportions. Lenders were initiating an average of 24,000 foreclosures per month, a rate that was nearly five times that of the 1920s. In fact, the number of foreclosures would have been much higher except for the fact that many lenders refused to take possession of a property because the decline in real estate values would have forced them to recognize a financial loss. The situation was so severe that the government estimated that 43 percent of all first mortgages on urban homes were in default with an average arrearage of fifteen months. The condition of the second and third mortgage markets was even worse, with 54 percent of these loans in default and an average period in arrears of eighteen months. Officials concluded that nearly 25 percent of these homeowners were in danger of losing their property.38

A more immediate problem, however, was the increase in commercial bank failures over the previous six months. Between October 1932 and February 1933, waves of panics and deposit runs forced nearly 6 percent of all commercial banks to cease operations, and significantly these failures were nationwide, affecting both rural and urban areas. In order to preserve the integrity of the banking system, by January 1933


some states began to order shut downs of all banks by declaring "bank holidays." State officials used any convenient reason to justify their actions, such as the Louisiana bank holiday called to celebrate the sixteenth anniversary of America's breaking of diplomatic relations with Germany during World War I. By March 1, ten states had declared bank holidays, and while these actions may have prevented local deposit runs in states where banks remained open people who feared their institutions would be the next to initiate other deposit runs. This created a domino effect that ultimately forced dozens of states to enact banking moratoriums, so that on the eve of Roosevelt's inaugural, so many states had declared bank holidays that the nation's banking system was essentially inoperative.

Roosevelt devoted a large portion of his inaugural speech to his plan to deal with the banking crisis. He declared a national bank holiday and called legislators back into session, which began the famous "Hundred Days" Congress. While thrifts and the home loan bank were included in the Roosevelt bank holiday, by March 13 the home loan bank was allowed to reopen and it began immediately making loans to members. This quick response by the Board helped dozens of thrifts meet withdrawal requests, and this action went a long way toward improving its tarnished public image. While this assistance was important, another reason B&Ls stayed solvent was the support individual members gave their associations. Thrift managers appealed to the cooperative spirit that had helped

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create the thrift movement and asked members to limit their withdrawals to meeting essential needs like buying food. No B&Ls failed during the national bank holiday.40

Even though assistance from the home loan bank helped many B&Ls survive the national bank holiday relatively unscathed, thrift leaders still feared that the White House was intent on terminating what some Roosevelt insiders referred to as the “Hoover banks.” Because the term of the FHLBB members expired on March 4, rumors abounded that the expirations would be used as an excuse to abolish the system, and these fears appeared to be confirmed when Roosevelt failed to reappoint any of the original Board members. The new Board consisted of South Carolina Congressman William Stevensen, newspaper publisher John Fahey, and three bankers, none of whom had ties to the thrift movement. Stevensen was chairman, and thrift leaders assumed he was the “hatchet man” who would disassemble the bank. To the surprise of many, instead of ending its existence the White House was ready to make the home loan bank a key element of its plans to provide direct relief to homeowners.41

Creating Federal Savings and Loan Institutions

One of the first tasks Roosevelt gave the new Board was to design an effective way to give immediate relief to home owners. Although one flaw in the home loan bank

40 Confidential Bulletin M20 (March 4, 1933), 1-2; Confidential Bulletin M21 (March 7, 1933), 1-4; Confidential Bulletin M22 (March 29, 1933), 1-3; “The Crisis and the Strong Measures that are Being Used,” ABAN 53 (March, 1933), 100-1; Henry S. Rosenthal, “We are Facing the Keenest Competition in the History of the Movement,” ABAN 53 (March, 1933), 196-7.

41 Confidential Bulletin M22 (March 29, 1933), 3-4; Confidential Bulletin M23 (April 15, 1933), 2; Russell, Savings and Loan Associations, 46-7; “United We Stand -- Divided We Fall,” ABAN 53 (March, 1933), 99; Ewalt, A Business Reborn, 66-8; Kreutz, The Way It Happened, 19-23.
was requiring homeowners to apply directly to the home loan bank for a loan, two other problems also needed attention if any direct assistance program were to be feasible. The first involved reducing the risks associated with lending money on properties that were highly leveraged, a situation that resulted from the extensive use of second and third mortgages in the 1920s. The Board had to find a way to not only refinance all the liens, but also reduce the monthly payment of the new mortgage over a longer term. The second problem involved increasing the availability of home loans nationally, since the hundreds of bank and thrift failures left one-third of all counties in the nation without any local source for mortgages.42

Administration officials met with the FHLBB on April 2, 1933 to discuss different proposals to implement a direct lending program. This meeting produced a number of ideas, and the task of crafting them into legislation fell to the Board's general counsel Horace Russell, a former president of Atlanta's largest B&L. On April 4, Russell presented his draft of a bill he titled the "Emergency Mortgage Act of 1933." The bill repealed the Couzens direct loan provision, and created a temporary agency operated by the home loan bank to help home lenders refinance individual mortgages. These loans would be made for up to 80 percent of the appraised property value and would be amortized in equal monthly installments for a period not to exceed eighteen years. Homeowners who possessed unencumbered property could also apply for an HOLC cash

loan for up to 40 percent of the appraised value. Finally, the bill created a national charter for thrifts to be called "federal savings and loan associations." These privately-run thrifts were intended not to compete with existing B&Ls, but would serve areas that lacked any mortgage institutions. The bill also gave the Board money to promote their creation, and allowed the government to provide “seed money” of up to $100,000 per association to help this system get started.\(^{43}\)

When Roosevelt read the Russell draft, he immediately approved it but changed its name to the “Home Owners’ Loan Act.” He also renamed the mortgage refinance agency to the Home Owners’ Loan Corporation (HOLC). On April 13, he sent the bill to Congress, and two weeks later the House overwhelmingly approved it after only 90 minutes of debate. The Senate took longer to consider the bill because of the large volume of pending legislation; but on June 6, after two days of hearings, it also passed the act, which Roosevelt then signed into law a week later. Although Congressional action on the Home Owners’ Loan Act was unusually fast, it was not because of a lack of controversy. In fact, several legislators objected to the federal savings and loan provision, and they questioned how these associations could give relief to those in immediate danger of losing their homes in a timely manner. They also opposed using public funds to promote federal thrifts, which they viewed as just propaganda for the

thrift movement. League leaders, however, urged legislators to view federal thrifts not only as replacements for the thousands of bankrupt lenders, but also as a long-term solution to improve mortgage finance, noting they will "give more relief to home owners over the next few years than any other legislation that could be enacted."^44

As was true with the home loan bank, this new government role in the thrift business was not completely embraced by those in the thrift movement. Some managers feared that federally-chartered thrifts would be formed in areas already adequately served by B&Ls and thus increase competition. Other officials, including state regulators, disliked this plan because it was an intrusion by the federal government into their affairs. To assuage these concerns, the League received assurances from the Board that it would not grant federal charters lavishly or in an unwise manner. Rather, because these new associations would complement existing thrifts serving areas not covered by other home lenders, the League portrayed them as a way to bring the gospel of thrift to new communities. It also contended that the new "federal" identity would significantly enhance the image and reputation of the thrift business. Finally, League leaders looked to

these more standardized institutions as a way to increase the overall uniformity of thrift operations across the country.  

Securing Deposit Insurance

Although the Home Owner's Loan Act was the piece of legislation which had the greatest impact on thrifts during the First New Deal, the Banking Act of 1933 was another key measure that had an indirect effect on the movement. While this law gave thrifts a competitive advantage by restricting the ability of banks to pay interest on savings, it also gave banks an edge with the Federal Deposit Insurance Corporation (FDIC), which insured commercial bank deposits. The FDIC was highly controversial, and at first the banking community vehemently opposed it. The Roosevelt Administration also considered it unworkable, but supported it because of pressure from the public and the bill's co-sponsor, Rep. Henry Steagell (D-AL). Since the law required all Federal Reserve members to join the FDIC, within a year nearly all commercial banks had coverage, and the psychological effect of this on the nation was profound. By giving depositors assurances they would not lose their money if an insured institution failed, the FDIC helped restore public confidence in the banking system to such an extent that the number of bank failures plummeted.  

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Like most bankers, Bodfish initially thought the FDIC was “essentially an unwise and unsound program” and took a wait-and-see attitude on whether to seek deposit insurance for thrifts. By the end of 1933, the effect of the FDIC on the public caused the League executive manager to change his mind, noting if “commercial bank savings are insured, then should not thrifts . . . enjoy the same privileges?” This desire to stay competitive with banks led the League to meet with the FHLBB in November 1933 to discuss a system of deposit insurance for B&Ls. While gaining parity with commercial banks was one goal for thrift leaders, they also saw deposit insurance as a way to increase membership in the home loan bank, spur the creation of federal associations, and reduce the flight of deposits from thrifts to insured commercial banks. From these meetings, Board counsel Russell outlined a plan for a Federal Savings and Loan Insurance Corporation (FSLIC), which the League reviewed in February 1934.47

Although both the FSLIC and FDIC insured consumer deposits, there were several important differences between the two programs. First, the FSLIC was under the control of the Board, whereas the FDIC was an autonomous agency. Second, since thrifts were not required to pay deposits on demand, FSLIC would also pay off depositors within three years; in contrast, the FDIC made immediate payments since it insured demand accounts. Third, the only associations required to join the FSLIC were those with federal charters, which reflected the fear that state regulators would put troubled state-chartered thrifts into involuntary liquidation and let the FSLIC pay off depositors.

47Confidential Bulletin M22 (March 29, 1933), quotes 2; Confidential Bulletin M36 (December 12, 1933), 3; Bridewell, The Federal Home Loan Bank, 364-77; Russell, Savings and Loan Associations, 97-8.
The one significant similarity between the two programs was that all FSLIC members would have to build their reserves to equal 5 percent of their assets. While the League generally supported this plan, it strongly objected to the reserve requirement; but Russell insisted it not be changed since it would force managers to take greater responsibility for their lending decisions and also improve public confidence in insured thrifts. Consequently, this one section caused the League to give the FSLIC a weak endorsement saying, "if we must have an insurance corporation, this is the right approach."48

While the White House favored thrift insurance, its greater concern was the continued doldrums in the housing industries. In 1933, new mortgages and home improvement loans were just 25 percent and 12.5 percent, respectively, of pre-depression levels. Furthermore, an estimated two million housing industry workers were still without jobs. In light of these facts, the Roosevelt Administration sidetracked consideration of thrift deposit insurance and focused instead on ways to increase lending through a mortgage insurance system. The rationale behind this decision was that if the risk of loss due to foreclosure could be minimized, lenders would make more loans, and in turn generate more jobs. The initial administration plan involved backing mortgages with a federal guarantee that entitled lenders who foreclosed on an insured loan to receive a bond equal to the unpaid principal. This bond would then be paid off over the original mortgage term. Because this represented a radical extension of government involvement in home finance, Russell roundly condemned it, fearing that it would lead to speculative

building and unnecessary foreclosures as a way to receive guaranteed government funds.49

Nonetheless, the administration wanted some form of mortgage insurance, and the Board directed Russell to prepare the desired legislation. The result was the National Housing Act of 1934, which consisted of four major sections. Title I created a mortgage insurance program that guaranteed payment of a home loan in an amount up to the appraised value of the underlying security. Title II authorized the government to charter tax-exempt national mortgage associations to make loans directly to home buyers as well as invest in mortgages. Title III established a voluntary insurance program for thrift shareholders that any B&L could join, while Title IV authorized the Board to make loans for home improvements and repair projects. This last section was part of a broader administration plan for a government-sponsored home modernization drive that would hopefully increase employment.50

The bill also created a new government agency, the Federal Housing Administration (FHA), to administer all the programs, with the exception of the FSLIC which the Board would control. The White House insisted on this separate housing agency primarily because it would diffuse the power of the FHLBB, which was already


coming under the influence of the League. While the administration was wary of this close relationship, thrift leaders like Bodfish thought that it was only proper that thrifts control the home loan bank because they owned the bank. In fact, when Bodfish was on the Board, he personally selected several regional bank officers and developed a list of criteria for choosing future officials as a way to prevent “liberalizing” forces from taking over. Consequently, given the dislike of the National Housing Act by the League, it was not surprising that the administration feared the Board would not administer these programs in a wholehearted manner.51

Roosevelt sent the National Housing Act to Congress on May 14, 1934, and the House Banking and Currency Committee held hearings shortly thereafter. While the League disliked the idea of mortgage insurance, it considered the national mortgage associations the greatest threat to their business. The main reason for this fear was that these associations would be tax-exempt, which was one of the few advantages B&Ls had over other mortgage lenders. Bodfish lobbied to prevent the creation of these potential competitors, and when the Committee sent the bill to the full House on June 12 the national mortgage association section had been removed and replaced with a provision to increase the HOLC investment in federal savings and loans from $100 million to $500 million. Because the current session was almost over, the revised bill was made a special order of business which limited debate to four hours. Despite this restriction, the debate

was lively, acrimonious and focused on League-inspired changes, which some referred to as the "Bodfish Amendment."^52

Unlike earlier Congressional debates on thrift bills, in which legislators generally praised Bodfish and the movement, the mood in the House was decidedly hostile toward the League. Representatives accused the Committee of abandoning the administration by submitting a bill that was the product of a self-serving thrift lobby. As a result, the full House rejected the Committee's revisions to Title II and restored the original White House proposal. One sign of anti-League sentiment was that Rep. Reilly, who supported the movement and was instrumental in passing the Home Loan Bank Act, argued to drop the Bodfish Amendment. In the Senate, support for the national mortgage association idea was strong, and some senators asserted that it would help thrifts. According to Sen. Robert Bulkley (D-OH), "building-and-loan associations at first feared that active competition would be started by the proposed mortgage associations. . . [But now] at least a large part of the building-and-loan associations feel that the competition will not be dangerous." Roosevelt finally signed the National Housing Act into law on June 27, 1934.53


While the League did manage to block the original direct loan power of the national mortgage associations and made them taxable businesses, the overall reaction to the NHA from the movement was one of fear and foreboding. Thrift leaders considered mortgage insurance an expensive program that would lead to fraud and unsound financial practices. Bodfish in particular believed that the law was the first step toward socialism in housing in which the government ultimately would control all aspects of home finance. The League’s greatest concern, however, lay in how successful the national mortgage associations would be. Aside from problems of competition, the League feared that the access these associations would have to low-cost government funds would drive down all mortgage rates and hurt thrift profitability. Despite such fundamental concerns over the NHA, the League pledged to support the law and hoped for the best regarding its implementation.54

One consequence of the struggle to pass the NHA was that Bodfish gained greater national recognition and even notoriety, given his ability to alter the bill during the House hearings. The Roosevelt Administration was incensed at what Bodfish did, and late in 1934 it called for an investigation of what it called a powerful and influential thrift lobby. Much to its chagrin, the White House did not find instances of unethical influence

peddling, but rather legitimate lobbying designed to protect the interests of B&Ls. Both friends and enemies of Bodfish on Capitol Hill praised him as a talented and effective lobbyist. The most appreciative group, however, was the League, and following passage of each law its leaders heaped praise on their executive manager. They not only recognized his ability to influence the creation of thrift laws, but lauded his work to promote the work of B&Ls among legislators. This work also assisted Bodfish's rise to power within the League, and helped in his other efforts to transform and modernize the character and nature of the thrift movement.  

Conclusions

By the end of 1934, the thrift movement was governed by a comprehensive system of federal regulations, complementing existing state regulations. In principle, thrift leaders generally approved of government oversight, since they viewed it as a way to accomplish certain goals that would improve their movement as a whole. Laws governing how a B&L should be organized and operated led to greater uniformity among associations and helped generate greater public confidence in the institutions. While the thrift movement generally supported state oversight, initially the pursuit of federal oversight was half-hearted at best. Prior to 1930, the only major federal issue with which B&Ls concerned themselves was taxation, and the League was vigilant in making sure all thrifts were exempt from federal taxes. The major reason for this lack of interest in

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federal oversight was that thrifts were local institutions that they felt should be regulated by the states.

This attitude of indifference changed, however, during the Great Depression when economic upheaval ravaged all financial businesses. As unemployed home owners faced the risk of foreclosure, President Hoover, who was himself a supporter of the thrift movement, decided in 1931 to create a federal home loan bank as a way to alleviate these hardships. The League, while initially hesitant, eventually jumped on board and worked hard for passage of the Home Loan Bank Act. While deteriorating financial conditions for thrifts were important in shifting opinions, another critical factor was that the League’s new executive director, Morton Bodfish, was able to work with legislators to make sure the new bank would serve the interests of the movement. In fact, his role was so significant that Hoover appointed Bodfish to serve on the first Board. Unfortunately, the new home loan bank met with operational problems, and its inability to meet the pressing demands of home owners to refinance mortgages almost led to its demise.

The other two major elements of federal involvement in the thrift business came during the Roosevelt Administration. The first of these was the creation of a system of federally-chartered thrifts to serve areas without sources for mortgages. The federal identity of these thrifts also enhanced the status of the movement and had the potential to introduce more uniform business practices. The idea of federal charters for thrifts was part of the Home Owner’s Loan Act of 1933, a law that also improved the home loan bank by creating the Home Owner’s Loan Corporation to assume responsibility for
making loans to individuals. The last aspect of federal oversight of the movement was the creation of a deposit insurance under the National Housing Act in 1934. While thrift leaders were skeptical of deposit insurance prior to 1933, the success of the FDIC convinced them of the desirability of a similar system for B&Ls.

Although the majority of B&Ls were either ambivalent to or resisted federal oversight of their business, the creation of a reserve bank, federal charters and deposit insurance were very important milestones. In just two years, the thrift movement acquired a regulatory system that had taken banks more than sixty years to obtain. Many of these accomplishments resulted from the work of the League and in particular Bodfish. Bodfish’s attention to lobbying key Congressmen helped ensure that federal oversight would be favorable to the interests of B&Ls and be one that would help the movement grow and prosper. Moreover, this work was just one aspect of the League’s broader efforts to institute change during the 1930s. Under the leadership of Bodfish, the League would finally achieve success in its long-sought goal of unifying the movement, and in turn transforming it into an industry.
CHAPTER 5
THE MOVEMENT BECOMES AN INDUSTRY, 1930-1945

The Great Depression and World War II were pivotal in the development of a modern thrift business. The broad changes that occurred during this period came in three major areas. The first of these involved improvements in the structure of the thrift trade association. Under the leadership of its executive manager Morton Bodfish, the League became more fully organized and more useful to its members. It developed a number of new programs that led to significant improvements in thrift business practices. At the same time, Bodfish and the League helped transform the mind-set of thrift leaders to think of their business less as a movement and more as an industry, in part by urging associations to adopt the common term “savings and loan” to replace the older “building and loan” nomenclature. A second body of changes affecting the thrift business centered on the consequences of the Great Depression. While the financial turmoil associated with deposit runs and loan foreclosures led to a number of thrift failures, most associations survived the period, and this experience strengthened the industry by improving the financial acumen of most managers. The final major changes affecting thrifts involved the work of the newly created federal regulatory system, including the Federal Home Loan Bank Board, the Federal Savings and Loan Insurance Corporation, and the creation...
of a system of federal charters for savings and loans. Each program steadily attracted members, and by the end of World War II they were firmly established as part of the American financial system. This success resulted in part from the leadership of the Board and its chairman John Fahey, who petitioned Congress to modify these programs to improve their effectiveness. Combined, these three areas of change helped enable the thrift business to experience virtually uninterrupted prosperity for nearly two decades following the end of the war.

Bodfish and the League

The 1930s saw a number of major changes for thrifts, not the least of which was the development of a trade association better equipped to meet the needs of its members. The League became a well-regarded and multifaceted organization by the end of the decade, with much of this improvement due to its executive manager, Morton Bodfish. Bodfish was twenty-seven years old when he joined the League in 1929, but he already had a broad understanding of real estate finance. His mission as manager was to unleash the potential of the thrift business, which he likened to a sleeping giant. To do this, Bodfish first sought to improve the organizational structure of the League, which up until then did not have a true headquarters or full-time employees. Bodfish consolidated operations in a downtown Chicago high-rise office, created new positions that he filled with experienced executives, and formed a number of standing committees to improve its long-term strategic planning capabilities.¹

In addition to formalizing its structure, the League improved the level of its communications with members. It expanded the content of its monthly trade journal, and began to issue its annual convention proceedings as a professionally-edited volume instead of a verbatim transcript. Bodfish formed a full-time publicity department to coordinate releases to newspapers and national wire services, and began two monthly newsletters: the Confidential Bulletin, which focused on federal legislative and regulatory developments, and the Legal Bulletin, which concentrated on state and federal litigation affecting thrifts. Most of these publications were directed to member thrifts, but the League also distributed them to schools, libraries, legislators and chambers of commerce in order to heighten the visibility of thrift work and make people more aware of thrift business activities.²

Finally, Bodfish worked hard to increase the number of associations which belonged to the League. Although thrift trade associations often flourished at the state, regional and even local levels, the national association had trouble attracting members, since many managers did not feel that the benefits of membership justified the costs. Just 12 percent of all thrifts were League members by 1931, and this low participation hurt the

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credibility of its leaders who testified for passage of federal regulation. To change this,
Bodfish and League officials literally hounded managers to join the trade association, and
as the legislative influence of the League led to the passage of favorable laws, thrifts
began to join in large numbers. By 1935, 42 percent of all associations were part of the
League, and these members accounted for more than 75 percent of total thrift assets. This
growth also made the League financially secure, giving it the ability to fund its new
programs.3

While Bodfish helped make the League a more powerful organization, his work
also helped increase his own standing within the thrift business. The executive manager
influenced the selection of state league leaders, and he showed them how to use grass­
roots lobbying techniques such as letter writing campaigns to secure favorable legislation.
These activities proved so successful and gained such an awesome reputation that the
mere threat of their use was enough to sway wavering legislators. Bodfish also tried to
affect the direction of federal oversight, and during his brief tenure on the Federal Home
Loan Bank Board (FHLBB) he made sure that the twelve reserve banks were controlled
by people who were “loyal organization men.” Even after leaving the Board, federal

3Thomas Fitzmorris, “Advantages of National and State Leagues,” Financial Review and
American Building Association News 18 (May, 1899), 165; J. G. Elder, “The Benefits to be Derived from
Membership in the State and United States Building and Loan League,” ABAN 26 (October, 1907), 195;
(November, 1915), 503-5; “Why Not Join a League?” ABAN 41 (September, 1921), 390; William Best,
“Growing Unity of the Building and Loan Business,” ABAN 52 (May, 1932), 216-7; John R. B. Byers,
“How to Change the Rope of Sand into a Rope of Steel,” ABAN 53 (April, 1933), 153, 181; “No More Free
Rides,” ABAN 53 (August, 1933), 344; “United States Building and Loan League Launches Membership
Campaign,” ABAN 54 (August, 1933), 345; J. J. O’Malley, “The Reasons Why Your Association Should
be a National Member,” ABAN 53 (February, 1934), 71-2; “Membership Campaign Shows Results,” ABAN
55 (October, 1935), 453.
officials continued to consult with Bodfish before making appointments or issuing new regulations. The net effect of this work at the local, state, and national levels was the creation of a virtual "Bodfish machine" of thrift leaders who supported the vision of the executive manager.4

Moving Toward Operational Uniformity

The second major goal of the League was to improve the level of uniformity and standardization of business practices within the thrift business. To do this, it focused primarily on improving management education, thrift accounting principles and real estate appraisal techniques. A key element in achieving this standardization was the American Savings and Loan Institute (ASLI), formed in the mid-1920s and made a League affiliate in 1930. The need for increased financial education became apparent during the Great Depression, which had "revealed that [thrifts], like all cooperatives and quasi-public enterprises, suffer from a lack of skilled management and staff services." The ASLI met this challenge in 1939 with the creation of the Graduate School of Savings and Loan. Held at Northwestern University during the summer, this three-year program offered a complete curriculum of courses ranging from accounting and business forecasting to personnel management and thrift law. It soon had a positive reputation for

its education program, and eventually became a training center for academicians and others wanting to know more about thrift business practices.5

Another major project of the ASLI was creating a standardized thrift accounting system. Because state laws rarely addressed accounting issues, associations had over time developed a myriad of financial procedures. While this was not necessarily a business problem, the League did see this lack of uniformity as detrimental to their business image. In 1934, it created the Accounting Division, which designed a series of standardized reporting forms that the FHLBB and thirty states later adopted for their own use. In 1936, the ASLI expanded on this work by organizing the first standard accounting system that created uniform classifications for all types of thrift assets, liabilities and equity. Hailed by the League as “the most significant non legislative work accomplished by the organized savings and loan business in many years,” this plan soon became the standard for all associations. This system consisted of a balance sheet, profit and loss report, and a reconciliation of net worth, which were laid out in such precise

detail that the level of financial reporting accuracy rose markedly. This system was also a boon to the League and regulators since it produced a wealth of new industry data.6

A final Institute project focused on designing a uniform real estate appraisal system that all associations could use. Although obtaining an accurate property value was critical to any mortgage lending decision, making a valuation was traditionally regarded as more of an art than a science. Most B&L appraisals were completed by directors with real estate or construction backgrounds; but because they often lacked formal training in appraising, their reports were usually cursory reviews of the property and neighborhood. This lack of detail reflected the fact that lenders generally considered the moral risk of a borrower to be as important, if not more so, than the value of the underlying collateral. As a result, loan reports frequently contained interviews with friends, creditors or employers of the applicant. Even League leaders felt that “the value of a property should [only] be a safeguard . . . in case the judgement of the borrower as a credit risk should prove wrong.”7


In 1926, real estate appraising became a more distinct and recognized profession when the National Association of Real Estate Boards formed the American Institute of Real Estate Appraisers (AIREA) to design the first accreditation system for appraisers. Unfortunately, because most of its members were with banks or insurance companies, the AIREA gave little attention to improving residential appraisal practices. In 1931, the League addressed this problem by forming the Appraisal Division, which created uniform guidelines for appraising residential real estate, as well as a standard appraisal form used by federal regulators. In 1934, the League sponsored the formation of the Society of Real Estate Appraisers to design specialized education programs in residential appraising, as well as a separate accreditation system and code of ethics.\(^8\)

*The League and Thrift Advertising*

The third major objective of the League in the 1930s was to improve the overall public impression of thrifts primarily by encouraging greater advertising and publicity. A 1934 survey found that, given a choice of different forms of investment, consumers ranked building and loan shares next to last in terms of desirability. Furthermore, only 10 percent of respondents would recommend a thrift investment to others. Even more...

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troublesome to League leaders was that just 29 percent would obtain a home loan from a thrift, while nearly half would use a commercial bank. To change this perception the League emphasized to managers the importance of well-designed advertising, and in 1935 it organized the Advertising Division to assist in this effort. One project of the division involved creating generic advertising packages that thrifts could have customized for their association. It also helped managers produce advertising for special events like office openings, dividend declarations or anniversaries.

In addition to these forms of local advertising, the League wanted thrifts to participate in regional and national publicity campaigns. Greater use of radio advertising was an important way to achieve this, and by 1940 nearly 20 percent of all money in thrift publicity budgets was spent on this medium. State thrift trade associations also cooperated to produce regional campaigns in traditional print media. Unfortunately, the League had little success in producing a national campaign because of the high costs involved. This changed, however, in 1937 when the League launched its first national advertising program that targeted residential professionals including Realtors, architects and builders. The Advertising Division placed advertisements in building trade

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publications that detailed the benefits of thrift financing, and urged these housing "middlemen" to support "your local savings or building and loan association."\(^{10}\)

The focus and content of thrift advertising also changed in the 1930s. The hard times of the depression required managers to stress the soundness of their organization, their service to the community, and their willingness to lend money. The League urged associations to "tell about your reserves, tell about your management, the standing of your directors [and] do it all in a positive, aggressive, confident and 'we are doing business as usual' manner." It also wanted managers to tout their participation in the federal home loan bank and deposit insurance systems as a way to instill additional public confidence in their institutions. While such recommendations made practical business sense, the League also hoped that an emphasis on financial integrity and managerial expertise would professionalize the image of thrifts.\(^{11}\)

*The "B&L Becomes the "S&L"

The fourth major objective of Bodfish and the League was to modernize the way in which thrift executives viewed themselves and their business. Since the late-

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nineteenth century, thrift leaders had consistently referred to their business as a social and financial self-help movement. The League consciously linked its mission of encouraging thrift and home ownership to patriotism, personal liberty, and community values -- an attitude neatly summarized in its slogan, "the American Home, Safeguard of American Liberties." Furthermore, people often served as thrift managers out of a sense of service to the members and their community. Given these beliefs, it is not surprising that the League traditionally glorified its work as an altruistic mission that improved personal morals and the general welfare of the nation. In many ways, thrift leaders wanted the public to think of these associations more like religious institutions than as financial institutions.

The rapid expansion of the thrift business during the 1920s led some observers to question the effectiveness of maintaining this type of image. Business Week noted wryly that "the 'movement' -- they still call it that -- is imbued with a tinge of evangelism," implying that thrifts were not on a par with other financial institutions like banks. Another critic chided the League for "relying too much on sentiment and moralizing for support." At the same time, the inclusion of thrifts under federal regulation had brought greater attention to B&Ls as distinct financial businesses. As a result, some thrift leaders began to tone down their references to "the movement," and Bodfish was among them.

He noted in 1935 that “while the thrift and home financing institutions may be appropriately referred to in their social significance as a ‘movement’ there seems to be a definite need . . . to develop the concept of these institutions as a business. While the business remains essentially cooperative and quasi-public, it must be continued as a business procedure with the same demands for skill and managerial ability which characterize any business enterprise.” Such an attitude was reflected in his efforts to have the League take the lead in professionalizing and standardizing the thrift business.13

Another sign of how thrift leaders were trying to change their identity away from a movement toward a financial industry lay in their efforts to get all associations to adopt uniform nomenclature. For decades, thrifts had used a wide variety of descriptive association names, but by 1933 the creation of the federal savings and loan system led to a concerted campaign to persuade all thrifts to adopt the term “savings and loan” in their names. According to Bodfish, “the opinion is gradually developing that the term ‘savings and loan’ . . . is the more appropriate since it emphasizes the investment and systematic savings phase as well as the provision for home ownership.” To encourage these efforts, the League changed its name to the United States Savings and Loan League in 1939. While Massachusetts thrifts continued to be called “cooperative banks,” associations in

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nearly every other state dropped the older term “building and loan” in favor of “savings and loan.” By the end of World War II the transition was virtually complete, marking another major step toward greater industry unity.\(^{14}\)

*Exercising the Regulatory Machine*

While the League worked to modernize and unify the S&L industry during the 1930s, the government focused on establishing its new role in home finance through the Federal Home Loan Bank, the Federal Savings and Loan Insurance Corporation (FSLIC), and the federal savings and loan system. Even though the League strongly supported the home loan bank, it was slow to attract members since many thrifts wanted time to evaluate the merits of participation. Consequently, after four years of operation just 33 percent of all S&Ls representing 49 percent of total assets were home loan bank members. Over the next five years, however, membership increased steadily, and by 1941 associations representing more than 90 percent of S&L assets were part of the home loan bank. Despite this growth, many smaller associations and those in strong financial condition resisted joining, in part because of the cost of membership as well as a basic dislike of government involvement in their affairs. This resistance persisted for years, and only in 1960 did this credit reserve bank system acquire a numerical majority of all thrifts as members.\(^{15}\)


One reason for this growth in membership was that the FHLBB worked hard during the 1930s to expand the range of home loan bank services. These services included a monthly magazine and the systematic collection of industry statistics which it distributed to its members. In 1936, the Board launched the Federal Home Building Service Plan (FHBSP) as a way to help thrifts satisfy the public demand for low-cost homes. The FHBSP was a comprehensive package of design, construction and financing services that S&Ls used to advise home buyers, and even included a certificate of recognition from the government given to the new homeowner. In addition to stimulating construction of affordable housing, the FHLBB hoped that combining multiple services into one package would improve the public perception of thrifts as experts in residential finance. While the FHBSP was advertised extensively, with the American Institute of Architects supplying more than 500 different home designs, it got off to a slow start and after one year was available in only three Midwestern cities.\(^7\)


Thrifts were initially reluctant to use the FHBSP, fearing it would lead to speculative building and lower real estate values. Others did not feel that home buyers would use such a broad array of services. Both the Board and the League worked with association managers to allay their fears, and by 1938 the program had spread to more than twenty cities. Local newspapers also began to feature these projects, which led to greater business for the participants. An additional benefit of the FHBSP was that thrifts began to cooperate more with other home building trades, which further enhanced the reputation and visibility of the industry. By 1941 the plan was so firmly established that the Board transferred its administration to the individual home loan banks.17

While the home loan bank generally received strong support, the FSLIC was much slower to gain acceptance, but the reasons for this had little to do with the idea of deposit insurance. Most thrift managers approved of insuring accounts, especially given the positive experience banks received with the FDIC. Their main objection was that the FSLIC charged thrifts an insurance premium that was twice the rate for bank insurance. Not only did this action reduce member dividends, but it also gave the perception that thrifts were not as safe as banks. They also disliked the asset reserve requirement since it

restricted their ability to allocate resources. Furthermore, the League objected to the broad regulatory powers the FSLIC had assumed, especially because these rules were made by “inexperienced persons and brain trusters” who appeared to focus more on political infighting than thrift matters.¹⁸

Because of these concerns, Congress passed legislation to make the FSLIC more attractive to the thrift industry. The Banking Act of 1935 lowered the insurance premium to that of the FDIC, extended the reserve creation period to twenty years, and gave the FSLIC authority to infuse cash into a “sick” thrift in order to restore solvency as opposed to simply closing it. These improvements led the League to change its official position on deposit insurance from “use it only if you need it,” to recommending all thrifts join the agency. In 1938, the League reaffirmed its support of the FSLIC when it noted that “its earlier ‘reform-em and regulate-em’ spirit [had] pass[ed].” Between 1935 and 1940, the number of thrifts with deposit insurance rose from 11 percent to 30 percent of all associations. Significantly, most of the new members were among the largest S&Ls, since 51 percent of total industry assets had insurance, a trend that mirrored the experience for the home loan bank.¹⁹


The least successful of the major federal thrift programs in the 1930s was the federal savings and loan association system. Despite strong promotional efforts, three years after federal charters became available in 1933 only 10 percent of all thrifts were federal associations. The main reason for the resistance was that the federal associations had fewer powers that thrifts with state charters. There was also strong resistance to coming under federal scrutiny, especially given the uncertainty as to how similar federal regulations would be to state rules. Feelings among local thrift leaders were so negative that federal thrift organizers felt like pariahs when attending trade meetings. At one such gathering in Florida, a speaker announced that “if there was a federal man in the audience [he] was going to throw him out.” The League was also apprehensive about how the public would accept federally-chartered thrifts, and as Bodfish said, “frankly, I can’t seem to get as exercised over federal savings and loan associations as some of the folks.”

Like the other federal thrift programs, the federal S&L system received a boost when these industry concerns were met. In 1936 the Board introduced a new charter which broadened the powers of the “federals” and placed them on a par with state-
chartered thrifts. The League interpreted this new Charter K as a "business-wide go ahead signal" for federalization, and as public opinion on federal charters appeared to be increasingly favorable, many thrift leaders saw the "federal" name as a way to restore confidence in the business. A final factor encouraging the growth of these associations was the inability of state regulators to prevent their spread. From the moment Congress created the federal thrift charter, the states tried to limit their use, primarily because they saw this as another intrusion by Washington into their business. In 1937 Wisconsin regulators sued the FHLBB alleging that federal charters did not conform to state law. The United States Circuit Court of Appeals, however, ruled the charter constitutional since it met the "public welfare" clause. These changes led to a slow but steady increase in the number of federal associations to 24 percent of all S&Ls by 1945.21

**Thrifts and Other New Deal Programs**

Aside from government programs that directly affected the industry, other New Deal agencies required the League's attention. The three most important of these were the National Recovery Administration (NRA), the Home Owners' Loan Corporation (HOLC), and the Federal Housing Administration (FHA). The NRA, created in 1933 and hailed by the League as "a historic change," proved to have the least impact on thrifts due

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to its short duration and diffuse objectives. Thrifts were part of the NRA’s Group 1700, "Miscellaneous Commercial and Professional," subheading "Financial," which included commercial banks, savings banks, trust companies, brokerage and finance companies, insurance companies, real estate agents and pawn shops. The NRA required all industries, including thrifts, to draft codes of fair competition; and, since the law made trade associations a major unit in business and industrial government, the League assumed this task. The NRA adopted the thrift code in December 1933, and the agency gave the League great latitude in its administration and enforcement. While the NRA ended in 1935, the overall experience was positive for the League because it gave the trade association valuable national exposure and recognition. The League also saw the code as contributing to its work to make the industry more unified.22

The most significant non-regulatory New Deal agency in the short term was the HOLC, whose main objective was to provide immediate relief to homeowners in danger of losing their houses. The HOLC accomplished this goal by refinancing a homeowner’s existing mortgages with government funds. Petitioners applied directly to the Corporation for a loan through a nationwide network of agency offices. If it approved the request, the HOLC issued government bonds of up to 80 percent of the appraised value to

the existing lien holder in payment of the old debt. The main benefit of refinancing with
the HOLC for the homeowners was that the new loans were fifteen years long and had
below-market interest rates, which resulted in a lower monthly payment. Also, HOLC
mortgages were direct-reduction loans, which meant that the interest portion of each
payment fell as the principal balance declined. This repayment method, which some
thrifts had used for decades, was more beneficial to borrowers than the traditional sinking
fund calculation method and far superior to straight loans used by most banks.23

Within days of its creation, the HOLC was inundated with thousands of loan
requests from both individuals and institutions that wanted to trade delinquent mortgages
for government bonds. The agency responded so quickly and effectively to these requests
that the HOLC became one of the most successful of all New Deal programs. At its peak
in 1934, the HOLC operated 458 local, state and regional offices employing nearly
21,000 people. When lending operations ended in 1938, it had processed more than 1.88
million applications worth nearly $6.2 billion. The agency approved more than one
million of these requests totaling $3.1 billion, and of these thrifts acquired $770 million
in HOLC bonds, which represented 13 percent of total thrift industry assets. While the
majority of these loans were repaid in full, the HOLC did foreclose on almost 20 percent
of its borrowers. Remarkably, when it wound up its business in 1946, HOLC operations

23Confidential Bulletin M41 (April 24, 1934), 1; William Stevenson, “How to Procure Loans from
the Home Owners’ Loan Corporation,” ABAN 53 (July, 1933), 309, 322-3; William Stevenson, “Home
Loan Corporation,” Building and Loan Annals 1933, 225-38, 299-305; Russell, Savings and Loan
Associations, 57-8.
did not cost taxpayers any money, and it even returned a profit to the United States Treasury.\(^2\)

Because the scope of HOLC operations was so broad, its practices and procedures had a tremendous impact on home lenders. One of the most significant outcomes was the widespread adoption of the direct-reduction mortgage, which was easy to understand, accrued lower interest costs, and had fixed monthly payments. HOLC administrators later claimed this ability to "blaze the trail" in the use of long-term amortizing mortgages was their greatest contribution to residential home finance. The HOLC also encouraged home lenders to make higher leverage and longer term mortgages. A third important benefit of the HOLC experience was that it revealed the tremendous potential of making home improvement loans. The HOLC initiated the first large-scale home modernization program in the nation, which resulted in the reconditioning of more than 500,000 houses. For thrifts, making rehabilitation loans not only helped in the disposal of foreclosed housing, but also was a profitable way to generate business from existing customers.\(^3\)


\(^3\)Russell, *Savings and Loan Associations*, 59-61; Ben R. Mayer, "Direct Reduction Loan Plan Gaining Headway," *ABAN* 54 (May, 1934), 221-2; C.A. Schroetter, "Direct Reduction Loans," *ABAN* 58 (September, 1938), 408-11; Memorandum from J. Francis Moore to John H. Fahey, 27 December 1945, quote 6 and memorandum from W.D. Baker to John H. Fahey, 11 December 1945, quote 4; Regional Managers Conference; Correspondence of Chairman John Fahey, 1940-47 (Fahey Papers); RG 195; NACP; "A Summary of New Lending Features to Attract the Home-Owner," *FHLB Review* 2 (July, 1936), 166
A fourth important consequence of the HOLC experience was its effect on residential appraisal practices. The HOLC wanted to use an appraisal system that would both accurately reflect current conditions and produce values high enough to pay off the existing mortgage. To do this, the agency created an appraisal system that consisted of three different valuation methods. Commonly known as the sales comparable approach, cost approach, and income approach, these three methods provided a comprehensive range of values from which to arrive at a final valuation. Also, because these appraisals relied primarily on factual data, not opinion, the property values had a higher degree of reliability. As part of this valuation process, the HOLC required appraisers to describe the neighborhood and determine its stability by examining factors like zoning, access to schools, and types of development. Appraisers also had to provide the race and ethnicity of the residents, which the appraisal form initially limited to classifications of "American, Foreign, Negro, Oriental." Appraisers then used all this information to justify any value adjustments for properties that did not conform to existing developments, or if they were in areas that were improving or declining. Because the HOLC hired 8,500 appraisers who made more than one million valuations, equal to about 10 percent of all non-farm homes, the appraisal practices created by the HOLC, including the compilation of racial

and ethnic data, became standard for all residential appraisers and were adopted by the FHA.26

A final effect of the HOLC on home finance was its use of property security maps that used neighborhood characteristics to evaluate loan risks. These maps classified neighborhoods into one of four categories. Category "A" included the best areas, which were stable with consistent development, followed by "B" neighborhoods, which had older properties, or lower pride of ownership, but were still desirable to live in. The "C" neighborhoods were "definitely declining," with "influences that cause original owners to move to another community." "D" neighborhoods were considered hazardous living environments with a distinct "undesirable element;" the majority of urban slums fell into this category. By 1936, the FHLBB began to encourage thrifts to create their own security maps using a "scientific analysis of the entire community." It cautioned thrifts, however, against relying too much on neighborhood traits in making loan decisions, maintaining that properties located in even the worst areas could be good risks provided the lender used proper precautions.27

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When Congress created the HOLC in 1933, the League agreed in principle with its goals, but also regarded it with trepidation. Because it feared that the HOLC would become a permanent agency, the League insisted that Congress make it self-liquidating. Also, thrift leaders did not like the fact that borrowers with the ability to repay their mortgages sometimes sought HOLC refinancing just to lower their interest rates. As the HOLC's operations grew, League concerns mounted, and in 1934 it called the agency "the most serious problem we face today." In response to industry protests, Congress passed legislation that restricted HOLC loans only to applicants who could prove they were in default or faced the loss of their homes due to tax sale. It also extended the government guarantee on HOLC bonds from just interest payments to include bond principal, which increased the willingness of thrifts to accept government debt for existing mortgages. Despite such changes, Bodfish still wondered if the HOLC would "be the end or the beginning of government financing in the home ownership field."

The New Deal agency with the greatest impact on thrifts was the FHA. Created in 1934 by the National Housing Act, the FHA was not a direct lender, but rather administered two important home finance programs. The first of these was the chartering of national mortgage associations to increase the availability of home finance, and the second was creation of a system to insure mortgages. When the League learned of this

plan to establish a permanent system of national mortgage associations operated by the
government, it immediately lobbied Congress to kill it. While it failed to prevent passage
of this provision, the League did succeed in changing the scope of these associations from
making direct loans to just buying and selling FHA-insured loans. This critical change
ultimately doomed the success of the national mortgage association plan, as only one
such association was formed over the next three years. In 1938, Congress ended its
support for national mortgage associations, and it instead created a new government
agency, the Federal National Mortgage Association, to fulfill the mission of buying and
selling FHA-insured mortgages from lenders who did not wish to hold them.29

The second function of the FHA involved creating a mortgage insurance program,
which was intended to increase lending activity by reducing the risk of losses to lenders if
they had to foreclose on a loan. Under this plan, if a borrower defaulted, the government
would step in and continue making the regular payments until the loan matured.
Although the League lobbied hard to kill this program, White House support was so
strong that Congress approved it with few changes. An important aspect of ensuring the
success of the FHA was making it relatively easy for borrowers to qualify for coverage.
Consequently, the FHA accepted loans up to a maximum loan to value ratio of 80
percent, and a maximum term and an interest rate of 20 years and 5 percent, respectively.

29“Will Title II of the Housing Act Affect Building and Loan?” ABAN (June, 1934) 249-50;
Confidential Bulletin M45 (July 12, 1934), 7; Confidential Bulletin M47 (September 9, 1934), 9;
Confidential Bulletin M53 (March 18, 1935), 7-8; Ansel Beckwith, “New FHA Loan Laws,” ABAN 58
(February, 1938), 74-5; “National Housing Act Amendments of 1938,” FHLB Review 4 (March, 1938),
196-8, 215.
The borrower, in turn, paid an insurance premium equal to 1 percent of the loan amount at closing. The mortgage insurance program, however, got off to a slow start and after three years of operation only 18 percent of all mortgages had FHA insurance. In 1938, Congress modified the program and raised the maximum loan to value ratio to 90 percent, increased the term to 25 years, and cut the insurance premium in half. These changes increased public appeal significantly, and by the end of World War II 34 percent of all mortgages had FHA insurance.\(^\text{30}\)

Significantly, thrifts were not large providers of FHA-insured loans. Most associations avoided FHA lending because of the federal "red tape" involved, as well as the fact that Congress set strict limits on interest rates for these loans. Thrifts did, however, use federal mortgage insurance for riskier types of lending like home improvement loans, which were typically secured by second liens on the property. The result was that thrifts accounted for just 10 percent of all FHA loan volume between 1935 and 1945, with the majority of these loans taken out by commercial banks and mortgage bankers. The ability to get these banks involved in making smaller, long-term amortizing loans was what FHA Commissioner Stewart McDonald later described as a key achievement for the agency. Eventually, as these lenders became a greater competitive

threat, the thrift industry made sure its traditional loan terms kept pace with changes in
the FHA program.31

Surviving the Great Depression

While a more active League and improvements in the federal thrift programs were
both important developments for individual thrift managers, their most pressing concern
was simply surviving the Great Depression. While the waves of deposit withdrawals
were a major short-term crisis, the most daunting challenge they faced was the problem
of reduced liquidity caused by an increase in payment delinquencies. Although the home
loan bank was available to make liquidity loans, many thrifts lacked the necessary
amount of current mortgages needed to pledge as collateral. Similarly, as property values
continued to fall, managers avoided foreclosure because it was difficult to resell the
property without incurring a large loss, which in turn would reduce the thrift’s net worth.
As a result, thrifts often agreed to carry loans as past due, in some cases for as long as
two years. This way the property remained occupied and maintained, which helped
preserve its value, and allowed additional time to renegotiate loan terms. Still,

Confidential Bulletin M77 (August 30, 1937), quote 2; John C. Hall, “Making Title II of the Housing Act a
Building and Loan Aid,” ABAN 55 (May, 1935), 199-200, 236; Confidential Bulletin M55 (May 29, 1935),
10; Confidential Bulletin M78 (November 15, 1937), 5; L. D. Ross, “Lending Policies Today,” ABAN 58
(August, 1938), 261-4; “Loans Being Made at Varying Terms,” The New York Times, 16 January 1938, 10;
“Buyers Profiting by New Mortgages,” The New York Times, 7 April 1939, sec. 9, 1; Twenty-Seventh
Housing Administration Annual Report (Washington DC: USGPO, 1939), 41; Coppock, Government
Agencies, 7.
foreclosures did occur, resulting in large increases in real estate owned; by 1935 they totaled nearly 20 percent of industry assets.\textsuperscript{32}

In some cases, thrifts that experienced a significant number of foreclosures and large deposit withdrawal requests became “frozen” and unable to conduct normal business. Despite such dire circumstances, a frozen thrift was not necessarily doomed to failure. Instead, managers took advantage of a legal concept called “segregation of assets” to stay in business. When a thrift segregated its assets, it was essentially divided in two. The first part of the association consisted of all remaining good mortgages, and the second part held the frozen assets. The ratio of good assets to total assets was calculated, and each member’s account was written down to reflect the smaller “good” thrift, which then returned to business. Members also received a certificate of participation for the balance of their original accounts in the “bad” thrift, and as management “thawed” the frozen assets by selling them, members received any proceeds in the form of liquidating dividends.\textsuperscript{33}

In practice, segregating assets proved to be an effective way to fix impaired thrifts, and in many cases shareholders actually lost nothing on the liquidation of the


\textsuperscript{33}“What Can Be Done With Frozen Assets?” \textit{FHLB Review} 1 (October, 1934), 7-8; Bodfish, \textit{Depression Experience}, 13-14.
frozen assets, although liquidation often took years to accomplish. A second, quicker solution to repair a frozen thrift was to undergo reorganization, a process that many troubled associations did as a prerequisite to obtaining state or federal deposit insurance. A typical reorganization involved the cancellation of all outstanding thrift shares, with the original shares replaced by new shares written to reflect current asset values. The main difference between these two ways of dealing with frozen thrifts was that a reorganization produced an entirely new association, while the segregation of assets was more accounting-based. In either case, however, shareholders voted on the decision, which was never made at the sole discretion of managers or directors.34

While the problem of frozen thrifts essentially ended by the mid-1930s, the problem of liquidating foreclosed properties was a much more drawn-out process. In 1935, the value of real estate owned by thrifts peaked at $1.16 billion, or 19.8 percent of total assets, and finding ways to turn foreclosed real estate into productive assets became a top priority. One solution was modernizing these properties to improve their appeal, but the fear of throwing good money after bad initially limited remodeling. Over time, the positive results of rehabilitation lending by the HOLC helped increase this type of financing. Another innovation was to encourage borrowers to keep their homes up-to-date, which would help retain property values. To do this, thrifts offered maintenance mortgages which gave borrowers a credit reserve for property repair and upkeep. What

ultimately allowed the industry to whittle away at the backlog of real estate owned was the demand for housing caused by World War II. During the late 1930s, the level of real estate owned by thrifts fell steadily, and by 1942 this backlog was just $206 million or 3 percent of total assets.35

By the late 1930s, the financial condition of many associations had improved to such an extent that managers could begin to focus on improving the physical appearance of their offices. This issue was important because many S&Ls were not in keeping with the more modern image the League was trying to project for the industry. Traditionally, thrifts had simple austere offices which were often designed to look just like commercial banks. The new redesigned offices combined all the elements of a financial institution with more comfortable environments that were distinct from banks. Interiors tried to replicate a family living room, with carpeted lobbies, photomurals on the walls, and color coordinated drapes and furniture. To emphasize the ties between the thrift and the community, offices often had customer lounges, meeting rooms, and recreational facilities which were available for group gatherings. Between 1938 and 1941, more than

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1,000 associations moved to new quarters, and the trend of keeping thrift offices modern and inviting became a trademark of the industry.36

**Thrifts in Wartime**

As had been true during World War I, when America entered World War II the thrift business saw its deposit base soar while lending opportunities dwindled. For the country, the most important economic consequence of the war was that it ended the Great Depression. As industries converted into an “arsenal for democracy,” unemployment fell sharply and personal income rose steadily. The war also reduced the opportunities for people to spend their money on consumer goods, which naturally led to strong growth in personal savings. Like all financial institutions, thrifts were major beneficiaries of this windfall, and during the war deposits skyrocketed by 60 percent. S&Ls, however, had few ways to invest these funds, since the war also forced a virtual cessation of residential construction, as rationing of building materials caused new housing starts to plummeted by nearly 66 percent from 1939 to 1945.37

Although thrifts had few opportunities to make new mortgages during the war, they could still generate business by encouraging customers to refinance existing loans.

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The lack of new construction also allowed S&Ls to liquidate the most of their foreclosed properties. The most important role of the thrift industry during the war, however, was as a buyer and seller of government war bonds. The League even organized a bond purchase program for its members, allotting quotas for each state. Between 1941 and 1945, thrifts sold more than $1.6 billion in war bonds to outside investors and acquired an additional $1.7 billion for their own portfolios. By the end of the war, nearly 28 percent of all thrift assets were in government securities.

_Evaluating the Industry_

Even though the number of S&Ls had fallen by nearly half, at the end of World War II, the thrift industry was fully recovered from the economic crisis of the 1930s, as seen in Table 5.1:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. B&amp;L</th>
<th>Chg./Yr.</th>
<th>Assets (000,000)</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1930</td>
<td>11,777</td>
<td>---</td>
<td>$8,829</td>
<td>---</td>
</tr>
<tr>
<td>1937</td>
<td>9,225</td>
<td>(3.4%)</td>
<td>$5,682</td>
<td>(6.3%)</td>
</tr>
<tr>
<td>1941</td>
<td>7,211</td>
<td>(5.9%)</td>
<td>$6,049</td>
<td>1.5%</td>
</tr>
<tr>
<td>1945</td>
<td>6,149</td>
<td>(4.0%)</td>
<td>$8,747</td>
<td>9.6%</td>
</tr>
</tbody>
</table>


Table 5.1: Number of Thrifts and Assets - 1930 to 1945

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The consolidation of the industry was one significant trend during this period, as the total number of thrifts fell by half in fifteen years. While failures accounted for part of this decline, another factor was the rise in urban-area thrift mergers toward the end of the 1930s. A second trend was the strong rebound in total industry assets. Assets fell every year in the 1930s, but in 1941 the improving economy produced the first annual increase. The rise in consumer savings during the war helped the industry recover to such an extent that by 1945 total assets were essentially at the same level as in 1930. The third industry trend of the 1930s was that most thrifts significantly increased their reserves. In 1930, the average S&L paid out 91 percent of earnings as dividends, but by 1937 this figure had fallen to 77 percent, reflecting the general decline in dividend rates as well as the need to build capital in order to absorb losses on real estate owned. A final milestone achieved during this period was that thrifts became the single largest source for residential mortgages in the country, accounting for 35 percent of all long-term home loans in 1945, up from 20 percent in 1929.39

As they revived and expanded, thrifts faced an increased need for better trained personnel, which indirectly benefitted female employees. By the late-1930s, more and more S&Ls created specific departments that performed well-defined functions, like

accounting, appraisals and government lending. Because of this change, managers could no longer be jacks-of-all-trades, but instead had to hire professionals to fill these specialized positions. By the outbreak of World War II, a growing number of these new people were women, which resulted in greater opportunities to advance within the firm. The increase in female thrift employees was so large that by the end of the war, 42 percent of all personnel, including 44 percent of all junior executives, were women. As in other businesses, however, most high-level women lost their jobs when the men came home, which meant that future jobs for women were lower-skilled clerical and teller positions. However, because most thrifts continued to follow their traditional policy of promoting from within, over time women reemerged as executive managers.40

The war years also produced a major change for the League. By the 1940s, Bodfish’s quest for power over the previous ten years had produced a growing resentment toward the League leader. This was especially true among government officials, many of who loathed him. The White House disliked Bodfish’s criticisms of the New Deal, which Bodfish described as “brilliantly conceived in theory but its execution has been unsatisfactory.” Regulators were angered by his interference in the affairs of the home loan banks, which included seeking special treatment for friends as well as unsolicited recommendations for new rules. One reason for this animosity was that Bodfish resented not being reappointed to serve on the FHLBB in 1933. Stories circulated that he had to


179
be physically removed from the Board office when his successor tried to move in. Although he consistently pointed out how any new Board appointees lacked thrift industry experience, Bodfish did not necessarily want to return to Washington, since he had already “saved the country once.”

Other thrift leaders also resented Bodfish’s often arrogant and dictatorial control of the League. When people refused to do his bidding, Bodfish was known to try to “get” them, and sometimes these disagreements devolved into public shouting matches. Other officials saw his 1935 acquisition of a controlling interest in the $11 million First Federal Savings and Loan of Chicago as another major problem, since it not only took away from the time Bodfish devoted to League activities, but also raised conflict of interest concerns. Eventually, Bodfish made a number of enemies within the Illinois thrift community because he expected its members to defer to his judgment in Chicago banking matters. Despite such criticism, the executive manager still had a close-knit group of loyal supporters that included former and current League presidents, and this power base made it virtually impossible to remove Bodfish from power. In fact, the League made Bodfish executive vice president in 1940, a move which infuriated his enemies.

Because of the seemingly irreconcilable differences between the pro- and anti-Bodfish factions, a handful of his staunchest critics broke away from the League in 1943

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41 Confidential Bulletin M35 (November 15, 1933), quotes 1, 4; Confidential Bulletin M22 (March 29, 1933), 3-4; Confidential Bulletin M32 (August 21, 1933), 1.

to establish the National League of Savings and Loan Associations (NLSLA). In a letter to League members, NLSLA officials said they did this not over policy differences with the League, but because they considered Bodfish’s very bad relations with federal regulators and other government officials the key reason why no League-sponsored legislation of consequence was being considered or passed. Initially, all NLSLA members were headed by people who hated Bodfish, but over time others joined because they liked being in a smaller, more personable trade group. Most of the new members, however, also retained their original League memberships. While the NLSLA never had more than 600 members and did not achieve the same political power as the League, it did help the industry by giving legislators an alternative point of view on thrift issues. In 1953, merger talks between the two groups failed because, according to an NLSLA official, “whether we have been right or wrong, it was one personality who caused the rift, and it has been that same personality that has made it impossible for anyone to consider even for a moment a regrouping.”

Fahey vs. The Industry

A final effect of World War II on thrifts was the change in the structure of federal regulation. The mobilization for war led to the creation of dozens of new government agencies, including the National Housing Agency. Created by Executive Order 9070 on

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43 "Report of the First Convention of the National Savings and Loan League," *ASLN* 64 (June, 1944), 225, 240; “Generes Reports on League Start,” *National Savings and Loan Journal* 11 (June, 1956), 36-7; Letter from Philip Lieber to Walter McAllister, 3 August 1953, quote; National Savings and Loan League Consolidation, 1953; Correspondence of Chairman Walter W. McAllister 1952-56; RG 195; NACP.
February 24, 1942, the Agency consolidated the FHLBB, the FHA and the U.S. Housing Authority, which administered public housing, into one super-agency as a way to coordinate wartime housing and home finance. This change not only ended the Board's existence as an independent body, but its five members were replaced by a single commissioner. While wartime conditions warranted this move, the League still saw this move as a significant blow to the prestige of the industry, since the Board now played a very minor role in Washington. An even greater concern was that putting a single person in control of thrift regulation created the potential for arbitrary decision making.  

The commissioner of the home loan bank during the war was John H. Fahey, a longtime government official who was very familiar with the thrift industry and the League. A patrician figure with a distinctive Van-Dyke beard, Fahey had served as FHLBB chairman since 1934 and had headed the HOLC between 1933 and 1938. Fahey was an authoritarian administrator whose main objective as chief S&L regulator was to make certain the thrift reserve banking system served the public interest. One way to accomplish this involved reducing the influence of the League in the operation of the individual home loan banks. Because these banks were owned by the thrift members, the League felt strongly that they were primarily for the benefit of the industry and it in turn would use them to serve the public. Fahey, however, felt that industry dominance over

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bank management and operations was potentially dangerous, and as early as 1937 he wanted to set limits on how many thrift executives could serve as bank directors.45

The issue of whether the regulator or the regulated should control the home loan banks finally came to a head in 1944. That year, the Los Angeles home loan bank elected as their new leader a thrift executive supported by a small group of members headed by Thomas Gregory, the flamboyant president of Long Beach Federal Savings and Loan Association. Gregory was in many ways the epitome of new-style bankers that the more traditional S&L executives called “the fast-buck boys.” These younger executives took advantage of rapidly growing markets in states like Florida and California to achieve aggressive expansion of their associations. Many of these people also owned businesses outside their S&Ls, which often led to conflicts of interest. Gregory acquired Long Beach Federal in the late-1930s and quickly expanded it into a $26 million institution. The Board contended he did this, in part, by making large loans to a real estate developer who bought construction materials from a company that Gregory had a half interest in.46

In the face of these allegations, Fahey quickly developed a strong distrust of Gregory and his “willful and ambitious” followers. He suspected that they were trying to use the Los Angeles home loan bank election to increase their control of the bank for their own gain. To prevent this, Fahey exercised his right as commissioner to approve


the choice of all home loan bank officers and refused to approve the election results. For the next year and a half, Gregory and his supporters worked feverishly to pressure Fahey to change his decision. Using his connections in Congress, Gregory tried to initiate an investigation of the FHLBB, and he also increased his public attacks on the commissioner. With tensions rising, Fahey announced in March 1946 that the Los Angeles FHLB would be abolished and consolidated with the smaller Portland FHLB. The new bank would then be moved to San Francisco. Two months later he authorized the seizure of Long Beach Federal and the removal of Gregory as president. Although Fahey said he did this because the S&L was engaged in certain “unsafe and unsound practices,” the seizure was the first time regulators ever took over a healthy thrift. This event led to considerable local publicity and sparked a run on deposits, which drained $6 million from the thrift in just one week.  

In June 1946, the months of congressional lobbying by Gregory finally led to the formation of the Special Subcommittee to Investigate the FHLBB, which held hearings on the recent events. Angry committee members lambasted Fahey for abusing his power,
and in its final report they demanded the reinstatement of the Los Angeles FHLB and urged that Long Beach Federal be returned to Gregory. Fahey, who did not like anyone questioning his authority, flatly refused, and Gregory took the matter to court. With the case still pending, in July 1947 Congress tried to dilute Fahey’s power by expanding the Board to three members. However, because Fahey was still chairman, he successfully prevented any consideration of these issues. The Long Beach controversy finally ended when President Harry S. Truman refused to reappoint Fahey when his term expired in December 1947. A month later the FHLBB gave Long Beach Federal back to Gregory. The Board, however, did not reinstate the Los Angeles FHLB, not only because the new bank in San Francisco was successful and following more conservative lending policies, but because it also wanted to prove it could not be swayed by thrift industry leaders.48

Conclusions

The Great Depression was one of the most significant periods in the development of thrifts as modern financial institutions. Between 1930 and 1945, fundamental changes occurred that produced greater internal organization, improved business procedures, and greater interaction between thrifts and the federal government. A key force behind the creation of these new business practices was the League and its executive manager

Morton Bodfish, who helped modernize the operations of the trade association and increase member services. One of the more underrated League accomplishments, however, was its ability to change the public image of the thrift business away from that of a semi-philanthropic movement and toward a true financial industry. Since the earliest days of the thrift business its leaders referred to their work in almost evangelic tones, noting the moral and spiritual benefits of saving and home ownership. While this approach helped attract members and aided growth, as thrifts became more professional, the League realized that the business also needed a more modern identity. Related to this was the nearly universal adoption of the term “savings and loan” to describe an association. Not only did it emphasize the dual roles thrifts provided to consumers, but it also achieved greater industry uniformity.

A second major development during the 1930s was the rise of federal thrift regulation. While commercial banks also experienced increased regulation during the depression, they paled in comparison to the scale and scope of federal government involvement in the thrift business. Between 1932 and 1934, the government created a mortgage reserve bank, designed federal charters for associations and implemented a deposit insurance system. Despite the potential benefits these agencies offered to promote growth and public confidence, many thrifts were wary of them which resulted in managers adopting a "wait and see" attitude toward participation. As these new agencies established their rules and practices, this hesitancy declined and resulted in increased industry participation.
The final major challenge that faced the industry lay in dealing with the economic turmoil caused by the Great Depression. To survive the waves of deposit withdrawals and foreclosures, thrift managers adopted a number of innovative solutions. As the near-term crisis passed and confidence improved, thrifts resumed their interest in expanding business. By the end of the 1930s, S&Ls began to actively seek lending opportunities for home renovation and new construction. While World War II offered few opportunities for home lenders, given the restrictions on construction, thrifts still found ways to increase their role as financiers. Defense housing loans rose during these years, but the more significant change was in the growth of personal savings. These funds would be a crucial source to finance the homes demanded by returning serviceman. Despite the turmoil of the 1930s and 1940s, thrifts were in an excellent position to help millions of Americans realize the dream of home ownership in the postwar period, which would help propel the industry to greater heights.
CHAPTER 6
THE GLORY YEARS, 1946-1955

In the decade following World War II, the savings and loan industry grew at the fastest rate in its history, and the key to this expansion was the tremendous postwar demand for new homes. Because residential construction nearly dried up during the Great Depression and the war, when peace came the need for new houses exceeded all expectations. The result was an unprecedented demand for mortgages, and S&Ls responded with new products that met customer needs, while also designing better ways to attract deposits to fund these loans. The result was that by the mid-1950s the thrift industry was not only the preeminent source for home finance, but also the second largest repository for consumer savings. Another reason for the expansion of S&Ls was their effort to adopt a more progressive business image that combined their traditional role of community institutions with modern convenience and efficiency. The League assisted in this work by expanding management education programs and promoting more effective advertising methods. It also worked with the Federal Home Loan Bank Board to design industry-friendly regulations. These relations grew so close that Congress eventually investigated the role of the League in government activities.

While the expansion of the thrift industry in the early 1950s was indeed remarkable, some changes during the period seemed threatening for the future. Chief
among these was the greater role of the government in home finance, as the Federal Housing Administration, Federal National Mortgage Association and the Veterans Administration all expanded their mortgage lending activities. Another major change came in 1955 when the continued demand for home loans produced the first significant postwar credit crunch that signaled an end to this period of easy growth. While the thrift industry would continue to expand for years to come, these experiences had a major impact on internal relations as well as the regulatory environment.

Planning for Suburbia

When government and housing industry leaders began to consider the postwar housing needs for the nation in 1942, their primary concern lay in trying to prevent the severe shortages that had plagued the country after World War I. These fears stemmed from the fact that for the past fifteen years the construction of new homes had not kept pace with demand. From a peak of 900,000 new homes in 1925, housing starts fell steadily during the last half of the 1920s, before plummeting to an all-time low of 90,000 in 1933. While construction did increase steadily over the remainder of the 1930s, the number of houses built in any one year never matched the annual increase in new families. Complicating matters was the virtual ban on nondefense-related building and the restrictions on home renovations during World War II. When the war ended, not only was there a shortage of new homes, but millions of dwellings also required repairs and
reconditioning. Housing officials predicted that more than 7 million new non-farm homes would have to be built by 1950, and up to 16.1 million by 1955.¹

In deciding how best to meet this shortfall, some former New Deal officials wanted to create large-scale planned communities reminiscent of the Greenbelt town projects of the late-1930s. Their plans stressed federal control over new building to ensure that development was well-balanced among inner cities, suburbs and rural areas, with a particular emphasis on low-cost homes. Congress and business leaders, however, opposed these ideas and in 1944 the Senate formally assumed control of postwar housing plans. The war ended, however, before plans were in place, and this situation was complicated by the quick removal of wartime controls on wages. Builders, however, were still unable to resume full-scale construction because Congress did not relax controls on building materials and home prices because of fears about inflation. The result of these contradictory actions was a housing shortage so severe that by the end of 1945 more than 30 percent of all married veterans lived in trailers or “doubled-up households.” Finally, in December 1946 Congress eliminated the remaining wartime building restrictions; and, while this action did cause home prices to soar more than 50 percent above their prewar levels, it also gave developers freedom to build new homes.

Much of this construction occurred in the suburbs, marking the latest phase in the long-term evolution of American cities.2

Although the growth of suburban communities was one of the defining characteristics of postwar America, it was not a development unique to the 1950s, since suburbs had been a part of cities for centuries. Traditionally, most urban areas had been compact and densely-built with the wealthiest living closest to the center, and the poor relegated to the periphery. As late as the 1830s, a suburb was regarded as a substandard place in which to live. One reason for this living pattern was that in the eighteenth century work and home life were intertwined with little real distinction between the two. A more important reason, however, was that most cities lacked efficient transportation systems, which meant that pre-industrial urban centers were “walking cities.” This situation began to change in the 1850s as industrialization began to make cities more congested and the short-distance railroad was perfected. Because the railroad was an efficient and reliable form of transportation, city residents could now commute to work; but, since it was also expensive to take the train regularly, the wealthy were the only

people who began to relocate outside the city center into new luxurious communities with large custom-built homes on large lots with rich landscaping.³

A second major wave of suburban development came in the 1890s following another critical innovation in transportation, the electric streetcar. The streetcar was a convenient and cheap way to travel around the city, and it allowed cities to design integrated mass transit systems that all urbanites could use. This flexible form of transit also made it possible for middle-class professionals to live farther away from work, resulting in the growth of “streetcar suburbs.” These communities were five to ten miles from downtown and made up of moderately-priced homes on smaller lots within easy walking distance of the streetcar lines. In established cities like Boston, streetcar suburbs often overwhelmed the original suburbs of the wealthy, who sold their large lots to developers and moved to newer communities farther out from the city. In newer cities, the building of streetcar lines and middle-class suburbs occurred in tandem, and it was common to find the same people controlling both projects. In Los Angeles, transit system owner Henry Huntington used his development of suburbs to support his rail service, which in turn caused the city’s population to grow from 11,200 in 1880 to more than 319,000 by 1910.⁴


A third wave of suburban development came in the 1920s, and again was tied to a revolution in transportation. The automobile, which became widely available and affordable after World War I, produced massive road construction programs, and eventually led to the creation of a new type of community, the “automobile suburb.” Like the streetcar suburb, the automobile suburb was intended for the middle class, but because roads offered greater access to land and design freedom, homes tended to be on larger lots located along winding roads, much like the suburbs of the wealthy. Developers also used zoning laws more frequently, as a way to increase the exclusivity of neighborhoods. While intended to separate and control residential and commercial development, zoning laws also had discriminatory side effects as developers used them to exclude “undesirable” housing and residents. Ultimately, zoning laws and covenants would be a way to separate suburbanites based on race and economic status.⁵

A fourth significant wave of suburban growth came after World War II, but unlike the earlier patterns of residential development this new exodus from the city was not in response to a new mode of transportation. Rather, the 1950s suburbs were a response to the explosion of new families that appeared after the war. Almost as soon as World War II ended and for several years thereafter, the rate of new marriages across the country soared, and with this marriage frenzy came a corresponding increase in the birth rate. This rise, in turn, translated into a significant increase in the number of American

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households, which rose from 37.5 million in 1945 to 47.8 million by 1955. This so-called "baby boom" also sparked a sharp increase in consumer purchases, and one of the major beneficiaries of this spending was the automobile industry. Between 1945 and 1955, car registrations jumped from 31 million to 62.7 million; and, because this change demanded new roads, highway construction by state and federal governments rose from 18,000 miles per year to 76,000 miles per year over the same period. 6

This network of roads and highways was critical to meeting the postwar housing demand because it opened up large tracts of land to residential development. Home builders used this availability to design communities that would allow residents to commute to their urban jobs, while also having access to shopping and recreation facilities. Despite this advantage, home builders still needed to develop more efficient construction methods that would allow them to build high-quality homes in a quick and cost-effective manner. Meeting this requirement, however, was difficult since most traditional home building methods relied on skilled trade workers. While using prefabricated materials was a potential solution, the high cost of using this method meant that the prices of these homes often were outside the price range for most aspiring buyers. The best solution involved applying mass-production technologies to home construction,

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processes that were pioneered by Bill and Alfred Levitt in the construction of Levittown on Long Island.\textsuperscript{7}

The Levitts used elements of big business organization and mass-production techniques to produce simple yet adequate homes which almost anyone could afford. The construction methods used by the Levitts relied on scientific management principles in which work crews performed discrete functions and moved from house to house in assembly-line fashion. This division of labor proved so efficient that during peak production a new house could be completed every fifteen minutes. The homes sold at a price that was 20 percent below that of competitors, but which still produced a 15 percent profit per home. The Levitts further improved the efficiency of their operations by integrating vertically through the ownership of lumber yards, nail works, and a sales and finance company – a change that reduced costs and improved long range planning.

Although criticized as “cookie-cutter” developments, the Levittown model was soon followed by other builders, and by 1950 the growth rate of suburbs was ten times that of the central city. Such changes were so pronounced that in 1958 the Census Bureau...

\textsuperscript{7}The Prefabrication Industry and Housing Costs prepared for the Housing and Home Finance Agency for the Subcommittee on Housing Costs, 9 January 1948; Prefabrication, Correspondence of Chairman William K. Divers (Divers Papers); Records of the Federal Home Loan Bank Board, Record Group 195 (RG 195); National Archives, College Park (NACP); Letter from Harry J. Durbin to William K. Divers, 12 May 1948; Du; Divers Papers; RG 195; NACP; “Kreutz Talks on Mass Production in Postwar Housing,” \textit{ASLN} 64 (July, 1944), 268-9; Jackson, \textit{Crabgrass Frontiers}, 233-4; Joseph M. Guilfoyle and J. Howard Rutledge, “Levitt Licks the Housing Shortage,” \textit{Coronet} 25 (September, 1948), 112-16; “High Housing Costs are Laid to Profits for Distributors,” \textit{The New York Times}, 15 November 1947, 1.
created a new population measurement, the Standard Metropolitan Statistical Area, to define the phenomenon.  

*Financing the American Dream in the 1950s*

The postwar years redefined the role of S&Ls in American finance, as the tremendous demand for mortgages caused by the housing boom produced unprecedented industry growth. The prosperity for S&Ls was so seemingly effortless that it was alleged that all thrift executives had to do to succeed was to follow the "3-6-3 Rule" -- pay 3 percent on savings, charge 6 percent on loans, and be on the golf course by 3 p.m. In reality, the success following World War II resulted not so much from a windfall to lending opportunities, but from concerted efforts by the League and S&Ls to make sure their industry met consumer demands. These demands included creating affordable mortgages, attracting deposits to fund these loans, improving operating efficiency and making the image of thrifts modern and progressive. These changes produced an industry that bore but scant resemblance to the one that had existed before the war.  

Like federal government officials, thrift leaders anticipated a sharp rise in the demand for housing and home finance after the war, and to meet this need the League developed a comprehensive mortgage known as the Uniform Savings Loan Plan, or the

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US Loan Plan. This mortgage combined features of several types of loans into one flexible financing package that would help both builders and consumers. Builders benefitted from its simplified closing and funding procedures, while borrowers liked the long twenty-year repayment term and the option to defer temporarily payments after the first three years. The US Loan Plan also contained a provision that allowed borrowers to obtain additional advances after the loan closed for home improvement projects, an option that eliminated the need for refinancing or seeking a second mortgage. This "open-end" feature became so popular that by 1953 these mortgages accounted for nearly $330 million of total industry assets.10

As the thrift industry saw its loan volume grow, it turned its attention to finding ways to increase its share of consumer savings. Although thrift deposits rose by almost 60 percent during World War II, in the seven years after the war total industry deposits soared by 117 percent, a gain that dwarfed the 22 percent increase for commercial banks during the same period. The main reason for this phenomenal growth was that S&Ls, unlike banks, faced few restrictions on the interest rates they could pay on savings. Under the Banking Act of 1933, bank regulators could limit commercial bank savings account rates. This rule, known as Regulation Q, did not apply to thrifts, and since the rule had not been changed for nearly twenty years, the average annual yield on bank deposits in the

early 1950s was less than half the rate for S&Ls. Because bankers strongly objected to this disparity, federal officials began to raise rates by the middle of the decade, and as deposit competition increased some thrifts responded with their own rate increases. The League, however, discouraged this type of response and instead wanted S&Ls to attract funds from the estimated 40 percent of all American families that did not have savings accounts. Associations did tap into this resource, and by 1955 over one-third of all S&L deposits came from new members.11

Beyond working to build loans and deposits, a third area of attention for thrift managers lay in working to improve business efficiency by using office automation technology like microfilming and thermo-fax photocopying. They also organized their staffs more formally by hiring college-educated middle managers to lead departments assigned specific functions like loan processing and appraisals. These and other changes produced significant savings, as the ratio of total operating expenses as a percentage of gross income for the thrift industry fell steadily between 1945 and 1954. Furthermore, S&L workforces became more efficient as the number of employees per $1 million in assets declining from 1.7 to just 1.0 over the same period. Finally, thrifts improved the

physical appearance of their offices, with more than 85 percent of all S&Ls either moved into new quarters or modernized existing spaces. These new offices were often modern environments that offered greater services like night deposit boxes to drive-in windows as well as suburban branches or satellite offices in shopping centers and supermarkets. These changes helped create a public image that was both distinct from commercial banks and customer-friendly. By 1955, S&Ls began using what became the symbol of the postwar thrift, the time and temperature sign.12

The League in the Glory Years

The 1950s also was a time of significant change for the United States Savings and Loan League, as evidenced by an expansion of member services. One of its goals in the postwar period was to help S&Ls advertise in more innovative ways, since the public still did not fully understand the nature of the thrift business. One sign of this appeared in a 1948 survey in which only 15 percent of respondents felt that S&Ls were the best places to get a mortgage, while just 7 percent said they would save money there. Although newspaper advertising was the dominant form of publicity used by associations, the League did not feel that it was “of the quality or size that is befitting a $13 billion business.” To change this, it recommended that S&Ls emphasize service, not rates, in

their advertising and, above all, to make sure the advertisements were well-designed and run frequently. The League also encouraged thrifts to use new office openings to show their commitment to the community, and their financial statements to promote their strength. As television became more common, S&Ls also sponsored shows like *Hop-a-long Cassidy* as a way to attract young savers.13

Another way the League wanted S&Ls to reach the public was through the use of specialized publications or house organs. While these publications usually focused on the issuing S&L, many, like *The Second Federalist* of the Second Federal Savings and Loan Association of Cleveland, pledged to their readers that this newsletter “will not be overloaded with advertising of this association, but it will be an assembling of brief news items that should interest men and women who love their homes and are ambitious to get ahead.” To assist S&Ls unable to produce their own house organs, the League printed *Home Life*, a glossy color magazine that could be tailored to the exact needs of each individual association. Through these more personal and direct forms of advertising, the

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League hoped to build an industry image focused on meeting the needs of the family and the community, ideals that harkened back to the older spirit of the thrift movement.¹⁴

A second objective of the League during this period was to see that thrift employees were well-educated professionals. Between 1948 and 1955, the total industry workforce more than doubled; and, as S&L offices became better organized and more automated, proper training became a major concern. To meet this need, in 1946 the American Savings and Loan Institute (ASLI) resumed its Graduate School for thrift executives. Located at Indiana University, the Graduate School met during the summer and offered classes in thrift law, financial systems, home construction, advertising, personnel management and training, regulation and supervision, and business economics. The program took three years to complete, and students had to submit a thesis and pass an oral defense to graduate. By the mid-1950s, the annual enrollment in the Graduate School exceeded 300, of which nearly 100 were women. While offering a solid financial education was the primary objective of the Graduate School, it also presented a unique opportunity for S&L employees to network with others.¹⁵


The third major objective of the League involved increasing its role in the design of thrift legislation and regulation. Although the League had always monitored political affairs as they related to S&Ls, the growing complexity of housing laws and federal regulations necessitated a more permanent presence on Capitol Hill. In 1942, the League hired Stephen Slipher to coordinate the industry’s government affairs work, and eight years later it formally opened a Washington office. While Slipher did lobby on behalf of the League and thrift industry interests, he primarily provided legislators with information on housing and home ownership, and during his thirty-year tenure in Washington, D.C. he became known as the “dean of financial lobbyists.” Also, to keep members informed about legislative issues, the League created the Flash News, which could be sent to all members within twenty-four hours. This rapid dissemination of information allowed it to mobilize the industry for grassroots lobbying.\(^6\)

This increased attention to legislation and work in Washington eventually led the Justice Department in 1948 to use the trade association as the test case for the recently-passed Lobbying Registration Act. Although a judge dismissed the case in 1949 as “too vague and indefinite,” the House Select Committee on Lobbying Activities still launched an investigation of the League the following year. The House probe focused on what the League had played in the formation of housing legislation over the previous three years; and, while the committee found that people like League leader Morton Bodfish had unusually close relations with key legislators, its final 749-page-long report did not

\(^6\)Horace Russell, “The Legal Side,” SLN 68 (March, 1948), 31-3; Ewalt, A Business Reborn, 303.

202

As the League expanded its scope of operations, it also underwent internal changes. By 1950, more than 50 percent of all thrifts were League members, and the trade association employed more than 150 employees in its Chicago headquarters. It also had six major affiliated organizations and published ten different periodicals on a wide range of subjects related to housing and the thrift industry. While Bodfish was instrumental in helping the League expand operations, by the late 1940s he had become such a lighting rod for controversy that some within the League saw him as a liability. Although opponents of Bodfish tried to reduce his power in 1947 by moving him into the largely ceremonial post of Chairman of the Executive Committee, he still insisted on running the trade group personally. His ability to do so, however, was affected by a series
of personal setbacks including a divorce, and by the early 1950s the chairman was drinking heavily and taking frequent unannounced trips to his Arizona ranch.\textsuperscript{18}

Eventually, even Bodfish’s staunchest supporters decided something had to be done, and in 1952 the League named Norman Strunk as executive vice president. Strunk joined the trade association in 1938 after having earned an MBA from Northwestern University, and was in many ways the mirror opposite of Bodfish. Strunk was a mild-mannered leader who worked to achieve consensus decisions, and his more relaxed style was a welcome relief from the confrontational tactics of his predecessor. Although Strunk’s unassuming personality caused some to question his ability to lead the League, his superior knowledge of the thrift business helped him flourish on the new job. In 1953, Bodfish formally left the League to focus on running the First Federal Savings and Loan of Chicago, a thrift he had organized in 1935 and which had become by the mid-1950s one of the largest in the nation. While the departure was cordial on the surface, Bodfish was bitter about leaving the spotlight, and until his death in 1963 he continued to provide solicited and unsolicited advice to industry and government leaders.\textsuperscript{19}


\textsuperscript{19}Letter from Walter McAllister to Don Geyer, 14 November 1953; United States Savings and Loan League 1953 - , General; Correspondence of Chairman Walter W. McAllister 1953-1956 (McAllister Papers); RG 195, NACP; Norman Strunk “A Look Behind and a Look Ahead,” \textit{Savings Association Annals 1979} (Chicago: United States League of Savings Associations, 1979), 171-2; Letter from Morton Bodfish to Walter W. McAllister, 9 November 1954; Bodfish, Morton, 1953- ; McAllister Papers; RG 195, NACP; Theobald, \textit{ Forty-Five Years}, 174
Evaluating the Glory Years

Given the tremendous demand for housing following World War II, the thrift industry recorded unprecedented expansion as seen in Table 6.1:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. S&amp;L</th>
<th>Chg/Yr</th>
<th>Assets (000,000)</th>
<th>Chg/Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945</td>
<td>6,149</td>
<td>---</td>
<td>$8,747</td>
<td>---</td>
</tr>
<tr>
<td>1949</td>
<td>5,983</td>
<td>(0.7%)</td>
<td>$14,622</td>
<td>13.7%</td>
</tr>
<tr>
<td>1952</td>
<td>6,004</td>
<td>(0.1%)</td>
<td>$22,585</td>
<td>15.6%</td>
</tr>
<tr>
<td>1955</td>
<td>6,048</td>
<td>0.2%</td>
<td>$37,800</td>
<td>18.8%</td>
</tr>
</tbody>
</table>

Source: Savings and Loan Fact Book, 1955, 43; Savings and Loan Fact Book, 1956, 45

Table 6.1: Number of Thrifts and Assets - 1945 to 1955

The most remarkable trend of this period was the spectacular asset growth rate for the thrift business – not only an industry record, but also the highest in any home financing industry. In states like California, thrifts recorded a spectacular 380 percent jump in assets, while in the Northeast the growth was a more modest 240 percent. Also, the industry experienced a decline of the number of thrifts, resulting from both the closing of associations that still suffered from Depression Era problems, as well as thrift mergers. This continued trend towards consolidation caused the average size of a thrift to rise to more than $6 million, up from $770,000 before the war. Similarly, in 1955 the industry remained the single largest source of residential mortgages, providing 36 percent of all home loans, which was nearly twice the amount provided by commercial banks.
Furthermore, S&Ls were the primary mortgage providers for middle-class and lower-middle-class borrowers, as well as for nonwhite borrowers. Finally, by 1954 thrifts had assumed the position as the second largest repository for personal savings, and had in fact narrowed the gap that separated them from the largest depository, commercial banks. Between 1945 and 1954, thrift savings grew by almost 16 percent each year, which was twice the rate of increase for banks. By 1955, S&L deposits were 70 percent of bank savings, up from 25 percent a decade earlier.20

The home loan bank, the federal savings and loan system, and Federal Savings and Loan Insurance Corporation (FSLIC) also expanded. Between 1940 and 1955, membership in the home loan bank grew from 77 percent to 96 percent of all thrifts, and this increase in subscriptions allowed the Federal Home Loan Bank Board (FHLBB) finally to liquidate the government’s original $125 million investment in the reserve bank by 1950. The number of thrifts in the FSLIC also rose during this period, rising from 40 percent to 59 percent of all associations, while the level of industry assets with insurance coverage climbed from 70 percent to 90 percent. Furthermore, because the FSLIC had to extend financial assistance to only one member thrift during this period, the insurance reserve of this agency grew steadily. Finally, the federal savings and loan system saw

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206
modest growth with just over a quarter of all thrifts having federal charters. These same S&Ls, however, were quite large, accounting for more than half of total industry assets.21

Fine Tuning Federal Thrift Programs

The main reason for the growth of federal S&Ls was that regulators created a new charter for these associations, which unleashed the potential of these thrifts. Issued in 1949, Charter N simplified thrift operations by reducing the number of different types of savings accounts from five to one, permitting full withdrawal requests in a timely manner, and increasing the maximum loan amount and loan-to-value ratio (LTV) for mortgages. A technical, but important, improvement allowed federal thrifts to take advantage of regulatory changes without having to obtain permission from the shareholders to amend the thrift charter. Another technical change under Charter N involved the rules regarding the terms they could use to describe their business. The charter dropped all phraseology associated with shares, like share accounts and share repurchases, and replaced them with the common terms of savings accounts and withdrawals. At the same time that it issued this charter, the Board announced it would also have a “free hand” to approve branches for federal thrifts, without regard to state laws.22


22Theobald, Forty-Five Years, 170; Letter from William K. Divers to John Bricker, 25 April 1949; Federal Savings and Loan Rules and Regulations 1949; Divers Papers; RG 195; NACP; Memorandum from John M. Wyman to Home Loan Bank Board with attachments, 9 April 1952; Federal Savings and Loan Charters; Divers Papers; RG 195, NACP; Letter from William K. Divers to William J. Hallahan, 6 June 1952; Home Loan Bank Board 1948; Divers Papers; RG 195, NACP; Memorandum from Harold Lee to Mr. Fahey with attachments, 5 December 1947 National Savings and Loan League General 1948-1949; Divers Papers; RG 195, NACP; Memorandum from John M Wyman, 6 May 1949; Federal Savings and Loan Associations
Federal thrifts quickly adopted Charter N, and by 1952 almost half of all federal thrifts operated under the new charter. That same year, the Board issued a revised Charter K so that associations which liked the more detailed document could also benefit from the new rules. Finally, these federal changes led state regulators to enact similar provisions for state-chartered thrifts. Despite the popularity of Charter N, when the Board presented it to the League for comments, the trade group gave it a tepid endorsement. In contrast, the American Bankers Association (ABA) was outraged at the new charter, contending the new account terms would purposely mislead the public into thinking that money held by thrifts was very liquid and not an investment toward the purchase of shares. The Board countered that the banking industry did not have a “God-given right” to the use of terms like withdrawal, deposit or savings account; and banks were unable to prevent these changes. Such changes in terminology helped make S&Ls appear more like banks in the mind of the public.23

Like the increase in the federal savings and loan system, the rise in FSLIC membership resulted from efforts by the FHLBB to make it easier for S&Ls to join. One reason that thrift managers did not have deposit insurance was that the premium for coverage was higher than that charged for banks under the Federal Deposit Insurance Corporation (FDIC). There were other differences between the FDIC and the FSLIC that

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208
discouraged thrifts from becoming members, and eventually banks began to use this lack of coverage as an advertising weapon. A 1938 ABA pamphlet called “The Bank Customer Inquires” made FDIC membership appear superior to the FSLIC and led thrifts to respond with their own negative publicity. This conflict ultimately escalated to such an extent that in 1948 regulators of both industries urged an immediate cessation to these smear tactics. The best way to end this type of competition was to eliminate the differences between the two programs, a goal for which the League began to lobby.  

Although the FHLBB disliked anything that made the FSLIC appear inferior to the FDIC, regulators did not recommend that Congress follow the League’s requests to make both programs equal. They, in fact, thought that their insurance premium should stay high to let FSLIC reserves to grow at the same pace as industry assets. This action would also counter the general decline in the reserve ratio for all thrifts, which fell from 8.2 percent in 1942 to 7.6 percent by 1949. Even though it did not have the support of regulators, the League rallied the industry to push for change, and in 1950 when it held its annual convention in Washington, D.C., hundreds of S&L executives descended on Congress. As a result, the industry got a bill introduced that would make the FSLIC equal

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24When the draft thrift deposit insurance bill circulated for comment in 1935, Assistant Treasury Secretary and former Utah banker Marriner Eccles insisted the FSLIC charge a higher premium than the FDIC in order to gain White House support. Horace Russell, Savings and Loan Associations, Second Edition (Albany, NY: Mathew Bender & Company, 1960), 99-100; Memorandum for the files from W. H. Husband, 8 July 1948; FDIC Controversy on Publicity; Divers Papers; RG 195; NACP; Memorandum from O. E. L. to Mr. Divers, 6 January 1948; FDIC Comparison with FSLIC 1948; Divers Papers; RG 195; NACP; Memorandum W. H. Husband to William K. Divers, 11 October 1948, quote 1 and Notes for FDIC Conference June 1, 1948, 5-7; FS&LIC Consolidation with FDIC 1948; Divers Papers; RG 195; NACP; “Bankers Planning Retaliation in Savings Association Dispute,” The New York Times, 30 May 1940, sec. 3, 1; “Banks Push Fight on Loan Methods,” The New York Times, 2 May 1948, sec. 3, 1; William Reinhardt, “Insured Savings and Loan Associations -- State and Federal,” ASLN 63 (May, 1943), 201-3.
to the FDIC in terms of premiums, insurance coverage and payout of insured accounts. Curiously, approval of this law received the assistance of southern legislators who used it to block an important civil rights bill, which, in turn, caused Congress to approve the FSLIC bill so that it could get to the civil rights measure before the session ended.\textsuperscript{25}

The FSLIC was also an issue in 1956, when the administration of President Dwight D. Eisenhower tried to remove it from the control of the FHLBB as part of a larger government restructuring effort. Based in part on the Hoover Commission on Organization of the Executive Branch of Government's recommendations, the FSLIC was to be run by a three-man board of trustees as a separate government agency, much like the FDIC. The General Accounting Office had made similar recommendations beginning in the 1940s. The main reason for creating two separate bodies was that the Board was perceived as having too much influence over the FSLIC, and the White House felt that there was a strong conflict of interest. Their argument was that as head of the FSLIC the Board had to make sure thrifts were as sound as possible to protect the insurance fund reserves, but at the same time its role in regulating home loan bank advances might allow thrifts to expand into some speculative lending areas.\textsuperscript{26}


Regulators strongly opposed this move in part because there were no operational problems to justify the change, with one noting that “if the machine is running well, don’t try to make it run better.” The Board also maintained that separating the FSLIC from its control would place in doubt the ultimate supervisory authority over federal savings and loan associations, since all federal thrifts also had to have deposit insurance. The League also opposed the change, because it would produce greater inefficiency, increase regulatory costs, and might diminish the prestige of the FHLBB and the industry. After intense industry lobbying, the House defeated the proposal, which was the only time that a government reorganization effort failed to become law during the 1950s.27

Increased Competition from Government

Although the 1950s was a period of tremendous prosperity for S&Ls, it was also a decade in which the federal government dramatically expanded its role in home finance. An important start came in 1944 when Congress passed the Servicemen's Readjustment Act, dubbed the “G.I. Bill of Rights.” This law, drafted in large part by the American Legion, was an effort to say “thank you” to an estimated 16 million veterans for their years of service to the nation. While this law offered veterans numerous benefits ranging

from long-term medical care to education tuition, one of the most popular features was
the financial assistance it gave to prospective home buyers. Under the GI. Bill, the
Veterans Administration (VA) could issue mortgage payment guarantees under this
program that were so complete that veterans were able to buy homes without any down
payment and with the lender providing 100 percent financing. Finally, to ensure that
monthly payments were affordable, the law capped interest rates on these loans.28

The League enthusiastically supported the GI Bill and helped draft the mortgage-
guarantee provisions. Viewing their participation in the program as a patriotic duty,
thrifts provided 80 percent of all VA-insured mortgages in the first year of operation.
Over the next four years, thrifts made only between 35 and 40 percent of VA loans, and
by 1955 this share had fallen to just 20 percent. The decline in VA lending by S&Ls
reflected their frustration with complying with the "red tape" and paperwork associated
with VA loans. More importantly, it was a sign that Congressional caps on interest rates
were well below market rates. Consequently, even though thrifts wanted to make VA
mortgages, their desire to maximize loan yields meant that participation in this program
waxed and waned in step with Congressional changes to the maximum VA rates.29

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Congress also passed a number of laws to expand the work of the Federal Housing Administration (FHA). First, it broadened the type of housing that could use mortgage insurance to include apartment buildings and inner-city projects. Second, Congress made it easier for borrowers to qualify for coverage by modifying the minimum loan terms that qualified for FHA insurance. These changes caused the volume of loans with FHA insurance to grow by more than 450 percent between 1945 and 1954, at which time the VA and FHA provided almost half of all new housing mortgages. Eventually, some thrift managers wanted similar changes as a way to give traditional mortgages a “shot in the arm,” but making thrift mortgage terms equal to government-backed loans was opposed by both the Board and conservative thrift managers. When the Board did try to move in this direction it “raised such a storm of protest throughout the business” that it was years before S&Ls offered the same consumer-friendly terms offered by the FHA.30

The final government housing program, the Federal National Mortgage Association (FNMA or “Fannie Mae”), also underwent major changes that increased its

role in home finance. Since its creation in 1938, Fannie Mae had just bought FHA-insured mortgages from the lenders as a way to improve their liquidity. In 1954, Congress allowed the FNMA to both buy and sell all types of government-insured mortgages, which created a formal secondary market for FHA and VA loans. Fannie Mae could also sell mortgage-backed securities on the open market to buy these loans, which made the agency a self-funding entity. While expanding the FNMA provided thrifts with a resource to help manage their government-loan exposure, the changes also resulted in greater competition for the industry by giving new life to mortgage companies. Since these firms specialized in making and selling loans to outside investors, the changes to the FNMA helped them become the largest originators of FHA and VA mortgages.³¹

The improvements in the VA, FHA and FNMA after World War II had an effect on home ownership and mortgage finance that was nothing short of revolutionary. One accomplishment of these programs was that it now became possible for millions of Americans, who otherwise did not have adequate financial resources, to buy homes. Between 1940 and 1955, the level of home ownership rose from 41 percent to 57 percent, the fastest increase in American history. Another consequence of this “democratization” of home ownership was its impact on shaping the values of the postwar middle class, causing most people to view owning a home as an inalienable right. Finally, government

involvement in home finance forced other mortgage lenders to adopt uniform practices in areas ranging from appraising to underwriting, as well as making loan terms more consumer-oriented. These lenders also began using the term “conventional” to describe any mortgage not under the FHA or VA programs.32

The Regulated Cozies Up to the Regulator

At the same time that the federal government was increasing its roles in housing, federal regulators began building closer relations with the industry they oversaw. The first step in this process required restoring the FHLBB as an independent government agency. The Board first lost this status in 1934 when Congress placed the Board under the FHA; and, while it retained significant autonomy within the FHA, the League interpreted the move as a blow to the prestige of the industry. The status of the FHLBB diminished further during World War II when Roosevelt issued Executive Order 9070, which created the National Housing Agency (NHA) to coordinate all defense-related housing. This order not only reduced the size of the Board from five members to one, but it also dropped the word “federal” from the agency name, changes the League again strongly disliked.33


In 1947, Congress expanded the Board from one to three members after the Los Angeles home loan bank controversy revealed the problems of having a single powerful commissioner oversee the industry. Legislators, however, ignored the League's pleas to make the Board a separate agency and instead made it part of the new Housing and Home Finance Agency (HHFA). While the Board had greater operational autonomy under the HHFA, the League still felt the thrift its industry deserved a separate regulatory agency. This goal became reality in 1955 when thrift leaders, responding to a Congressional action that gave the HHFA administrator complete control over Board policies, persuaded legislators to give the FHLBB its independence as part of the Housing Amendments Act of 1955, even though the White House strenuously opposed this change.\(^\text{34}\)

The fight to gain FHLBB independence showed how important it was to the industry that thrifts, like commercial banks, have an autonomous regulatory agency. At the same time, the League wanted the Board to consult with the industry to craft policies that would promote growth and enhance the public image of the industry. This desire for

\(^{34}\text{Memorandum from O.E. Loomis to Mr. Fahey, 22 October 1947, memorandum from O. E. L. to Mr. Divers, 29 April 1949, and memorandum from O. E. L. to Mr. Divers, 27 September 1949; Commission on the Organization of the Executive Branch of Government 1947; Divers Papers; RG 195; NACP; Memorandum from Walter W. McAllister to J. Aldrich Hall, 21 March 1955, Memorandum from J. Aldrich Hall to Walter W. McAllister, 21 March 1955, Letter from Walter W. McAllister to Herbert Hoover, 18 December 1953, and Reorganization Plan No. 1 of 1954 Clearance Draft; Reorganization of Home Loan Bank Board, 1953; McAllister Papers; RG 195; NACP; Memorandum from J. F. M. to Walter W. McAllister with attachments, 13 January 1955, Reorganization of Home Loan Bank Board 1955; McAllister Papers; RG 195; NACP; Letter from Walter W. McAllister to Harold A. Fitzgerald with attachments, 8 September 1955, Federal Home Loan Bank Board Independence Effective August 11, 1955, Correspondence of Chairman Albert J. Robertson 1956-1961 (Roberston Papers); RG 195; NACP, 2; Letter from Walter W. McAllister to Norman Strunk, 8 August 1955, McAllister Papers; RG 195, NACP; "HLB Board Independence Voted in Congress" SLN 75 (July, 1955), 8; "Congress Grants Independence to HLB Board" SLN 75 (August, 1955), 10; "A Message From Your President," SLN 75 (September, 1955), 14; Ewalt, A Business Reborn, 306.}
a cooperative relationship between the regulator and the regulated was in large measure fulfilled after World War II, as evidenced by the actions of the three Board chairmen who served between 1947 and 1961. Although the chairmen varied widely in background, they shared the opinion that to build a safe and healthy industry required working closely with thrift leaders to design appropriate regulations. The first of these, William K. Divers was an experienced federal housing administrator who established this pattern of cooperative relations.  

Divers wanted to create a regulatory environment that gave both the industry and supervisors sufficient latitude to make decisions. Because he strongly believed that savings and loan associations can “be among the least regulated and best supervised financial institutions in the United States,” Divers reduced the number of rules thrifts faced and consulted with the industry before issuing new regulations. These actions did not necessarily mean, however, that thrifts always got what they desired, since Divers also wanted to build an image of a safe industry. For example, when executives of several large associations petitioned the Board for permission to pay “bonus” dividends in order to attract funds, Divers refused, contending the change was not in the public interest. The decision was unpopular, but adhered to Divers’ philosophy of “strong but quiet...
supervision” of an industry that “is in too good a shape to permit a few reckless or poorly managed associations to damage its reputation.”

Another way Divers showed his support for the industry was his enthusiastic backing of the Savings and Loan Foundation, a nonprofit organization formed in 1951 to educate the public about the thrift business. Divers gave “unusual blessings” to the Foundation and instructed each regional home loan bank to encourage member thrifts to help fund it. The League, however, had mixed feelings about the mission of the new organization and objected to the fact that it would have no control over its operation. As a result, it took three years for the Foundation to raise enough money to launch its first national publicity campaign, but its subsequent success in building business proved the value of having such an independent body. The result was that membership tripled in just one year, and by 1960 over one-third of all S&Ls belonged to the Foundation. Divers’ commitment the Foundation’s mission to “teach millions of new savers to save modest amounts regularly” was such that he left the Board in 1953 to become its president.

36Speech Notes, Indiana Savings and Loan League Meeting, 16-17 September 1948, quote; Divers Papers; RG 195, NACP; Speech Notes, Kansas Savings and Loan League, 15 May 1953, quote; Divers Papers; RG 195; NACP; Speech Notes, Illinois Savings and Loan League Meeting, 12 October 1948; Divers Papers; RG 195; NACP; Letter from William K. Divers to John A Davis, 9 June 1952; Advertising and Broker Solicitations Insured Associations Dividend Bureau; Divers Papers; RG 195; NACP; Letter from Everett C. Sherborn to William K. Divers, 25 April 1952; Federal Savings and Loan Associations 1950 Shares Bonus On; Divers Papers; RG 195; NACP; Memorandum from John M. Wyman to Board, 15 September 1950; Federal Savings and Loan Associations, 1950 Shares, Bonus On; Divers Papers; RG 195; NACP; William K. Divers, “Current Savings and Loan Association Picture,” Savings and Loan Annals, 1950, 18-20.

37Memorandum from William K. Divers to All Bank Presidents, Public Relations Program, 19 May 1950; Savings and Loan Foundation 1950; Divers Papers; RG 195; NACP; Letter from George W. West to Joseph W. Hart, 11 March 1952, Quote; Savings and Loan Foundation 1950; Divers Papers; RG 195; NACP; Ernest T. Trigg to the Chairman of the Board of Directors and to the Presidents of Each FHLB, 8 June 1951, Savings and Loan Foundation 1950, Correspondence of Chairman William K. Divers, RG 195; NACP; Theobald, Forty-Five Years, 177; Address by Louis W. Grant to the Presidents of the Federal Home Loan Banks, 15 February 1954; McAllister Papers; RG 195; NACP; Letter from William K. Divers to Albert J.
Replacing Divers as chairman was thrift executive and former League president Walter McAllister. Although McAllister was the first industry leader to hold this position, senators did not seriously question his ability to run the Board in an impartial manner, and with the support of Divers and the two industry trade groups he was easily confirmed. The main reason McAllister agreed to become chairman was to help secure the Board’s independence from the HHFA, not to be a regulator. Throughout his tenure McAllister was uncomfortable as an administrator and warned friends not to “start thinking of me as a bureaucrat.” League leaders, however, considered him to be “part of the family,” and as a result FHLBB members were such frequent guests at trade group functions that some thrift executives complained that it was “easier to ‘talk shop’ without the ‘policemen’ around.”

Unlike Divers, whose term in office was relatively uneventful, McAllister faced a number of issues that required regulatory action. As the chairman confessed to his friend Bodfish, “I find the pressure to issue regulations right and left for this and that.”

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Robertson, 30 November 1956, and Letter from W.R. Youngquist to William K. Divers, 12 February 1957, Savings and Loan Foundation 1956, Robertson Papers; RG 195; NACP.

Transcript of meeting between Board members Divers and Adams, League executive vice president Gehrke and Savings and Loan Foundation executive Trigg, n. d., McAllister, Walter W. 1952; Divers Papers; RG 195, NACP; Letter from Walter W. McAllister to Morton Bodfish, 31 July 1953, United States Savings and Loan League 1953 - General; McAllister Papers; RG 195, NACP; Letter from Ben H. Wooten to Walter W. McAllister, 15 August 1953; Wooten, Ben; McAllister Papers; RG 195, NACP; Letter from Walter W. McAllister to Ben H. Wooten, 20 August 1953; Wooten, Ben; McAllister Papers; RG 195; NACP; Letter from Walter McAllister to Norman Strunk, 4 August 1953; United States Savings and Loan League, General; McAllister Papers; RG 195; NACP; Letter from Walter McAllister to Allan Shivers, n.d.; Sh; McAllister Papers; RG 195, NACP; Letter from Walter McAllister to W. W. Townsend, 5 January 1954, quote; Townsend, W. W. 1953 - ; McAllister Papers; RG 195, NACP; Letter from Norman Strunk to Walter McAllister, 20 April 1954, quote; United States Savings and Loan League Manager Conference, 1953; McAllister Papers; RG 195; NACP; Letter from Norman Strunk to Walter McAllister, 13 August 1954, quote; United States Savings and Loan League Meetings; McAllister Papers; RG 195; NACP.

219
most persistent and troublesome problem McAllister had to deal with was finding a way to regulate “give-away” promotions used by S&Ls to attract deposits. While most thrifts wooed savers with low-cost items such as pen and pencil sets, others that aggressively sought deposits offered customers expensive gifts like kitchen appliances. Initially, McAllister relied on moral suasion and pleas by League leaders to limit these practices, but much to his dismay these “jaw-boning” efforts rarely worked. Finally, in 1956 the Board reluctantly issued a rule limiting the value of gifts one customer could receive to $2.50 per account. Although McAllister knew this regulation was not perfect, it did end the most grievous abuses and set a precedent that subsequent Boards would build upon.39

The use of brokered deposits as a way to build savings was another issue the McAllister Board tackled. Like the use of “give-aways,” some managers were abusing this source of funds to achieve rapid growth. Deposit brokers were firms that solicited money from investors from around the country and placed them in associations that paid the highest rates; these institutions paid the brokers a fee for this service. Because brokers moved funds whenever rates changed, these deposits were known as “hot money,” and thrifts sometimes engaged in rate wars to attract and retain these funds. The League and the Board condemned the excessive use of brokered deposits, but to little avail. The San Francisco home loan bank, pressured by its members, even insisted there

should be no attempt to prohibit these practices by regulation. By 1953, this continued abuse led the Board to limit the territory from which thrifts could solicit brokered deposits. The Justice Department, however, nullified this rule since it restricted competition. A thoroughly frustrated McAllister opted to let later Boards wrestle with this issue.40

In 1956, President Dwight D. Eisenhower named as the new Board chairman Albert J. Robertson, who was a career bureaucrat with little knowledge of the thrift industry. Robertson had been Assistant Postmaster General prior to coming to the Board, and his early policies conformed to the same pro-industry positions of Divers and McAllister. During his five-year tenure, Robertson did not significantly expand thrift powers, and most changes simply codified new authorities granted by Congress. One such rule allowed thrifts to make loans of up to 5 percent of total assets for the acquisition and development of unimproved residential sites, while the most beneficial rule gave S&Ls permission to buy and sell loan participations to other thrifts. By allowing S&Ls to buy and sell up to half of a loan, as long as the originating institution retained at least the other half of the loan, the Board hoped to improve the distribution of surplus funds across

40Memorandum from R.R. Burklin to Mr. Divers and Mr. McAllister, 2 September 1953, Letter from Leo W. Tosh to Walter W. McAllister, 2 December 1953, and Memorandum from T. Wade Harrison to members of the Board, 11 November 1953; Advertising and Broker Solicitations, 1953; McAllister Papers; RG 195; NACP; Memorandum from T. Wade Harrison to members of the Board, Department of Justice Views on Proposed Regulations, 9 August 1954; Advertising and Broker Solicitations, 1954; McAllister Papers; RG 195; NACP; Letter from Walter W. McAllister to Perry Marsh, 22 November 1955; Advertising and Broker Solicitations, 1955; McAllister Papers; RG 195; Letter from Walter W. McAllister to Norman Strunk, 19 July 1956; United States Savings and Loan League 1953 - General; McAllister Papers; RG 195; NACP.
the country and allow thrifts to finance larger housing projects. In 1960, the Board amended this rule to allow loan sales to pension funds.41

While the League maintained generally cordial relations with the Robertson Board, sometimes the chairman grew annoyed with persistent industry requests for broader business powers. When the FHLBB raised the limits on apartment loans to 75 percent of appraised value for a maximum term of fifteen years, Strunk applauded the decision as "a step in the right direction." An incredulous Robertson noted to the other Board members "if this is only a step in the right direction, what is the ultimate goal, 100% in perpetuity?" Despite such instances of apparent frustration with industry desires, Robertson, like previous chairmen, was content to give the industry considerable latitude to police itself. This was especially evident in how Robertson dealt with the continued abuse of "give-aways," in which he conceded, "we can't do much better on the subject. Our best guess is to give the industry a free hand with the hope that sooner or later it will recognize the futility of overdoing these programs."42

The Robertson Board also relied on traditional "jaw-boning" to persuade thrifts to change their ways, especially if self-policing failed to achieve the desired outcome. This


42 Letter from Norman Strunk to Albert J. Robertson, 22 August 1958, and Attachment from Albert J. Robertson to Dixon and Hallahan, 25 August 1958, quote; Federal Savings and Loan Associations, Loans, General; Robertson Papers; RG 195; NACP; Letter Albert J. Robertson to Hamilton Patton, 4 February 1960; P; Robertson Papers; RG 195; NACP; Letter from Albert J. Robertson to G. E. Karlan, 11 February 1960, quote; Advertising - Give Aways; Robertson Papers; RG 195; NACP.
approach was used to stop thrifts from raising their dividend rates in 1958 and 1959. Robertson tried to convince managers that by raising rates thrifts would not gain a competitive advantage, but would rather create a floor that all other S&Ls would have to meet to avoid losing funds. When these appeals failed, the chairman told thrift leaders in 1960 that, while he opposed regulation, he hated competition even more, and warned that rate controls like those for commercial banks would be inevitable if the destructive rate wars persisted. Although he had no intention of following through on this threat, his willingness to raise the issue of extending Regulation Q over S&Ls was a sign that regulatory goodwill did have limitations.

The one issue on which the Board did act was restricting the use of brokered deposits by fast-growing thrifts, especially in the West. Robertson, like McAllister, thought that brokered deposits were useful when used in moderation, but he was concerned that some thrifts were far too reliant on this unstable funding source to achieve growth. In 1960, over 6 percent of all California thrift deposits came from brokers, and for one S&L this figure was almost 70 percent. Not only did Robertson see this concentration of funds as a hazard, but he feared that managers would make riskier loans to generate the income needed to hold these deposits. By 1959, Robertson had received enough complaints from other thrifts to draft a rule that limited brokered deposits to 5 percent of assets and restricted the fees brokers could receive. While the League did not take a strong stand on this issue, the brokered deposit community immediately tried to

43 Ed W. Hiles “Do We Want a Regulatory Dividend Ceiling?” SLN78 (February, 1957), 32-6; Speech by Albert J. Robertson to the Little Rock Federal Home Loan Bank Shareholders Meeting, 4 April 1960; Federal Savings and Loan Associations, Dividends - Ceiling; Robertson Papers, RG 195; NACP.
prevent passage of the new rules. Despite their public relations efforts to sway Board opinion, the rule was not modified and, according to Robertson, appeared to solve the problem."

On the surface, the policies of these three ideologically pro-industry chairmen gave the impression the industry had "captured" the FHLBB and had essentially made it a third S&L trade association. In reality, however, the Board was not entirely sympathetic to industry needs, but generally supported the conservative mainstream of the industry as evidenced by rules that promoted the activities of smaller associations and discouraged rapid expansion. Divers, for example, noted that "size alone is no criterion; it is O.K. if it means service to common encouragement of thrift and economical finance, but no good if done for size alone." Similarly, the Boards of the 1950s did not let the industry dictate the rule-making agenda and in several instances specifically rejected any attempt by the League to influence opinion. Even McAllister, who was the closest to the industry, felt that on some issues the Board had to act independently and not look to the "so-called trade associations for advice." The conclusion to be drawn about this period of regulation

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"Letter from Albert J. Robertson to F. Marion Donahoe, 8 July 1958; Advertising and Brokers, Regulations, September 1956 - 1958; Robertson Papers; RG 195; NACP; Letter from Clarence Smith to John E. Barriere, 11 February 1959; Advertising and Brokers, Regulations, 1959; Robertson Papers; RG 195; NACP; Letter from Albert J. Robertson to F. Marion Donahoe, 8 July 1958; Advertising and Brokers, Regulations, September 1956 - 1958; Robertson Papers; RG 195; Letter from Norman Strunk to Member Managers, 2 December 1959; Advertising and Broker Regulations, 1959; Robertson Papers; RG 195; NACP; Letter from Albert J. Robertson to Philip A. Hart, 5 August 1960; Advertising and Brokers, Regulations, 1960; Robertson Papers; RG 195; NACP; H. R. Amott, "Savings and Loan Broker Restrictions Not in Public Interest," Investment Dealers Digest 26 (8 February 1960), 5; Marvell, The Federal Home Loan Bank Board, 133-6.
was that the Board wanted industry growth as long as it did not compromise industry safety.\textsuperscript{45}

*Thrifts Hit Some Bumps in the Road*

Although the S&L industry generally viewed the postwar years as the best of times, it also suffered some legislative and business setbacks. The first of these was the Housing Act of 1949, which formally made it the responsibility of the federal government to “guarantee a decent home and suitable living environment for every American family.” Although the first federal housing assistance program had appeared in 1937, the role of the government in housing the needy received greater attention in the postwar period. One of the champions of increasing federal support was Sen. Robert Taft (R-OH), who was an ardent supporter of free enterprise, but who also believed that the government did have an obligation to house the least advantaged. As chairman of a wartime subcommittee examining postwar housing needs, Taft renewed the debate on federally-financed public housing, and from 1945 to 1948 he cosponsored legislation each year to establish a federal housing program for the poor.\textsuperscript{46}

\textsuperscript{45}“Setting the Record Straight,” Address of William K. Divers before the Annual Convention of the National Savings and Loan League Meeting, 17 June 1949, quote; National Savings and Loan League Meeting June 15-18, 1949; Divers Papers; RG 195; NACP; Letter from Walter W. McAllister to R. V. Walker, 5 December 1955, quote; Federal Savings and Loan Associations, Conversions, 1955 October-December; McAllister Papers; RG 195; NACP; Marvell, *The Federal Home Loan Bank Board*, 267-8.

While the League agreed that there was a need for low-income housing, it strongly opposed any effort to provide this need through public housing. Industry leaders argued that a broad government housing program would hurt the building industry by driving up labor and material prices, and that the tremendous cost of any public housing plan would increase taxes for all Americans, including the poor. Aside from these economic arguments the League had strong ideological objections to this potential intrusion of government into housing. It contended that subsidized housing was pure socialism, an extension of the welfare state, and a direct threat to private enterprise. League officials also pointed to the problems of subsidized housing in Great Britain as proof that such an experiment should not be tried in America. Such arguments helped defeat every attempt to create government-subsidized housing through 1948, and many government officials at the time believed as Governor John Bricker (R-OH) did, that housing can “only be met by the savings and loan, real estate and home building industries. Government cannot and should not do it.”

The prospect of creating a broad public housing program gained strength when several key House and Senate housing committee members lost in the 1948 election. Public housing advocates interpreted their defeat as a mandate to improve the deteriorating condition of inner cities, and charged lenders for not financing urban

housing while focusing almost exclusively on suburban development. Such repeated
attacks caused the League to become very defensive, and allowed supporters to introduce
desired reform bills. The Housing Act of 1949 called for the construction of 810,000
public housing units over six years, and a five-year campaign to clear urban slums. The
League was aghast by this scope of the bill and saw it as the first step toward government
control of housing. Recently-elected Senator John Bricker concurred with this
assessment and asked “Where do we stop? . . . With the Government threatening to
encompass between one-third to one-half of the home-financial field, your very existence
is at stake.” Still support for the measure as strong, and some representatives who
personally opposed it voted in favor because “it was what my people want[ed].”
Subsequent funding for these programs was reduced and only a fraction of the proposed
units was built. Still, like the Employment Act of 1946, the Housing Act of 1949 affected
domestic housing policy for years to come.48

A second legislative defeat came when Congress finally made S&Ls subject to
federal income tax laws. The League had long been able to secure an exemption from
federal taxes for the thrift industry by arguing that thrifts were not-for-profit associations
similar to other self-help charities. The growth of thrifts after World War II, however,

48The total cost of these programs was estimated to be $15-20 billion. U.S. House of Representatives,
Housing Amendments of 1949, Hearings Before the Committee on Banking and Currency, 81st Congress, First
Session, HR 5637 (Washington, D.C.: USGPO, 1949), 275-8; U. S. Senate, Housing Amendments of 1949,
Hearings Before the Committee on Banking and Currency, 81st Congress, First Session, S 2246 (Washington,
6; Stephen Slipher, “A Glance Behind the Housing Act,” SLN 69 (August, 1949), 13-14; John W. Bricker,
Executive Committee on Legislative Matters,” Savings and Loan Annals, 1949, 13-19, quote 18-19, 142-8;
“The Battleground of the Housing Fight,” SLN 68 (May, 1949), 18-20, quote 19; Theobald, Forty-Five Years,
168-9.
made it more difficult for League leaders to maintain this position, and even the industry
trade journal joked that thrift executives “feel like a million -- tax-free of course!” In
1950, this situation changed for the first time when the House, responding to pressure
from commercial bankers, passed the first revenue bill that would tax S&Ls at the same
rate as other corporations. While the League successfully lobbied to defeat the measure,
the industry was not fully unified in opposing it. The National Savings and Loan League
even told Congress it was willing to support a tax bill provided it exempted thrifts whose
reserves were less than some reasonable percentage of total assets. Such a concession not
only angered many in the League, but also opened the door for creating a federal thrift
tax.

The next year, the House passed its annual revenue bill, and to the delight of the
League it contained no S&L tax language. The Senate, however, shocked the industry by
amending the bill to tax any association that held a loan-loss reserve in excess of 10
percent of total assets. The League again lobbied for changes in the bill, but unlike the
cases in earlier fights, thrift leaders no longer hoped to prevent passage of a tax. They
were just trying to minimize its impact. By arguing that the proposed tax would penalize
associations with large surpluses and discourage managers from making prudent
allocations for potential loan losses, the League was able to change the bill so that S&Ls
would be taxed, but only after they built up a reserve equal to 12 percent of assets. While
the League disliked losing its cherished tax-exempt status, and regulators feared managers

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49 Cartoon, SLN (May 1952), 19; George Mooney, “Savings Units Join to Fight Taxation,” The New
York Times, 21 May 1950, sec. 3, 3; Memorandum from O. E. Loomis to Mr. Divers, 28 February 1950, 6-7;
Taxes Mutual 1950; Divers Papers; RG 195; NACP.
would use dubious accounting procedures to avoid paying taxes, overall the new law had very little effect on the industry since only a handful of thrifts maintained a 12 percent reserve.50

A third challenge for the industry came during the Korean War when Congress passed the Defense Production Act of 1950. Like previous efforts to convert the economy from domestic to wartime production, this law restricted residential construction. It did so, however, through indirectly controlling home finance, as opposed to the direct control of building materials imposed during World War II. The law led to the creation of Regulation X, which gave the Federal Reserve authority to reduce the loan-to-value ratios for home loans and require shorter loan maturities, all in an effort to reduce the demand for non-defense-related housing. At the same time, the Federal Reserve reduced the money supply, which increased mortgage interest rates. Although such controls seemed harsh, the provisions of Regulation X proved to be more palatable than strict rationing; and, since the Federal Reserve administered the rules flexibly, the impact of these changes on thrifts and consumers was gradual, which helped in its general success.51

50 Morton Bodfish, “A Look at the Year Ahead,” Savings and Loan Annals, 1950, 26-7; Memorandum from John M. Wyman to Files, 10 September 1952; Taxes Mutual 1952; Divers Papers; RG 195; NACP; Marvel. The Federal Home Loan Bank Board, 136-8; Ewalt, A Business Reborn, 300-1; Theobald, Forty-Five Years, 187.

The final crisis the industry faced came in 1954 when the nation experienced its first major credit crunch since the end of World War II. That year, the booming economy finally began to show signs of weakness, and slid into a mild and brief recession. The dip in the economy did not dampen consumer spending; and, as personal income fell, people began using their savings to pay for expensive goods like automobiles and televisions. Unfortunately, the market for home loans also remained red-hot; and, as thrifts saw savings withdrawals increase in early 1955, they reacted by raising dividend rates to hold onto this money. This tactic, however, was not successful, and in an effort to make more loans, thrifts borrowed heavily from the home loan banks. Between August 1954 and May 1955, home loan bank advances rose 25 percent to $821 million, and over the next three months they jumped to over $1.2 billion. This rapid increase forced the Board to authorize an unusually large bond issue to fund these advances in June 1955. The sale of these notes, however, almost failed because it occurred when debt markets were already saturated and the Federal Reserve Board was curbing the flow of credit to banks.\(^{52}\)

The Board realized that because banks were the primary buyers of their debt, it would have to offer the bonds at higher interest rates to ensure future sales, a move that would likely fuel inflation. In September 1955, the Board announced a moratorium on new borrowing from the bank, which McAllister justified by telling thrift executives \("you


230
had a lender’s paradise . . . but if the trend [of increased bank loans] had been continued we would have been responsible for contributing an unnecessary inflation” to the national economy. This sudden cut off of liquidity had an immediate effect on the availability of S&L home loans. During the first nine months of 1955, the volume of thrift mortgages was 28 percent higher that the same period in 1954, but in the fourth quarter S&L volume was slightly lower that the previous year. In November, the Board lifted its restrictions, but tight money conditions eased only slightly as the country again moved toward a recession. For industry leaders, the events of 1955 indicated the seemingly limitless growth of the “glory years” were near an end and that future expansion would require greater management skills and business innovation.53

Conclusions

By all accounts, the late 1940s and early 1950s was the most successful period in the history of the thrift industry, and a large part of this success resulted from the major social changes that the nation experienced during these years. The return of millions of servicemen who were eager to take up their prewar lives led to a dramatic increase in marriages and new families, and related to this “baby boom” was the need for new homes. Although postwar housing shortages were not new in America, the way in which this problem was solved in the 1940s was different. Improvements in automobile

transportation and construction techniques allowed builders to develop large suburbs of
single-family houses in order to meet the unprecedented demands of prospective
homeowners. Because these communities combined the benefits of being close to the
city with the space and freedom of country living, millions of Americans became
suburbanites establishing a trend that would dominate residential development for the rest
of the twentieth century. The demand for homes and the large-scale development of
suburbs proved to be a financial windfall for the savings and loan industry as S&Ls
aggressively pursued lending opportunities with mortgage plans designed to meet the
needs of the postwar consumer.

The thrift industry trade association was an important force in helping thrifts
attain a major role in America’s financial structure during the 1950s. The League advised
S&Ls on how to advertise their services effectively, expanded its education programs,
and refined its own internal organization and leadership so as to help push the industry
forward. Industry growth was also aided by changes in federal regulations. Redesigned
charters for federal associations and more favorable requirements for deposit insurance
led to strong increases in thrift participation in these major programs. At the same time,
federal regulators became more industry-friendly by issuing rules that supported S&L
growth and expansion. Eventually, the increasingly close relationship between the
regulator and the regulated combined with the political clout of the League became a
concern of other Washington officials, but few efforts to change it proved successful.

By the middle of the 1950s, the thrift industry bore little resemblance to the
business that had existed in the 1930s. S&Ls controlled over $37 billion in assets,
provided nearly half of all home mortgages, and were the second largest private industry repository for consumer savings. Despite these impressive gains, signs were appearing that the industry was beginning to fragment. The first came when the credit crunch of 1955 led to splits within the League over what was considered reasonable ways to attract funds. Over the next ten years divisions between large and small thrifts as well as between S&Ls in the East and the West would grow and eventually lead to greater internal dissent and legislative scrutiny.
CHAPTER 7

EXTERNAL CHALLENGES AND INTERNAL DIVISIONS, 1956-1966

The second decade after World War II presented far more challenges and uncertainties for the thrift industry than the earlier Glory Years. One such challenge was greater difficulty for S&Ls had in attracting and finding lending opportunities, resulting from a slight slowdown in the American economy combined with increased competition from other financial industries. The federal government also broadened its role in home finance as Congress made it easier for borrowers to qualify for mortgage insurance through existing federal programs. A third concern was the need to give greater attention to the home ownership needs of minority groups resulting from the growth of a national civil rights movement. Finally, federal oversight of the thrift industry became more active, reflecting the work of more dynamic regulators.

Despite such challenges, the thrift industry maintained a very strong growth rate in the late 1950s and early 1960s, during which time it surpassed the $100 billion asset milestone and achieved control of nearly half the residential home finance market. This expansion, however, also led to greater divisions within the thrift industry. Differences between large and small thrifts, those in the eastern half of the country and those in the faster growing West, as well as between mutually-owned and publicly-traded S&Ls were all signs that the industry was becoming fragmented. For its part, the League tried to
bridge these rifts, but by the mid-1960s it was apparent that these gaps had instead widened. The most significant challenge for the League and the industry, however, lay in trying to prevent the imposition of legal controls on savings rates. Despite their best efforts, thrift officers were unable to keep this from happening, and in 1966 S&Ls became subject to the same rate controls banks faced under Regulation Q. This development not only formally ended the years of easy S&L growth, but ushered in a new period of uncertainty that would culminate in industry deregulation.

*The Economy Cools Off and Competition Heats Up*

During the late 1950s and early 1960s, S&Ls found it more difficult to attract business than in the previous "glory years" for a variety of reasons. A general slowdown in the economy made it impossible to maintain the growth rates recorded in the first ten years after World War II. Between 1945 and 1954, the Gross National Product (GNP), and level of personal spending rose at an annual rate of 6.6 percent and 8.1 percent respectively, but over the next ten years, these figures declined slightly to 5.5 percent and 5.9 percent, respectively. Furthermore, unlike the case in the immediate postwar decade, which was a time of almost uninterrupted expansion, the country went through brief recessions in 1954, 1958 and 1961; and, as a result, unemployment, which averaged just 3.7 percent through 1954, rose to 5.4 percent by 1965. The main reason the economy was not as prosperous in the late 1950s as it had been in the early part of the decade was that manufacturing had caught up with the tremendous postwar demand for consumer goods, and had entered a more normal production cycle.¹

Like the economy as a whole, the level of home construction in the second decade after World War II was erratic. Between 1945 and 1954, housing starts rose in every year except 1951, and on average increased at an annual rate of 6.6 percent. Over the next ten years, however, housing starts rose and fell nearly every other year, and the result was an average annual increase between 1955 and 1965 of just 0.2 percent. This anemic performance reflected not only the fact that the large postwar housing shortage had finally been met, but also the lower rate of new household formation, which caused the demand for homes to fall slightly. Because of these conditions, the increase in home ownership, which had risen at an average annual rate of 2.6 percent between 1940 and 1950, slowed to just 1.2 percent during the 1950s, and was virtually unchanged between 1961 and 1965. The one positive trend of this period was that during the 1950s the average annual rate of personal savings more than doubled to 5.7 percent of household income.²

While an uneven economy and slow-growth housing industry presented one set of problems to S&Ls, another equally important challenge came from other financial institutions, notably commercial banks. Although banks had not traditionally been major home mortgage lenders, during the early 1960s they expanded their activity so that by the middle of the decade banks accounted for more than 14 percent of the total residential mortgage market. The main reason for this development lay in the work of Comptroller

of the Currency James J. Saxon, a former banker who took office in 1961. He helped transform the formerly staid banking industry into a modern financial force. During his controversial five-year tenure, Saxon issued more than 6,000 new regulations, the majority of which liberalized banks' powers. Among these were rules that allowed banks to make residential mortgages on essentially the same terms as S&Ls, thereby making both types of institutions equal competitors for the first time in their histories.3

Commercial banks also provided a new competitive threat in the contest to acquire consumer savings. Historically, thrifts had held a 2 to 3 percent rate advantage over banks for deposits, primarily because banks faced strict rate controls under Regulation Q. This advantage allowed thrifts to garner nearly 60 percent of all new deposits in the first ten years after World War II, as compared to around 20 percent for banks. Following years of banker complaints, in 1954 the Federal Reserve changed Regulation Q for the first time, and over the next ten years it continued to make rate adjustments to help keep banks competitive with thrifts. As a result, by 1965 banks attracted 60 percent of all new savings while thrifts won just 19 percent. Bank savings received another boost following the creation of a secondary market for long-term

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237
certificates of deposit (CDs) in 1962. Although term CDs were not covered by Regulation Q, their traditional lack of liquidity meant that few banks could use them as a funding source for short-term loans. The ability to buy and sell these market-rate certificates made them liquid financial instruments, and the result was that between 1961 and 1965 more than half of the increase in bank deposits came from the issuance of term CDs.4

While banks and thrifts tended to dominate the fight for funds, they were not the only financial institutions in this battle. Mutual funds emerged as an important competitor for investor money in the 1950s after the Maloney Act, passed in 1940, placed companies offering mutual funds under regulations similar to issuers of stocks and bonds. The law helped remove the taint of scandal that mutual funds had acquired in the early-1930s, after federal investigations showed that several prominent fund managers had engaged in fraud and pyramid schemes that had cost investors millions. Many of the new firms of the 1950s, like Merrill Lynch, also followed more diversified investment strategies that helped reduce market risks and boost investor confidence. The result was that during the 1950s investments in mutual funds increased at an annual rate of 45

percent, and by 1965 accounted for more than $17 billion in consumer savings, up from just $1 billion twenty-five years earlier. While still a minor part of the overall allocation of national savings, by the 1970s mutual funds would have a dramatic effect on how well thrifts retained funds.  

A third source of competitive pressure came from the federal government, which continued to expand federal housing programs under the Federal Housing Administration (FHA) and the Veterans Administration (VA). During the 1950s, Congress significantly liberalized the requirements for federal mortgage insurance by raising the maximum loan-to-value ratio for mortgages from 75 percent to 95 percent and increasing the maximum term from twenty to thirty years. Aside from making FHA and VA loans more consumer-friendly, Congress also improved their marketability, and in 1954 it redesigned the Federal National Mortgage Insurance Administration (FNMA) so it would focus solely on buying and selling FHA and VA insured loans. This creation of a secondary market allowed mortgage bankers, who relied on a uniform clearinghouse to finance operations, to become major providers of these loans. As a result, mortgage companies accounted for two-thirds of all FHA and VA loans by 1965, up from 43 percent twelve years earlier. With these changes, the volume of outstanding government-insured loans rose from $38.9 billion to $72.2 billion between 1955 and 1965; and, although the share

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of government never exceeded 3 percent of the total market, their more consumer-friendly terms forced thrifts to make similar changes for their home loans.6

_An Increased Focus on Minority Housing_

Yet another major issue facing S&Ls in the late 1950s was the growing attention given to the housing needs of African-Americans. Following the 1954 Supreme Court ruling in Brown vs. Board of Education, civil rights leaders began pushing for greater equality, including greater access to housing and home ownership. While achieving this goal required changing social attitudes on race relations and integration, it also required expanding the availability of home financing for minority applicants. For decades, blacks had had trouble obtaining mortgages because white-owned institutions frequently discriminated against minority applicants with financial tests, such as large down payments, that whites did not have to meet. This treatment, combined with the harsh reality of segregation in the South, was one reason why African-Americans had to form their own banks and insurance companies after the Civil War as a way to get loans. By the turn of the century, dozens of minority-owned financial institutions operated

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throughout the South, and some, like the North Carolina Mutual Insurance Company, were substantial operations with hundreds of members.  

African-Americans also organized their own S&Ls to help urban blacks acquire homes. The earliest minority-owned building society was formed in Kinston, North Carolina in 1865, and the first association based on the traditional building and loan plan appeared in Baltimore in 1881. By the end of the nineteenth century, seventeen African-American thrifts were in operation, and in cities like Philadelphia and Charlotte the leaders of these associations formed their own local trade associations to promote their business interests. One reason why African-Americans could easily form a thrift was that most states did not impose strict financial requirements for charters. Also, attracting new members was not very hard because many early African-American S&Ls held meetings at local churches, which were primary social institutions in the black community. In the early 1900s Booker T. Washington claimed that, "perhaps the most numerous and popular form of cooperative business in which our people have engaged is that of the building and loan associations." He also noted that half of the homes owned by blacks in Virginia were built using loans from minority-owned thrifts.  


Aside from forming minority-owned thrifts, African-Americans often found it possible to become members of white-owned associations. Throughout the South, many S&Ls allowed blacks to join on an equal status with whites. In 1896, the League reported that nearly 7 percent of all Louisianan thrift members were African-American men and women, and that the majority of the thrifts in that state drew "no line of distinction on color" when making loans. By the 1910s, many associations accepted members of "any age, sex, color, vocation or habitation." One reason for doing so was that industry leaders saw their business as a way to encourage self-help and moral uplift. As one white Southern thrift leader noted, "it is the providence of the building associations in the South to educate the colored man along the lines of economy and savings and home building, and from this work more good will come than from all the vaporings of all the politicians in the land." This sentiment was shared by many blacks, and one minority-owned thrift advertised, "think of the habits of saving as how it makes for independence of the individual and of the race."

[Quote 161.]


242
The early phase of the development of African-American thrifts, which lasted from the 1880s into the early 1900s, was followed by solid expansion after the First Great Migration of World War I. The lure of jobs in the urban North led millions of blacks to leave the South, and between 1915 and 1930 minority populations in Chicago and Philadelphia rose by 63 percent and 114 percent, respectively. While blacks in the North did not face the problems of legal segregation that existed in the South, there was still a *de facto* policy to separate the races, and this policy led to rising racial tensions, especially in cities such as Detroit and St. Louis. Housing was one area where the races were separated by practice, and black leaders alleged that landlords and banks often conspired to restrict blacks to certain neighborhoods. In these circumstances, northern blacks also began forming their own S&Ls. Unlike what had been the case in the 1880s, the League appeared to be quite interested in their work. Industry leaders noted that increasing home ownership among blacks not only helped reduce mortality, but also strengthened their commitment to the community, which helped ease racial tensions.

Philadelphia, which was the home of the American thrift movement, also had the most active collection of minority-owned thrifts in the country.  

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Because Philadelphia historically had a large African-American population, it also had a well-organized network of minority-owned businesses whose leaders took an active role in forming black S&Ls. The first African-American thrift in the city appeared in 1886, and by 1926 there were thirty-six associations serving black members. These thrifts also had their own trade group and monthly magazine. Philadelphia was not unique; almost every major city in the North with a sizable African-American population had at least one black-owned S&L, including Baltimore with ten, Chicago with three. In addition, Newark, New York, Milwaukee, Cincinnati, Dayton, and Los Angeles each had at least one African-American S&L. By 1930, seventy-three minority-owned thrifts controlled more than $6.5 million in assets, and operated in fourteen states from coast-to-coast. Because these S&Ls focused on meeting the home finance needs of members drawn from the local neighborhoods, the average thrift was small with about $75,000 in assets. Just two had more than $400,000 in assets; by comparison, the industry average was more than $700,000.11

Although relatively few in number, the activities of African-American S&Ls in the 1920s did help increase the level of black home ownership. Between 1910 and 1930, the number of black homeowners nationwide rose from 20 percent to an estimated 28 percent, and in cities where thrifts were active the change was even larger. In Philadelphia, 12 percent of all black families owned their own homes in 1920, up from just 5 percent in 1910, while Dayton saw an increase from 23 percent to 29 percent over

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the same period. Minority home ownership also rose significantly in the South, and in
cities such as Norfolk, Virginia and Charlotte, North Carolina, the value of black-owned
property rose 46 percent and 53 percent, respectively. A federal study of minority
housing credited the roles of white- and black-owned thrifts for these changes, noting,
"Negro buyers fare better in communities where building and loan associations are
prominent. Many communities have thriving Negro associations, and white associations
often welcome Negro clients."\(^{12}\)

Following growth in the 1920s, minority-owned thrifts suffered during the Great
Depression, recording a failure rate well above that of the thrift industry in general.
Between 1930 and 1938, the number of African-American thrifts fell 37 percent to 47,
while the assets managed by these associations dropped by 46 percent to $3.5 million
over the same period. In contrast, the entire thrift industry experienced only a 26 percent
decline in associations and a 36 percent drop in assets. While unusually high black
unemployment and the sharp drop in real estate values provide a partial explanation for
the decline of minority-owned thrifts, other problems, including the inexperience of
managers, were also factors. Moreover, black shareholders appeared to have less
confidence in their institutions; and minority-owned S&Ls had more incidents of deposit
runs than other thrifts. Despite these problems, the Great Depression provided valuable

\(^{12}\)Blanch Halbert, "Home Improvement Among Negro Families," *Southern Workman* 60 (May,
1932), 209-16; Blanch Halbert, "Leadership for Better Homes," *Southern Workman* 56 (April, 1927), 169-74;
President's Conference on Home Building and Home Ownership, 1932), 79-86, 92-6, quote 96.
lessons for those African-American thrifts that survived, and in turn helped them take advantage of growth opportunities in the 1940s.\textsuperscript{13}

As had been true during World War I, the Second Great Migration of World War II brought millions of blacks out of the South to the North and West, and this movement produced a third wave of expansion for African-American thrifts. Between 1938 and 1949, the total assets controlled by black-owned associations soared to more than $16.4 million, but because their number had fallen to twenty-nine, these thrifts were much larger. Furthermore, their credit quality was fairly strong, with one black manager reporting in 1949 that his thrift had had no foreclosures in its entire fifteen-year history of lending to mostly black homeowners. One important reason for this growth was that blacks had more access to housing after the common practice of maintaining “colored neighborhoods” was found unconstitutional in 1948. In the landmark ruling of \textit{Shelley v. Kraemer}, the Supreme Court outlawed the use of restrictive deed of trust covenants that barred the sale of property to blacks. This decision created a technical opening for blacks to move into traditionally all-white neighborhoods.\textsuperscript{14}

The mass movement of African-Americans from the South also led the thrift industry as a whole to again realize the business potential of lending to minorities. This


\textsuperscript{14}Other major cases on ending racially segregated neighborhoods include \textit{Buchanan v. Warley} 245 US 60 (1917), \textit{Harmon v. Tyler} 273 US 668 (1927), \textit{City of Richmond v. Deans} 281 US 704 (1930), Rosenberg, \textit{Negro Managed Building and Loan Associations in the United States}, 49-54; Robert R. Taylor, “Financing Minority Group Homes” \textit{SLN} 69 (January, 1949), 33; Memorandum from John Fahey to Office of the Chairman, 21 February 1941, with attachments; “He”; Correspondence of Chairman Lohn Fahey, 1940-1947; RG 195; NACP.
was especially true after Congress passed the GI Bill of Rights in 1944, an act which required lenders making mortgages under this law to do so without regard to race, creed, or color. By 1950, the League had brought to the attention of its membership the need to lend to minorities, stressing that African-American borrowers were generally excellent credit risks. Surveys in 1946, 1948 and 1954 by the FHLBB on lending to minorities confirmed that the rate of loan delinquencies for black and white borrowers was similar, and that most thrifts tended to approve or reject a loan on the basis of financial eligibility and not race. Interestingly, the Board could not compile accurate statistics on the actual number of minority loans made by S&Ls since none of the associations surveyed separated their accounts based on the race of the applicant.¹⁵

Despite the surface positive attitude of white thrift managers toward African-American mortgage applicants, there were still signs that discrimination existed within the industry. One lender, who said that associations in his state "with no exception that I know of" discriminated against minorities. He also noted that "it is only when the Negro applicant expects special or preferential treatment that we run into difficulty" providing them with loans. In particular, he commented on how some builders of minority housing demanded "much looser and more generous" terms than the S&L normally granted. At

the same time, this executive noted “if there is any factor which is limiting the spread of home ownership among the colored folks, it is because they have not yet acquired the habit of thrift to the same extent as the white.” Such attitudes indicated that black applicants still experienced a perception problem in the home lending process.  

Given this persistent and subtle discrimination, some African-American thrift leaders felt they needed an organization that would address the problems facing minority home buyers. Although the League did not discriminate in its membership, and allowed African American thrift employees equal access to education and other trade association services, several state leagues did prohibit black S&Ls from joining. These conditions contributed to the formation of the American Savings and Loan League (AS&LL) in November 1948 to represent the interests of African-American S&Ls. Like the larger League, the AS&LL worked to promote thrift and home ownership, but it also sought ways to increase lending to minorities and discourage the use of race-based criteria in evaluating African-American loan applications. Thus, AS&LL leaders pushed regulators to make it easier for blacks to form their own associations and to create a new position within the FHLBB to focus on minority housing issues.

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16 Rosenberg, *Negro Managed Building and Loan Associations in the United States*, 22-3; Divers to McAllister, 6 December 1954, and Letter from Everett C. Sherbourne to William K. Divers, 8 November, 1954, quotes 1-3; Housing, Minority 1954- ; McAllister Papers; RG 195; NACP.

While the FHLBB agreed with the AS&LL that there should be more minority thrifts, there were limits to this support. Board Chairman Divers expressed a “desire to see Negroes help themselves” in becoming home owners, but also emphasized that only “strong groups [with] resources, strong community support [and] a reasonable likelihood of success” should form new thrifts. Because he wanted to make sure that no new S&L would become a problem for the FSLIC, Divers felt it was inappropriate to lower the minimum capital requirements and to make it easier for minorities to organize thrifts. Such a position did not help the AS&LL since blacks traditionally had only very limited access to capital. This gap between rhetoric and action during these years after World War II was confirmed in a 1961 report to the Commission on Civil Rights. In it, the Board conceded that “we are not aware that the 1940s was a period of unusual encouragement” for African-American thrifts, and attributed the growth in new minority S&Ls during this period to the national Civil Rights Movement. The FHLBB contended it was now more supportive of minority thrifts as evidenced by an approval rate for black applications that exceeded the rate for white applicants.18

Although the AS&LL did not make substantive headway with federal regulators in increasing the number of minority-owned thrifts, the work of the existing associations

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continued to expand into the 1960s. While the majority of these S&Ls remained small, with less than $7 million in assets, some were large and prosperous concerns. In New York City, Carver Federal Savings and Loan, which began in 1949 with $225,000 in subscribed capital and only $15,000 in actual cash had grown to more than $24.4 million in assets by 1963. This thrift was so well known that Vice President Richard M. Nixon visited it in 1957 to highlight the Eisenhower Administration's commitment to civil rights. The largest African-American thrifts, however, were in California. Los Angeles had four black-owned thrifts which controlled nearly $154 million in assets, while San Francisco was home to the biggest, Trans-Bay Federal, with more than $74 million in assets. Overall, thirty-four African-American thrifts held more than $400 million in total assets, and from this modest beginning, minority-owned thrifts continued to meet the mortgages to both black and white applicants into the twenty-first century.19

S&Ls and the League Continue to Grow

Despite the various challenges facing all S&Ls, the thrift industry continued to grow in the late 1950s and early 1960s. Federal regulators broadened their lending powers to include apartment and condominium mortgages, which were lucrative fields, but which also involved additional risks, since multifamily apartments were often

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nonowner-occupied and condominiums involved unique legal considerations. Another change was the right to make short-term "trade-in" financing to help borrowers gain access to their equity in existing homes to purchase new houses. Regulators also permitted S&Ls to sell up to 75 percent of loans to other associations, a change which allowed thrifts to come together to meet loan requests that exceeded the legal lending limits of a single association. The ability to sell participations also improved the flow of mortgage funds across the country. Finally, the Board allowed thrifts to lend for home-related items such as appliances and furniture, which opened the door to consumer lending, albeit in a limited way.  

Congress also helped the thrift industry with new legislation, the most significant of which was the Housing Act of 1964. This law expanded the lending authority of thrifts to make education loans, as well as financing for the acquisition and development of raw land for residential purposes, which made it possible for a single association to finance all aspects of home construction. Other changes included a doubling of the

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251
lending territory in which a federal S&L could make direct loans up to 100 miles from
the home office, and authority to invest up to 5 percent of S&L assets in any standard
metropolitan statistical area, which effectively established nationwide lending. Finally,
the law allowed S&Ls to invest up to 1 percent of their assets in unregulated service
corporations, which thrifts used initially to manage “back-room” activities like data
processing. Over time, however, service corporations would be an important way for
thrifts to enter business fields prohibited by regulators.21

The League also tried to help the industry stay competitive during this period by
creating new incentives for lending and saving. To promote a more efficient flow of
mortgage funds, the League received regulatory permission in 1955 to form the
Voluntary Home Mortgage Credit Program (VHMCP). Under this program, associations
with excess funds joined with other thrifts to make FHA and VA loans in rural areas.
The League promoted the VHMCP to show how thrifts were committed to meeting
mortgage demand in all parts of the country, and also to blunt any efforts to increase
government involvement in financing homes. In terms of finding ways to attract more
stable savings, although the League failed to win approval to pay variable rates on

21"A Savings Account for That College Education," Good Housekeeping (September, 1958), 148;
Letter from Philip Lieber to Harold Bauman, 27 February 1956, FS&LA, Lending, 1953 - ; McAllister
Papers; RG 195; NACP; Press Release, 5 October 1964; FS&LA Loans, Educational; McMurray Papers;
RG 195; NACP; "Education Loans: Will Associations Rise to the Challenge?" SLN 86 (April, 1965), 36-42;
"Education Loans: Associations Rise to the Challenge," SLN 87 (February, 1966), 30-6; Press Release, 25
May 1964; Federal Savings and Loan Insurance Corporation [hereafter FSLIC], Reserves, Regulations and
Press Releases, 1963-1967; McMurray Papers; RG 195; NACP; Press Release, 25 January 1965; FS&LA,
Loans, Extending Lending Area, 1961 - ; McMurray Papers; RG 195; NACP; “Property Improvement
Lending" SLN 83 (April, 1962), 59-69; "Survey Reveals Swing to Greater Use of Own Plan Property
Improvement Loans" SLN 76 (November, 1955), 78-92, 104; Press Release, 21 December 1963; FS&LA,
Loans, Acquisition and Development of Land 1961 - ; McMurray Papers; RG 195; NACP; Stephen G.
savings, it convinced regulators to allow S&Ls to pay quarterly dividends as well as bonus dividends on large deposits held for at least one year. Thrift leaders argued that this incentive was justified since it promoted systematic saving and encouraged customers to plan for the long term.  

While the industry gained many new powers, it did not get everything it wanted. One such failure was a federal mortgage insurance program for conventional loans, which the League wanted as a way to compete against the improvements to the FHA and VA mortgage programs. Although years of lobbying did not work, an acceptable alternative was private mortgage insurance through firms like the Mortgage Guaranty Insurance Corporation, which insured the portion of a mortgage that exceeded 80 percent of appraised value. A second failure was the inability to create a secondary market for conventional loans through the FNMA. Although the League argued that the ability to buy and sell traditional mortgages would improve liquidity and the overall flow of funds, Congress was generally opposed to providing thrifts with what some saw as a direct federal subsidy. Finally, the League failed to win approval for its idea to create a

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consumer bill paying service, since regulators considered it to be too much like regular bank checking accounts.\textsuperscript{23}

\textit{Evaluating the Industry}

Despite increased competition for loans and deposits, the growth of the thrift industry continued to amaze outside observers and League officials. Between 1955 and 1965, the industry passed a number of major milestones and posted one of the fastest growth rates of any financial industry, as seen in Table 7.1:

\begin{table}[h]
\begin{tabular}{|c|c|c|c|c|}
\hline
Year & No. S\&L & Chg./Yr. & Assets (000,000) & Chg./Yr \\
\hline
1955 & 6,048 & --- & $37,800 & --- \\
1959 & 6,223 & 0.8\% & $63,401 & 13.7\% \\
1963 & 5,992 & (0.9\%) & $107,559 & 14.1\% \\
1965 & 6,071 & 0.7\% & $129,442 & 9.7\% \\
\hline
\end{tabular}
\end{table}

\textit{Source: Savings and Loan Fact Book, 1966, 92-4.}

Table 7.1: Number of Thrifts and Assets - 1959 to 1965

By 1965, S&Ls controlled 26 percent of consumer savings and provided 46 percent of all single-family home loans—tremendous gains over the comparable figures of 7 percent and 23 percent, respectively, for 1945. The financial condition of the industry also was strong, as operating income and net income in 1965 of $7.1 billion and $5.3 billion, respectively, were both records. By comparison, these same figures in 1955 were $1.7 billion and $1.2 billion, while in 1950 they were only one-tenth the 1965 level. Although the net margin for the industry declined, it was not because of a drop in operating efficiency, but rather from increased spending for advertising and office expansion. Operating efficiency, in fact, improved significantly, as the increased use of office automation caused the average number of thrift employees per $1 million in assets to fall from 1.44 people in 1945 to .62 people by 1965.24

The rapid industry expansion, combined with the slower formation of new thrifts, meant that the average S&L in 1965 was significantly larger than the same thrift had been just ten years earlier. From having less than $6 million in assets in 1955, the average thrift in 1965 had nearly $21 million in assets, a change the League attributed in part to the industry's continued effort to provide better customer service than competitors. Thrifts were among the first financial institutions to incorporate drive-up teller windows and locate branches in suburban developments closer to their customers.

By 1965, 22 percent of all associations had at least one branch, and the total for the industry exceeded 2,500. Branching, however, had a number of potential problems, and League groups like the Savings Institutions Marketing Society provided advice on how best to locate branch offices and market their services. Finally, the League continued to attract new members, and by 1965 its membership roles topped 5,000.25

A less positive trend, however, was the slow but steady decline in the industry reserve ratio, which averaged just 6.7 percent by 1965, a level far below the 11.5 percent average for commercial banks. The main reason for the disparity was the continued emphasis by thrifts on paying high dividends, which was reflected in the decline in the average share of net income to reserves from 30 percent in 1955 to 16 percent by 1965. While the majority of all thrifts maintained reserves well above regulatory minimums, regulators were still very concerned with the slow pace of reserve growth, especially since the level of real estate owned for the industry soared from $60 million to more than $1 billion over the same ten-year period. Because reserves were the only financial cushion thrifts had to absorb these losses, serious problems would result if these trends continued.26


A second adverse development during this period was the tax status of the industry. Although S&Ls had become subject to federal taxes in 1952, few actually paid any taxes because of generous exemptions for associations with low levels of reserves. While League lobbying made certain this favorable treatment did not change, by the early 1960s S&L profits were such that it was virtually impossible to keep this advantage much longer. As a result, when the League lobbied against a provision in the Revenue Act of 1962 that made thrifts subject to “full taxation,” President John F. Kennedy threatened to “blast against savings and loans ‘such as he gave steel’” if they caused the tax bill to be defeated. Although the League acquiesced, and accepted changes that required most S&Ls to pay taxes on 50 percent of their earnings, they did prevent enactment of the “full taxation” language originally considered by legislators.\footnote{League lobbying was exceptionally well organized, and during the 1962 tax debate two Congressmen reported receiving 120,000 letters from constituents opposing the S&L tax provisions. USS&LL Memorandum to Members with attachments, 2 February 1962 and 13 February 1962; Taxes, Mutual, January - June 1962; McMurray Papers; RG 195; NACP; “Savings and Loan Taxation” S\textit{LN} 79 (March, 1958), 27-32; Norman Strunk, “Our Present Tax Status: Why it is Right for Us,” \textit{S\textit{LN}} 80 (June, 1959), 25-30; W. O. DuVall, “Taxation” \textit{S\textit{LN}} 83 (October, 1962), 22-7; Wright Patman “A Banker’s Bonus Bill,” \textit{S\textit{LN}} 82 (November, 1961), 35-40; “ABA Set for New Attack on Association Tax Law,” \textit{S\textit{LN}} 82 (November, 1961), 10; “S-L Men Rip JFK Tax Bill,” \textit{Los Angeles Herald-Examiner}, 10 May 1962, 9; \textit{Confidential Memorandum}, undated, quote 1; \textit{Membership Bulletin}, M303, 23 February 1962, 1; “Tax Post-Mortem,” \textit{Savings and Loan Annals} 1962, (Chicago: United States Savings and Loan League, 1962), 66-8; “A Tax Crackdown on S&L Companies,” \textit{US News and World Report}, 28 January 1963, 44.}

\textit{The Industry Shows Signs of Division}

Another dominant trend of the late 1950s and early 1960s was increased tension and fragmentation within the thrift industry. Divisions mounted between thrift leaders in the East and Midwest, and those in the Southwest and West. While nearly every S&L prospered in the 1950s and 1960s, those in the West and Southwest were especially successful, due to the tremendous postwar population growth in these areas. During
World War II, millions moved to California in pursuit of defense industry jobs, and in the postwar period this migration continued. By 1960, the state’s population was 125 percent higher than in 1940. In contrast, states like New York, Ohio, and Pennsylvania experienced more modest population gains ranging between 20 and 40 percent. Such changes had a broad effect on shifting the balance of economic power from the industrial North to the West and Southwest.  

This shift in population allowed some S&Ls, especially in California, to become very large, while thrifts in the rest of the country remained much smaller. In 1965, nearly 600 S&Ls had more than $50 million in assets, while at the other end of the spectrum 2,700 associations had fewer than $5 million in assets, of which 1,032 had less than $1 million. Furthermore, the one hundred largest S&Ls controlled 26 percent of total industry assets, and many of these thrifts, including three that held $4.7 billion in assets each, were in California. Leaders of the smaller S&Ls, many of who were also top League officials, began criticizing the business practices of large association managers, giving them the derogatory nickname “the high rate boys.” Similarly, because these aggressive lenders often disagreed with the national leaders, it was common for groups like the large-S&L-dominated California Savings and Loan League to take policy positions that were opposite those of the League. Furthermore, since these same thrifts wielded tremendous political influence in Congress it was impossible for the Board to ignore their demands. Their power was such that when the Los Angeles-based Council of Savings and Loan Financial Corporations wanted to meet with President Lyndon B. 

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28 Historical Statistics of the United States, 56-60.
Johnson to discuss thrift legislation, a White House staffer admitted “I’m afraid of this group.”

A second major source of internal industry tensions lay in splits between mutually-owned thrifts and those that issued stock to the public. Although most S&Ls in the mid-1960s were owned by their members, a handful of associations were controlled by stockholders. This type of ownership first appeared in 1909 when the California legislature required all thrift organizers and managers to own guaranteed stock in their associations as part of a permanent guarantee fund. This law was designed to give members assurance that thrifts would meet their required dividend payments, since the permanent capital fund would be used to make the payments if regular income was insufficient to meet the needs. If this occurred, the stockholders had to replenish this fund with their own money. Conversely, if income exceeded dividends, the stockholders were allowed to reap the benefits. This arrangement gave management an incentive to stay with their association and operate it efficiently. Despite these advantages, only a handful of other states, including Texas and Ohio, followed the example of California.

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This situation changed after World War II when industry leaders in most of the fast-growing states petitioned their regulators to let them issue stock, and by 1967 twenty-three states allowed state-chartered S&Ls to sell stock to the public. While only 12 percent of all thrifts were stock associations, they controlled more than 20 percent of total industry resources, and in California publicly-held S&Ls accounted for more than 60 percent of thrift assets. A development related to the rise of stock-S&Ls was the formation of holding companies that owned a thrift, but issued stock in the name of an umbrella organization. The New York investment-banking firm Lehman Brothers organized the first thrift holding company, Great Western Financial Corporation, in 1955. Within five years it controlled more than twenty different S&Ls, as well as land development companies and an insurance agency. By 1966, ninety-eight holding companies controlled 134 thrifts with more than $16 billion in assets, or one-eighth of the industry total.31

The wisdom of thrifts issuing stock and forming holding companies was hotly debated within the industry. Supporters claimed that selling stock allowed thrifts to better fund loan demand, and provided a permanent source of capital that limited the liability of the FSLIC since it represented an additional reserve. Similarly, since the managers of these S&Ls were often also the owners, they had a vested interest in making

sure the thrift was sound financially. Opponents charged that stock associations limited ownership opportunities and raised conflict of interest problems, especially if a holding company owned non-regulated businesses. Also, since the members did not control these thrifts, local lending needs might suffer. Regulators also suspected, but could not prove, that closely-held stock associations pursued risky business simply to maximize profits for investors without regard to the federal insurance fund.26

Because of these concerns, federal regulators, supported by the League, began in 1956 to seek legislation restricting the activities of savings and loan holding companies. When Congress finally took up the issue in 1959, testimony from thrift leaders reflected the high level of division within the industry. The League wanted the law to help protect the reputation of mutual S&Ls, while holding company leaders, all of whom were from California, opposed it because there was "no evidence that anyone has been hurt." The Savings and Loan Holding Company Act, whose most important provision limited holding companies from owning no more than one thrift, did pass in 1960, but legislators considered it a stop-gap measure to allow for further study of the issue. The law was not strengthened for years, however, even though more than half of all its regulatory problems involved thrift holding companies.27

26Draft memorandum to members of the Federal Savings and Loan Advisory Committee with attachment, 9 March 1955, 1-2; FS&LA, Conversions, 1954; McAllister Papers; RG 195; NACP; Letter from Wm. Mosely to Walter W. McAllister, 1 February 1956, 1-4; FS&LA, Conversions, 1955, October-December; McAllister Papers; RG 195; NACP; Memorandum from A. D. Theobald to Joseph P. McMurray, December 1961; FS&LA Conversions, 1961-; McMurray Papers; RG 195; NACP; Letter from J. Ralph Stone to John E. Horne, 28 December 1967; United States Savings and Loan League (hereafter USS&LL), General; Horne Papers; RG 195; NACP.

27Letter from Neill Davis to Walter W. McAllister, 3 February 1955; FS&LA Conversions, 1954; McAllister Papers; RG 195; NACP; Letter from Morton Bodfish to Walter W. McAllister, 27 June 1955; FS&LA Conversions, 1955 April - September; McAllister Papers; RG 195; NACP; Letter from A. J.
A Revitalized Regulatory Environment

A related major challenge for the thrift industry was the end to the passive regulatory policies of the 1950s. When Albert Robertson resigned as Board chairman in 1961, President Kennedy named former New York City housing commissioner and past consultant to the Senate Banking Committee, James P. McMurray, to replace him. A stocky and energetic individual, McMurray immediately set out to revitalize the Board and reassert its authority over the industry. During his first year in office, he established a division to collect and analyze housing and thrift industry data, hired more home loan bank personnel, and, following the first in-depth organizational study of the agency, created a centralized Division of Examination and Supervision. As one League official later noted, McMurray "was a mover, a doer [and] by all odds the most interesting chairman since John Fahey." ^34

McMurray also formed a twelve-man task force composed of thrift leaders and outside advisors to consult on issues facing the Board. The new chairman thought that

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^34 Gurney Breckenfield, "Joe McMurray of the Home Loan Bank Board," *House and Home* (May, 1962), 47-8; Letter from Joseph P. McMurray to Edward E. Edwards, 17 July 1962; Edwards, Edward E., 1961- ; Murray Papers; RG 195; NACP; McMurray Papers; RG 195; NACP; Letter from Stephen Slipher to Joseph P. McMurray, 17 April 1961; FHLBB Task Force, McMurray Desk File, 1961- ; McMurray Papers; RG 195; NACP; Notes on First Meeting of Task Force, 27-29 May 1961; FHLBB Task Force Meetings, Notes 1961 - ; McMurray Papers; RG 195; NACP; Letter from Joseph P. McMurray to Dante Fascell, 11 March 1962; FHLBB Survey (Booz-Allen Hamilton), 1961- ; McMurray Papers; RG 195; NACP
the Board should be supportive of the industry it oversaw, but also wanted to make sure that it did not engage in practices that would tarnish its image. He described his role as "that of a good old-fashioned Irish policeman who smiles and jokes with the people on his beat, but can be tough with them when he has to." To make certain the industry was aware of this more active government/business relationship, the new chairman issued dozens of new policies that he called "the rules of the game." He was also more than willing to use not-so-subtle threats that went beyond simple moral suasion to make the industry "toe the line." While McMurray received very favorable public reviews, several within the industry grumbled over the changes.35

Although McMurray wrestled with issues long familiar to the Board, such as "give-aways" and brokered deposits, his greatest concern was the trend of rising dividend rates, something that he wanted to end for several reasons. First, if the Board could reduce rate competition it would also solve many of the other problems it faced. Second, when local rate wars did occur, S&Ls across the country typically had to match the higher rates to retain deposits. Finally, higher dividends usually required riskier loans to generate income, which in turn resulted in more defaults. This was especially true in the early 1960s as the level of delinquent loans for the entire industry rose an average of 35


263
percent per year, while in California where rate competition was fierce, the same annual
increase approached 60 percent.36

While McMurray warned California thrifts they would "find a heavy supervisory
hand on their shoulders" if they did not end their "avid" dividend practices, his pleas
produced few changes. As a result, in March 1962 the chairman announced new rules
that would make it harder to pay more on savings by requiring thrifts to set aside reserves
for both scheduled items and their annual increase in savings. In addition, all thrifts had
to contribute to the formation of a new secondary reserve for the FSLIC that would equal
2 percent of total insured savings. Saying he could "no longer wait for moral suasion to
take its course," the announcements shocked the industry, and League leaders told
McMurray that "the business was never more ‘up in arms’ over a regulation." When
these new rules failed to end rate competition, the chairman tightened them by linking
annual reserve contributions to total asset growth, which forced the fastest growing thrifts
to set aside the most in reserve.37

36Regulations, Legislation, and Policy Statements, 1-16; Regulations, Legislation, and Policy
Statements; McMurray Papers; RG 195; NACP, 3-5, 14; "Luring the Investors" Newsweek, 11 April 1960,
104; "Crackdown on Lures for Investors,” US News and World Report, 25 April 1961, 89; W. O. DuVail,
"Intra-Business Competition," SLN 81 (June, 1960), 27-30; Memorandum from John Wyman to Joseph P.
McMurray, 6 July 1961; Advertising, Give Aways, 1961-1962; McMurray Papers; RG 195; NACP; Ed W.
Hiles “Do We Want a Regulatory Dividend Ceiling?” SLN (February, 1957), 32-6; Memorandum from
George W. Murphey to Joseph P McMurray, 12 June 1963; Advertising, Give Aways, 1963; McMurray
Papers; RG 195; NACP; Letter with handwritten comments from Carol Fish to Joseph P. McMurray. 12
December 1963; Brokers, General; McMurray Papers; RG 195; NACP; Savings and Loan Fact Book, 1966,
108; Gladwin Hill, "Loan Warriors to Call Truce and Bury Premiums, The New York Times, 28 May 1961,
sec. 3, 1; “Board Members Discuss Three Major Problems Before U.S. League,” FHLBB Digest 4
(September, 1961), 3-5, 11.

37“Adventurous’ S&Ls Warned by McMurray,” Los Angeles Times, 10 October 1963, quote 15;
Savings and Loan Annals, 1963 (Chicago: United States Savings and Loan League, 1963), 18-22;
“Scrambling Towards a Worthy Goal,” The American Banker, 3 January 1964, 4; Letter from Joseph P.
The second major issue McMurray faced during his tenure was checking the activities of stock associations and holding companies. The Board believed that state regulators were allowing too many state-chartered, but federally-insured, thrifts to convert from mutual to stock ownership, and it suspected that many of these conversions were done simply to enrich management. This was one reason the Board originally had placed a moratorium on the conversion of federal S&Ls in 1955. This position, however, was strongly opposed within the industry, and in 1961 the Board lifted the ban. The number of conversions immediately soared, but unfortunately so did the reports of abuse, especially by insiders who opened large accounts just before a thrift was to issue stock. Because it was clear that not all existing members were receiving equitable treatment in such cases, McMurray reimposed the prohibition on conversions two years later, and this order would stay in place for the ten years.38

In 1965, McMurray retired from the Board, and President Johnson named John E. Horne as the new chairman. Horne was a soft-spoken Alabaman who had been a staffer

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38"Saving and Loan: A Troubled Year," The New York Times, 6 January 1964, 110; "Ceiling on Dividends," Barron's, 6 May 1963, 1; Marvel, The Federal Home Loan Bank Board, 199-208, 243-8; Letter from Walter W. McAllister to Daniel Robinson, 16 June 1955; First Federal Savings & Loan Associations, M-Z; McAllister Papers; RG 195; NACP; Letter from Walter W. McAllister to R. V. Walker, 5 December 1955; FS&LA, Conversions, 1955, October-December; McAllister Papers; RG 195; NACP; Memorandum from W. H. Husband to Len Creighton, 30 March 1962; FS&LA, Conversions, 1961-; McMurray Papers; RG 195; NACP; Memorandum from Rex Baker to Joseph P. McMurray, 31 July 1962; Stock Associations, 1961-; McMurray Papers; RG 195; NACP.
for Senate Banking Committee Chairman John Sparkman (D-AL) from 1947 to 1961 and FHLBB member since 1963. Like McMurray, Horne believed in vigorous oversight to end practices he termed “inimical to the best interests of the industry,” especially of a sudden rise in the number of problem thrifts in the early 1960s. Between 1965 and 1966, two Illinois thrifts and one Arizona S&L failed because of improper management practices, and resolving these problems cost the deposit insurance fund more than $118 million. Furthermore, the growth of supervisory cases during this time was such that the FSLIC estimated it may have to pay out make an additional $425 million to insured account holders over the next two years. These figures were unprecedented in the history of the FSLIC and raised concerns that the fund would be able to meet these needs.\(^{39}\)

To remedy this, Horne pressed Congress to give the Board stronger supervisory powers. Traditionally, if regulators wanted to end improper business practices, they sent management a written reprimand, revoked FSLIC coverage, or seized the association. This limited range of options often meant that regulators were “forced to use a bludgeon when all we want to apply is a restraining hand.” In 1966, Congress passed the Financial Institutions Supervision Act that gave the Board the authority to issue cease-and-desist orders that would force a thrift to change its practices without putting it out of business.

\(^{39}\)Actual FSLIC liabilities for this two year period were considerably less at just over $150 million. Marvell, *The Federal Home Loan Bank Board*, 270-1; through Edward Cowan, “Election by Bank Watched Closely,” *The New York Times*, 7 March 1964, 27; “Savings-Loan Men Relieved as McMurray Prepares to Resign HLB Post,” *The Wall Street Journal*, 14 September 1964, 16; Letter from Thomas T. Timons to Walter Purmort with attachment, 9 January 1968, quote; Advertising, Out of State; Correspondence of Chairman John E. Horne, 1965-1968 (Horne Papers); RG 195; NACP; Memorandum from Robert P. Perrin to John E. Horne, 4 April 1968; Coordinating Committee Meeting, 7 May 1968; Horne Papers; RG 195; NACP; “Hounding the S&Ls’ Own Watchdog,” *Business Week*, 20 August 1966, 51-3; Memorandum from Jery D. Worthy to Board Members, 25 August 1965; FSLIC, Debentures, General; Horne Papers; RG 195; NACP; Memorandum from Kenneth Scott to Board Members, 8 May 1967, 1-34; Federal Home Loan Bank Board, Plans and Objectives; Horne Papers; RG 195; NACP;
These orders could be used against any “unsafe and unsound practices,” whose definition was kept purposely vague so regulators had some latitude to apply this new tool. They could also issue a permanent injunction, which often required a court hearing to become effective, or the temporary order, which took effect immediately but also required greater evidence of wrongdoing.\footnote{Letter from Morris D. Crawford to Joseph P. McMurray, 12 June 1961; FS&LA, Conservators and Receivers, 1961-1963; McMurray Papers; RG 195; NACP; Memorandum from John Wyman to Kenneth Scott, 14 February 1964, Memorandum from Joseph P. McMurray to Kenneth Scott, 14 February 1964, and Memorandum from Thomas H. Creighton to Board members, 30 April 1964; FS&LA, Conservators and Receivers, January-August 1964; McMurray Papers; RG 195; NACP; Edward Cowan, “U.S. Seeks to Aid Saving Concerns,” The New York Times, 21 January 1963, 13; H. Erich Heinemann, “Dispute Boiling in Thrift Field,” The New York Times, 14 November 1965, Sec. 3, 1, 9 quote 9; John E. Horne, “Chairman’s Address,” Savings and Loan Annals, 1965, 30-1; John E. Horne, “Federal Savings Bank Bill,” Vital Speeches of the Day 32 (1965-66), 364-5; Memorandum from John E. Horne to Marvin Watson with attachment, 17 September 1966, memorandum from John E. Horne to Mr. Jacobson with attachment, 5 October 1966, and letter from John E. Horne to Marvin Watson with attachment, 3 November 1967; LE/FI 2, February 22, 1966 - ; WHCF LE/FI 2; LB IPL. Letter from John Horne, et al to the Speaker of the House, 29 March 1966; Federal Home Loan Bank Board; Wright Patman Papers; LBJPL; Marvel, The Federal Home Loan Bank Board, 32-4.}

Creating Rate Controls

The most significant development in the period 1955 to 1966 was the imposition on the thrift industry of the same type of interest rate controls that the banking industry had operated under for more than thirty years. When Congress passed the Banking Act of 1933, federal regulators got the authority to regulate the interest rates that commercial banks could pay on most types of deposits, including a complete prohibition on the payment of interest on demand deposits like checking accounts. While these rules, which were codified under Regulation Q, had helped restore stability to the banking system during the Great Depression, they also gave thrifts a major competitive advantage, since S&L managers had much greater freedom to determine their own rates. Despite
warnings from the Board and the League not to use this advantage to lure deposits, several short but fierce rate wars erupted in 1954, 1957, 1959 and 1962.41

By the early 1960s, banker complaints over the unfair restrictions they faced under Regulation Q reached the sympathetic ear of Comptroller of the Currency Saxon. He wanted banks to be more competitive in the marketplace, and he was willing to encourage the Federal Reserve to raise Regulation Q ceilings. Beginning in 1961, the Federal Reserve changed Regulation Q several times. By 1965, the difference in thrift and bank interest rates was less than 0.5 percent, a steep drop from the 2 to 3 percent cushion thrifts had enjoyed in the early 1950s. Because thrifts, especially in California, responded with increases of their own, the result was a spiraling pattern of higher rates. Adding fuel to this competition for money was the federal government, which began issuing more debt to finance the growing American involvement in the Vietnam War.42

The rate competition between banks and thrifts escalated sharply in August, 1965, when S&Ls in California and Florida raised dividend rates. Bankers demanded a change


in Regulation Q to match the increase, but Saxon was reluctant to add fuel to this latest rate war. In December, however, the Federal Reserve unexpectedly set Regulation Q at the same level as thrift rates, and for the first time in recent history savings rates for banks and thrifts were at parity. Thrifts responded with another round of increases, and by February 1966 the back-and-forth rate escalation had become so fierce that the leaders of both industries called for a truce. By April, market conditions had stabilized, and in August the Federal Reserve finally lowered rates under Regulation Q to further defuse the conflict. Because the rate war of 1965-1966 was the most serious to date, Congress held hearings in May 1966 to consider extending Regulation Q controls to include S&Ls. Their session ended, however, before any legislation was passed.43

Although McMurray indicated a desire to make thrifts subject to Regulation Q in 1962, the Board never seriously felt that rate controls were a good solution to the problem of competition. The events of early 1966, however, changed Board attitudes; and, in August Horne announced his support for an extension of Regulation Q to the thrift industry because of the adverse effects continued rate wars would have on the national economy. Privately, however, Horne did not think that having rate controls

would accomplish much, since most thrifts would invariably set their rates to equal the
ceiling, thereby making “the maximum rate the minimum.” Despite such misgivings,
Horne thought he had no alternative; and, as he told one League official, “I see headaches
with dividend controls, but presently there are more headaches without it.”

The White House also supported rate controls, and in March 1966, President
Johnson recommended enacting this legislation. After Congress adjourned, however,
Rep. Wright Patman (D-TX) announced he would introduce a bill to permanently roll
back rates on all CDs, a move that would essentially overrule the authority of the Federal
Reserve. The Administration feared this would “cause chaos in the financial markets”
and scrambled to dissuade him, while at the same time working behind the scenes to
convince others not to support the bill. Although there was little support for his measure,
Patman indicated that if it were not considered he would use delaying tactics to prevent
anything from being approved during the short summer session. To avoid a public and
embarrassing clash with this loyal friend of the President, the White House reached a
compromise with Patman that limited the term of the rate control bill to one year, and
give regulators more time to lower CD rates to levels acceptable to the congressman.

44"Rate War Joined by U.S. Agencies,” The New York Times, 29 June 1966, 61; Eileen Shanahan,
“Lawmakers Map Savings-Unit Aid,” The New York Times, 5 June 1966, 1; Letter from Thomas T.
Timmons to William Purmort with attachment, 9 January 1968; Advertising, Out-of-State; Horne Papers;
RG 195; NACP; Speech by John E. Horne to the Alabama Savings and Loan League, 19 August 1966;
Alabama Savings and Loan League; Horne Papers; RG 195; NACP; Letter from William J. Kerwin to John
E. Horne with attachment, 20 February 1967, quote; Dividends and Certificate of Deposit Controls; Horne
Papers; RG 195; NACP; Memorandum from Arthur Okun to Lyndon B. Johnson, 13 July 1966; EX FG
March 2 1966 to July 6 1967; WHCF Subject File FG 229 EX; LBJPL; Letter from John E. Horne to
Stephen Slipher, 6 September 1966, quote; USS&LL General; Horne Papers; RG 195; NACP.

45"Escalating Interest Rates,” The New York Times, 4 July 1966, 14; Memorandum from Gardner
Ackley to Lyndon B. Johnson, 28 June 1966, 1-3 and memorandum from Joseph Barr to Lyndon B.
Johnson, 12 May 1966, 1-4; FI 2 April 13, 1966 to July 31, 1966; WHCF FI; LBJPL; Memorandum from
Although the League initially objected to the proposed controls, the broad support for the change caused its leaders to find ways to reduce the impact it would have on the industry. While they liked the one-year limit on the bill because it placed the onus on Congress to renew it each year, their main focus was ensuring that thrifts be allowed to pay higher rates than banks. Using the justification that S&Ls deserved a rate advantage given their important role as home financiers, the League succeeded in having Congress insert in the Interest Rate Control Act of 1966 a guarantee that the S&L industry be allowed to pay more on savings than banks. Based on this provision, the Board and the Federal Reserve eventually agreed to set rates that would allow thrifts to pay 0.25 percent more than banks on savings. This rate differential became part of regulatory policy until the 1980s when rate controls were eventually phased out under deregulation.

As the new rate controls took effect, the League became more supportive of their continued existence. By the late 1960s, thrift officials predicted dire consequences to the availability of home financing if Congress refused to renew the law, and their testimony

Larry Levinson to Lyndon B. Johnson, 25 March 1966 and memorandum from Arthur Okun to Lyndon B. Johnson, 26 May 1966; LE/FI 2 February 22, 1966; WHCF LE/FI 2; LBJPL; Memorandum from Joseph Barr to Lyndon B. Johnson, 22 July 1966; EX FG March 2 1966 to July 6 1967; WHCF Subject File FG 229 EX; LBJPL; Memorandum from Joseph Barr to Marvin Watson, 15 August 1966; EX FG August 5, 1966- September 30, 1966; WHCF Subject File FG; LBJPL; Memorandum from Joseph Barr to Marvin Watson, 15 August 1966, memorandum from Henry H. Wilson, Jr. to Lyndon B. Johnson with attachment, 23 August 1966, memorandum and memorandum from Joseph Barr to Marvin Watson with attachment, 1 September 1966; Letter from William J. Kerwin to Wright Patman, 22 July 1966; National League of Insured Savings and Loan Associations; Wright Patman Papers; LBJPL.

was critical each year in securing an extension. Despite the benefits of the rate
differential to the thrift industry, the almost blind support of League for rate controls
proved to be a misplaced. By the 1970s, when Congress considered early legislation to
deregulate financial industries, League officials reacted in a knee-jerk fashion to any
attempt to deny thrifts their historic rate advantage. As a result, this lack of industry
backing to these bills served to postpone deregulation until it virtually became a necessity
in the early 1980s.\textsuperscript{47}

\textit{Conclusions}

Unlike the "glory years" thrifts enjoyed immediately after World War II, the
period from 1956 to 1966 presented a number of potential barriers to the continued
expansion of the thrift industry. One was recession, which slowed new home
construction at times, while a second factor was increased competition from banks,
mortgage companies, and federal housing programs. A more general challenge for the
industry during this period was an active federal regulatory environment that was
unwilling to give the industry the same degree of \textit{carte blanche} it enjoyed in the past.
Despite these challenges, the thrift industry managed to record phenomenal growth: by
1965 S&Ls commanded more than $125 billion in assets and made nearly half of all
residential mortgages in the country.

While this expansion pleased League leaders, it also caused increased tension
within the industry, as managers of the more traditional, smaller mutually-owned thrifts

\textsuperscript{47}Letter from Franklin Hardinge Jr. to Robert L Rand, 25 November 1968 and Letter from Norman
Strunk to Robert L. Rand, 18 December 1968 and memorandum from RLR to Horne and Greenbaum with
attachment, 2 October 1968; Coordinating Committee Meetings; Horne Papers; RG 195; NACP.
clashed with those of the billion-dollar publically-held behemoths in the West. While these divisions were not serious at first, over time they would widen and cause serious problems for the League and the thrift industry. An early example of this growing split came in 1966 when an intense interest rate war, initiated by aggressive thrifts, led Congress to consider extending rate controls under Regulation Q over both commercial banks and S&Ls. The result was the Interest Rate Control Act of 1966; and, although thrifts retained their traditional ability to pay higher savings rates than banks, the passage of this act marked an end to days of easy growth for the thrift industry.
CHAPTER 8

LOST OPPORTUNITIES, 1967-1978

From the inclusion of thrifts under Regulation Q to the onset of deregulation, the business environment for S&Ls grew increasingly more complex. A major reason for this situation was that the economy of the 1970s was very unstable, characterized by slow growth, rising inflation and high interest rates. This condition, called "stagflation," forced thrifts to redesign the traditional mortgage into a more affordable loan product, and also create new savings instruments to attract funds. A second factor was that technological innovations revolutionized finance and dramatically altered the way in which consumers could use their money. While many of these changes benefitted the thrift industry, they also led to greater competition with other financial intermediaries. Finally, the rise of a consumer movement forced lenders to end loan discrimination and be more responsive to the needs of individuals and communities. This development not only led to the passage of several pro-consumer laws, but also gave consumers voices in how S&Ls conducted business. While the thrift industry continued to expand and maintain its dominant role as mortgage providers during these difficult years, such broad changes in the marketplace led the League and government officials to reassess the basic structure of thrift regulation. Nonetheless, conflicts over different issues, both within the
industry and from other interest groups, delayed any substantive action for years. As a result, the industry was ill-prepared to deal with the economic decline that began late in 1979, and as Congress rushed toward deregulation it was clear that the failure to pass reform laws earlier was a critical lost opportunity.

*Contending with Stagflation*

The central challenge facing the thrift industry in the 1970s was responding to a slow-growth economy marked by persistent inflation and rising interest rates. While the economy, as measured by the gross national product (GNP), grew at an annual rate of 3.1 percent between 1969 and 1979, the expansion was very uneven and punctuated by recessions in 1969, 1974-5, and late 1979. The period was also marked by high inflation, as the consumer price index (CPI) rose at an average annual rate of 6.7 percent between 1970 and 1975, and 8.9 percent between 1975 and 1980. In contrast, from 1960 to 1968 GNP had grown at an average annual rate of 4.5 percent while consumer prices had risen by less than 2 percent per year. One important effect of these conditions was that it was difficult for government and business leaders to make long-term financial plans.₁

A central reason that the 1970s economy was so unsettled was that for the first time since the end of World War II energy costs in America rose significantly. Between 1951 and 1970, the country had enjoyed low and stable energy costs, as the average price of imported crude oil stayed between $2.66 and $3.00 per barrel. Prices, however, surged dramatically in October 1973 when the Oil Producing Exporting Countries (OPEC)

declared an embargo of America for supporting Israel in the Yom Kippur War. Because America relied on OPEC for more than 60 percent of its oil, the subsequent tripling of oil prices caused inflation and helped create a sharp two-year recession. Oil prices remained high through the 1970s, which limited overall economic growth and caused inflation to remain a major problem. Such unusual conditions led economists to coin the term “stagflation” to describe them.\textsuperscript{2}

The problem of inflation was exacerbated by rising interest rates, caused in part by increased federal deficits. Between 1963 and 1969, federal spending soared, and since revenues did not keep pace, the government had to sell more debt. The result was that in the last three years of the decade, short-term interest rates more than doubled, which also had a major effect on consumer debt rates. Long-term mortgage rates, which had averaged 5 percent in the mid-1960s, rose to 8.5 percent by 1970 and then to 11 percent by 1978. This adverse change, combined with a near tripling of the average price of a home during the decade, meant that it was very difficult for borrowers to qualify for a conventional fixed-rate mortgage. In response to these problems, home lenders devised products collectively referred to as alternative mortgage instruments (AMIs) to improve the ability of home buyers to get a mortgage.\textsuperscript{3}


One way that AMIs tried to lower the barrier to home ownership was by reducing the initial monthly mortgage payments, and the two main products that used this approach were the flexible mortgage and the graduated-payment mortgage. Under the flexible mortgage, borrowers made interest-only payments for up to five years with full principal and interest for the remaining term. The graduated-payment mortgage used a tiered payment structure that required only partial principal and interest payments during the early years of the loan, with the payment amount increasing on set dates to allow for full amortization. While both these plans helped lower the initial monthly payments, there were drawbacks to these plans. Using a flexible mortgage prevented the early accumulation of borrower equity in the property, while the graduated-payment mortgage resulted in negative amortization in which the loan balance initially increased in size. Lenders, however, justified these risks, claiming that borrowers would "grow" into the loan as their income increased.  

A second way AMIs tried to help consumers lay in provisions to protect the borrower and/or the lender from changes in interest rates. One such AMI, the rollover mortgage, did not have a fixed interest rate, but rather allowed the rate to be renegotiated at set intervals of three, five or seven years. A similar plan was the step-rate mortgage, which had an initial below-market interest rate that increased during the life of the loan.

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by preset amounts; the loan payment was also recalculated at each change date to ensure full amortization. Finally, variable-rate mortgages mitigated interest rate risk by tying the loan rate to a broader rate index, like that of the six-month Treasury bill; and, as the index changed, the loan rate and monthly payment changed accordingly. The main problem with all these plans was that it was difficult to protect both the borrower and lender, since consumers faced “payment shock” if rates increased suddenly, and negative amortization resulted if payments were kept too low. Because of such risks, the Board prohibited the use of variable-rate loans, and only state-chartered California thrifts could make them.\(^5\)

While finding ways to help borrowers qualify for loans during these years of rising rates was one challenge for S&Ls, an equally important problem was attracting deposits. Because thrifts faced rate restrictions under Regulation Q, whenever market rates rose above these controls depositors often moved their money into accounts that earned the higher rates, a process known as disintermediation. While the first instance of disintermediation in 1969 was short-lived, it still caused the thrift industry to post its lowest savings gain in three years. The second case of disintermediation, in 1973, was more severe: lasting for nearly a year, savers moved money constantly in response to the precipitous ups and downs of rates, and S&Ls lost and gained billions in funds nearly

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every month. Similarly, a major period of disintermediation in 1979 saw interest rates soar so high that thrifts experienced a 50 percent increase in the rate of withdrawals. Overall, this “yo-yo-ing” of deposits placed a serious strain on cash management, and made difficult any type of long-term planning.\(^6\)

To counteract disintermediation, thrifts pushed regulators to let them offer accounts that could compete with investments earning market rates. The first of these was the $1,000 four-year certificate of deposit (CD), which was free of any Regulation Q controls. Appearing in April 1973, these “wild card” CDs caused fierce rate wars between thrifts and banks, and ultimately cost S&Ls more than $1.2 trillion in savings; by October, Congress essentially banned their use. In June 1974, regulators approved another market-rate CD that could mature in as little as thirty days, but which also required a minimum $100,000 investment, which limited their use to high net worth investors. The most effective savings innovation, however, was the money market certificate, or MMC, introduced in 1977. Because the interest rate on the MMC was indexed to the six-month Treasury bill, there was little risk of rate wars, and the smaller $10,000 minimum investment made these products accessible to broader groups of savers.\(^7\)

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Although MMCs were extremely popular and reduced the risk of rate wars, many in the thrift industry did not see these and other market-rate accounts as a long term solution for retaining funds. Because these accounts paid rates higher than the limits set by Regulation Q, thrifts faced higher costs, which placed pressure on earnings. Similarly, holders of MMCs and other market-rate accounts were prone to move their funds if they could find higher yields. This was a major concern since by 1978 accounts that paid market rates made up 75 percent of industry savings, while more stable passbook accounts accounted for 25 percent. This was a major change from just twelve years earlier when passbook savings accounts provided 80 percent industry funds.8

Another way thrifts could obtain funds was through the sale of mortgage assets on the secondary market. In addition to the Federal National Mortgage Association (Fannie Mae), thrifts could use the Government National Mortgage Administration (Ginnie Mae), created in 1968, to buy and sell government-insured mortgages. This new market was different because it focused on small investors by trading small denomination mortgage-backed securities called pass-through certificates. Guaranteed by Ginnie Mae, these negotiable instruments were very popular, and by 1979 their market exceeded $24.5

billion. A third way to buy and sell home loans was through the Federal Home Loan Mortgage Corporation (Freddie Mac), formed in 1970. Controlled by the FHLBB, Freddie Mac was the fulfilment of a long-standing League wish because it traded securities backed by conventional mortgages, which improved the liquidity of these by staple S&L assets.

*A Revolution in Financial Technology*

A second factor making the 1970s a more complex environment for thrift operations was the sweeping technological advances occurring in finance. Although S&Ls first began using computers in the 1950s, their large size and high cost limited them to only the most labor-intensive operations like data processing. In the early 1970s, this changed following the perfection of electronic funds transfer (EFT) services, which allowed firms to move money accurately between different accounts and institutions. The ability to track money electronically led to the introduction of a host of new consumer products, including automated teller machines (ATM), automatic bill payments, direct deposit, and point-of-sale terminals. While these innovations created the

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281
possibility of a "paperless" society, their broad acceptance by financial institutions still faced a number of hurdles.\textsuperscript{10}

The main reason many banks and S&Ls were leery of adopting new technologies was that, even though their costs had fallen significantly, they were still more expensive than traditional manual methods. As late as 1977, the cost of processing ATM transactions was eight times the cost for paper checks, which posed a significant barrier to achieving scale economies. Managers were also concerned about the potential for technological obsolescence, security risks, and any adverse public reactions resulting from working with machines instead of human tellers. These fears diminished, however, when terminals became more standardized and reliable, and consumers, especially younger people, realized that using an ATM was more efficient and saved time. The result was that the number of ATM machines skyrocketed from just 1,858 in 1973 to 14,190 by 1979, an average annual increase of more than 110 percent. This growth did not mean that ATMs radically altered financial transactions, as more than 90 percent of all terminals were still located on-premise.\textsuperscript{11}


\textsuperscript{11}"What Ever It is, Electronic Money is Not a Customer Service," \textit{SLN} 94 (April, 1973), 66; "If It's a Good Product, Why Aren't More People Using It?" \textit{SLN} 94 (June, 1973), 62; "No Passbook Savings: Not a Question of Whether, Only How Soon" \textit{SLN} 94 (November, 1973), 57; "Pick a Teller" \textit{SLN} 97 (July, 1976), 50; "TMS: Will It Swing in the Marketplace?" \textit{SLN} 95 (May, 1974), 50-1; Rose, "Checkless Banking," 121-2; "The U.S. Has a Date," 70; Letter from Robert W. Minor to Jack Carter, 13 September 1972; In-House Files, September 1972; In-House Files, October 1972; Congressional Correspondence of Acting Chairman Carl O. Kamp (Kamp Papers); Records of the Federal Home Loan Bank Board, Record Group 195 (RG 195); National Archives, College Park (NACP); Allen H. Lipis, Thomas R. Marschall and Jan Tinker, \textit{Electronic Banking} (New York: John Wiley & Sons, 1985), 8-12; "More Associations Install
The first major S&L EFT system was the Transmatic System (TMS) developed by First Federal Lincoln of Omaha, Nebraska in 1971. Initially, customers accessed TMS by telephone, and they could only use it to authorize direct deposits and mortgage payments. By 1974, however, remote TMS terminals inside local supermarkets could be used for check authorization, deposits, withdrawals, and bill payments. Also, by using a plastic debit card issued by the thrift, customers could buy goods from select merchants, a service that made TMS a direct point-of-sale system and that turned the traditional savings account into a quasi-checking account. In the first six weeks of operation TMS generated more than $600,000 in new deposits, and this favorable acceptance caused other thrifts in Ohio, Delaware, and Washington to develop their own EFT systems. Since many of these operations were unique, the League tried to get S&Ls to adopt one uniform electronic banking card and standard system. Uncharacteristically, the League failed in this effort as most institutions became allied with Visa or MasterCard, whose credit card systems were accepted by merchants nationwide.\(^{12}\)

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More ATMs," *SLN* 103 (February, 1982), 104-5; "ATM Networks Span the Nation," *SLN* 104 (April, 1983), 48-52.

A negative consequence of EFT technology for S&Ls was that it produced new sources of competition. State-chartered banks began using automated transfers to allow customers to move money between their savings and checking accounts, which essentially allowed them to earn interest on demand deposits. Securities firms like Merrill Lynch used EFT systems to create the money market account in 1974. These accounts invested customer savings in low-risk but higher-yield instruments like Treasury securities or commercial paper, and also allowed customers to use the money to write checks, called negotiable orders. Money market accounts were so popular that within five years they controlled more than $34 billion, or 13.5 percent, of total household savings. Finally, in 1972 a Massachusetts savings bank used a loophole in state regulations to create negotiable order of withdrawal (NOW) accounts, which let customers write checks directly from their interest-bearing savings accounts. Like money market accounts, NOW accounts were an immediate success, and within a year savings banks throughout New England offered them.¹³

Despite broad public acceptance, regulators were skeptical about the legality of these new products, many of which they saw as blatant attempts to circumvent regulations. They also questioned whether remote terminals constituted illegal

branching, since they provided the same services as traditional brick-and-mortar facilities. Finally, they wondered what effect the higher cost of maintaining POS services or paying interest on NOW accounts would be on S&L earnings. Such concerns could not overcome the complaints from federally-chartered thrifts in New England that were losing funds to NOW accounts. As a result, in 1973 Congress made it legal for thrifts in states that permitted NOW accounts to have the same option. A year later, Congress formed a commission to make recommendations on how best to direct future EFT growth. Despite such moves, the controversy over products like NOW accounts would ultimately influence the debate over how to modify thrift regulations.

The Rise of Consumer Activism

A third major challenge facing S&Ls by the late 1960s was consumer activism. Beginning in the early 1960s, a consumer rights movement embodied a variety of efforts to make business more responsive to society, addressing issues like product safety. Another concern of these activists was ending financial discrimination against individuals by lenders that made loan decisions based on racist or sexist criteria like job stability, debt history or marital status. (Some lenders even asked female borrowers the type of

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birth control they used, or required them to sign an agreement not to have babies as a precondition for a loan! A second type of financial discrimination attacked by consumer activists was “redlining,” the practice of denying a loan request based on the location of the property. This referred to the use of red ink by lenders to outline neighborhoods, mostly in the inner-city, in which they would not lend.15

One of the obstacles to ending these forms of discrimination, however, was proving that such biased methods were the primary tools used to evaluate borrowers. Since most lending decisions required a wide range of information about the applicant or property, trying to show that one issue like race or sex was used to deny a loan was often impossible. Consequently, consumer rights groups wanted financial institutions to prove they did not discriminate through greater disclosure of lending policies and patterns. Organizations like National People’s Action, a coalition of more than seventy-five civil rights and consumer groups, also demanded that financial institutions open more inner-city offices and create liaison groups with community leaders to monitor lending activity.

While traditional forms of protest like picketing bank offices was the most common way

to gain attention to this cause, another very effective tactic was the threat of savings withdrawals, called "green-lining," to achieve change.\(^6\)

In addition to approaching lenders directly, consumer activists also worked with the FHLBB to secure anti-discrimination regulations. The Board responded with rules making it illegal to deny a loan request based on the age of the property or borrower criteria like an education or criminal record. Regulators, however, refused to meet some demands like having thrifts meet annual quotas for loans to minorities and women, since doing so would interfere with legitimate business issues. Congress did provide thrifts with an incentive to increase minority lending as part of the 1977 Housing and Community Development Act; lenders received tax breaks for making inner-city neighborhood loans, and regulators could take into account this record of activity when considering new facility or merger requests. Other important Congressional actions to end lending bias included the Fair Housing Act of 1968, which banned discrimination based on race, religion, or national origin, and the Equal Credit Opportunity Act of 1974, which extended the ban to include sex.\(^7\)

\(^6\)Donald L. Thomas, "The Banks and Redlining," *Vital Speeches* 44 (April 15, 1978), 407-10; Michael Massing, "Breaking the Bank," *Saturday Review*, 15 September 1979, 21-8; *Redlining: A Critical Review*, 2-10; "What to Expect From a CRA Protest" *SLN* 100 (April, 1979), 62-4; "Confrontation in Communities" *SLN* 95 (June, 1974), 40; "What to Expect From Community Groups" *SLN* 100 (May, 1979), 64-6.

Finally, consumer groups lobbied for laws to increase financial disclosure requirements, and in 1968 Congress passed the Truth-in-Lending Act, which the Board codified as Regulation Z. This law revolutionized consumer credit by requiring lenders to disclose an itemization of amount financed, details on total finance charges, the annual percentage rate, payment schedule, as well as prepayment and late payment policies. This law was followed by the Real Estate Settlement Procedures Act in 1974, which forced lenders to make available more information about a property, as well as give borrowers a chance to cancel a loan through the right of rescission. While lenders questioned whether or not these rules actually helped or confused borrowers, they did not strongly oppose these new rules. Their protests grew as each new rule produced more and more compliance forms and paperwork.

The League was sympathetic to most of the issues raised by consumer groups, but it also defended some allegedly biased practices as being appropriate ways to measure risk. One of these was the use of real estate appraisal data on neighborhoods, which

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S&L Industry,” American Banker, 16 September 1970, 8; “Spurring S&L Loans for the Inner City,” Business Week, 25 April 1977, 86-7; Memorandum from Orin Kramer to Stu Eisenstat, 22 June 1977; Banking Reform - Banking (General); DPS Subject Files, 1976-1981; JCPL.

18 Memorandum from Arthur Okun to Joseph Califano, 25 October 1967; EX FI 5, October 24 1967 to 31 January 1968; WHCF Subject Files FI; LBJPL; Barefoot Sanders to Lyndon B. Johnson, 6 March 1968; EX FI 5 1 February 1968 to 30 June 1968; WHCF Subject Files FI; LBJPL; Memorandum from Joseph Barr to Lyndon B. Johnson, 7 January 1968 and memorandum from Don Furtado to Matt Nimetz with attachment, 24 May 1968; LE/FI 5 January 1, 1968 to May 24, 1968; WHCF LE/FI 5; LBJPL; Letter from Ralph Nader to Jimmy Carter, 4 March 1977; Federal Home Loan Bank Board, 1/3/77-3/17/77; Landon Butler Files, 1977-1981; JCPL; “The Sticky Lessons of Settlement Standards,” SLN, 96 (November, 1975), 40; “CRA Exams: A Regulatory Can of Worms” SLN 100 (June, 1979), 38; “Redlining ‘Red Herring’: Community Groups Snipe at Initial Loan Disclosure” SLN 97 (November, 1976), 14; Letter from Steve Slipher to William A. Barrett, 14 March 1972; United States Savings and Loan League Legislative Program and Correspondence; Wright Patman Papers; LBJPL.
activists claimed lenders used to “redline.” The League countered that this information was needed to determine if neighborhood values were stable or changing, a key consideration for any secured lender. They also used government statistics to show that minority home ownership was rising, and that thrifts were the leading source of mortgages to these borrowers. Furthermore, they contended that they could serve minority applicants better if the Federal Housing Administration and the Veteran’s Administration would accept more inner-city loans for mortgage insurance. Despite such arguments, the negative publicity associated with consumer group protests led most S&Ls to work with these activists, primarily by forming mortgage review boards, opening more neighborhood offices, and hiring minority loan officers.¹⁹

Such efforts to satisfy consumer concerns did not, however, mean that lending discrimination had ended. One problem that was extremely difficult to change was the perception held by lenders that minorities and the poor were unsuitable credit risks. One thrift officer maintained that one reason these people did not use bank credit was because “financial institutions are imposing. They frighten lower income people.” Demands to become more supportive and encouraging of low-income borrowers caused another

officer to lament, “should our communication tell them how they can get a loan, or should it go further - encourage the initiative to rehabilitate? . . . Maybe they’ve never thought to take down the rusted gutter and put up a new one for the $300 they might blow on a wild Saturday night? Should a lending institution go that far?” Such comments, which were in stark contrast to the spirit of uplift that permeated the thrift movement in the early 1900s, meant that the issues separating financial industries and consumer groups would remain problems for years.20

The League Struggles to Adapt

Just as individual thrifts wrestled with the business challenges of the 1970s, the League faced its own problems in charting a future course. Because the increased complexity of consumer finance had blurred the traditional distinctions between financial industries, the League thought that it was necessary to redefine the S&L image. Since emphasizing the traditional role of thrifts as specialized home lenders could potentially limit industry expansion, while expanding thrift powers to gain parity with other institutions would likely lead to greater confusion, the League decided that thrifts should position themselves as “family financial service centers” focused on meeting all personal finance and investment needs. The intent was to make thrifts less specialized institutions, and the League hoped that this approach would justify receiving broader lending and savings powers, while at the same time retaining benefits like the Regulation Q rate

20Massing, “Breaking the Bank,” 22, 24; “What to Expect From Community Groups” SLN 100 (May, 1979), quotes 65; “Coping with Confrontation: A Case History” SLN 95 (June, 1974), 51; “Urban Revitalization Programs Provide Lending Opportunities” SLN 100 (December, 1979), 62-8.
differential. To help instill this more comprehensive consumer identity within its membership, in early 1974 the League changed its name to The United States League of Savings Associations, the third name change in its history.\textsuperscript{21}

The League worked with legislators to gain new powers needed to implement this "family financial service center" concept, and Congress responded favorably, passing several bills that benefitted the thrift industry. The Housing and Urban Development Act of 1968 let thrifts finance mobile homes and improvements for any type of real estate, issue debentures, and offer services like preauthorized bill payments. In 1974, the Housing and Community Development Act gave S&Ls the right to make lines of credit to builders, and the authority to invest 5 percent of assets in loans "a thrift might otherwise not make," like unsecured lending. Finally, federal S&Ls received permission to make consumer loans in states where state-chartered thrifts had that right.\textsuperscript{22}

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Another gain for the League was the expanded use of unregulated service corporations. The industry first obtained the right to invest up to 1 percent of assets in service corporations in 1964, which were primarily used by thrifts to manage nonfinancial operations like data processing. In the early 1970s, the industry had broadened the use of service corporations, so that by the end of the decade they were used to issue long-term debt, make direct consumer loans, broker mortgages, sell insurance and operate land development companies. The use of these firms by smaller S&Ls received a boost after 1970 when the Board allowed these thrifts to pool their resources and invest in one service corporation used by all the owners. While service corporations were often a valuable source of profits for some S&Ls, their continued expansion into areas further afield from home finance would become an important issue in the era of deregulation.  

While the League achieved some success in expanding thrift lending powers, in other areas, like the use of NOW accounts, it was far less effective. Even though these products were very popular with consumers, the trade group proved unable to take a

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Want In” SLN 94 (May, 1973), 36-8; “Bomar Presses Need for Consumer Lending” SLN 94 (October, 1974), 24; Norman Strunk, “Know Your Competition” SLN 98 (May, 1977), 46; “Consumer Credit: What You Should Know Before You Take the Plunge” SLN 98 (August, 1977), 60; Letter from Kenneth G. Heisler to Wright Patman, 3 July 1968; National League of Insured Savings Associations; Wright Patman Papers; LBPL; Letter from Norman Strunk to Wright Patman, 4 June 1968 and letter from Raleigh W. Creed to Richard E. Ehlis, 25 September 1968; United States Savings and Loan League Correspondence; Wright Patman Papers; LBPL.

definitive position on their use. Finally, in 1976, after three years of being neutral on the use of NOW accounts, the League came out in favor of nationwide use of NOW accounts. The following year, however, it reversed itself after Congress indicated it would end the Regulation Q rate differential as a condition of approval, and for the next two years it went back and forth on the issue. A key reason for this indecision was that thrifts were very divided on NOW accounts: large S&Ls wanted them, but smaller associations did not. When the League first favored NOW accounts in 1976, the presidency was held by the leader of a $1 billion thrift, while the year it opposed their use the president was from a $100 million association. Such changes reflected the deepening divisions within the industry that had first appeared in the late 1950s.24

Regulators in Limbo

The Board, like the League, had some trouble setting its agenda for the 1970s, in part because there were six different chairman between 1968 and 1979. The first chairman of this period was Robert L. Rand, who assumed the position in 1968 following the departure of John E. Horne. After Richard Nixon won the presidential election that year, several large California S&L leaders who had contributed heavily to his campaign wanted Nixon to appoint someone more amenable to their interests. The new president

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complied, and in 1969 named former California State S&L Commissioner Preston Martin as Board chairman. During his two years as the chief thrift regulator in California, Martin had relaxed many thrift regulations, and as Board chairman he ushered in a new period of pro-industry rule making.\(^5\)

Only 48 years old, Martin was determined to ease the pattern of close scrutiny established by Joseph McMurray and Horne, and his actions helped make him one of the most important regulators of the decade. His working motto of “another week, another rule” meant that regulations were constantly revised, with many of these changes favoring the industry. Among his initiatives were easing the rules governing S&L mergers in 1969, which sparked a wave of thrift combinations that lasted through the mid-1970s, increasing the authority to lend statewide, pushing for the creation of the FHLMC, and allowing virtually any S&L to open an unregulated service corporation without prior Board approval. Although he disliked NOW accounts, advising thrifts to “move slowly” in this area, he also felt that if states continued to let savings banks offer the product then thrifts should be given a similar right.\(^6\)


\(^6\)“S&Ls Look for Sympathy at the Top,” \textit{Business Week}, 29 March 1969, 72-6; “Administration Spurring S&Ls Lending Style to Boost Lending, Martin Says,” \textit{Los Angeles Times}, 7 May 1970, 13; H. Erich Heinemann, “New Policy Asked for on Housing Funds,” \textit{The New York Times}, 30 April 1969, 61, 67; Press Release, 20 August, 1969; Exchequer Club; Martin Papers; RG 195; NACP; Memorandum to all Member Institutions from Preston Martin, 1 July 1970; Service Corporations; Martin Papers; RG 195; NACP; Memorandum from Preston Martin to Art Leibold, 27 August 1970; Statewide Lending; Martin Papers; RG 195; NACP; Letter from Alexander Mintz to Preston Martin, 17 September 1970 with handwritten comments, and letter from Alexander Mintz to Preston Martin, 7 September 1971 with handwritten comments; Mintz; Alexander; Martin Papers; RG 195; NACP; Memorandum from Preston Martin to the Board, 2 November 1972; In-House Files, October 1972; Kamp Papers; RG 195; NACP; Letter from Preston Martin to Spiro Agnew, 7 March 1970; Legislation; Martin Papers; RG 195; NACP;
While many thrift leaders liked "Pres" Martin, other financial leaders were less enthusiastic about the chairman's work. One former Federal Reserve Board member grumbled that "Martin was less a regulator than an industry cheerleader." There were also concerns within the FHLBB that some of his plans could hurt the financial health of the industry and at the same time increase the risk to the federal deposit insurance fund. As one Board official noted with prescient words to his associates, "maybe we should eliminate all regulations and let them compete openly – and realize that the FSLIC may get a heavier future load." Although there was a wide range of opinions on the work of Martin, one important legacy was that his actions helped lay the foundation for many of the regulatory changes contemplated by legislators toward the end of the decade.²⁷

Martin left the Board in 1972, and over the next seven years, four different people held the post of chairman. The first, Carl O. Kamp, a Board member since 1969, was acting chairman from 1972 to 1973, but was never confirmed by the Senate. Thomas Bomar replaced Kamp as chairman and served to 1975, when he was succeeded by Board member Garth Marston as acting chairman. Between 1975 and 1977, the Board only had two members, until President Jimmy Carter named Indiana S&L executive William McKinney as chairman in 1977. McKinney held the job through the end of 1979 when

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Jay Janis, a prominent home builder who also served in Department of Housing and
Urban Development, ended the decade as chairman. While much of this turnover resulted
from changes in the executive branch, the fact that no one individual was Board chairman
for more than three years affected the consistency of regulatory oversight. Furthermore,
because these chairmen spent most of their time responding to crises like
disintermediation, there was little opportunity for them to set long-term strategic plans for
the agency. The result was that in 1979, when plans to deregulate thrifts were gaining
speed, the Board did not play a leading role in the process.

Evaluating the Thrift Industry

Although the problems of stagflation and increased competition produced a
number of concerns for thrift leaders, the industry still managed to post solid asset growth
between 1967 and 1979, as seen in Table 8.1:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. S&amp;L</th>
<th>Chg./Yr</th>
<th>Assets (000,000)</th>
<th>Chg./Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>6,071</td>
<td>---</td>
<td>$129,442</td>
<td>---</td>
</tr>
<tr>
<td>1970</td>
<td>5,669</td>
<td>(1.4%)</td>
<td>$176,183</td>
<td>6.4%</td>
</tr>
<tr>
<td>1974</td>
<td>5,023</td>
<td>(2.9%)</td>
<td>$295,545</td>
<td>13.8%</td>
</tr>
<tr>
<td>1979</td>
<td>4,709</td>
<td>(1.3%)</td>
<td>$579,307</td>
<td>11.8%</td>
</tr>
</tbody>
</table>

Source: *Savings and Loan Fact Book, 1980*, 48-51

Table 8.1: Number of Thrifts and Assets - 1965 to 1979

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28Memorandum from Robert McKinney (?), 14 May 1977, and Consumers Federation of America,
Press Release, 11 May 1977; Federal Home Loan Bank Board President, 2/1/77-11/1/77; Landon Butler

296
The strong growth of the thrift industry during the 1970s is noteworthy first, because it occurred during difficult economic conditions, and second, fewer S&Ls were in operation in 1979 than at the start of the decade. This later trend was important, since it represented the first time since the end of World War II that the number of thrifts had fallen by an appreciable amount. The main reason for the change was the wave of acquisitions of smaller thrifts by large S&Ls that were seeking to expand their markets and achieve economies of scale. Between 1969 and 1975, there were at least 95 thrift mergers annually, peaking at 132 in both 1971 and 1974. A related development was the stunning growth of S&L branches, which increased at an average annual rate of 27 percent. The result was that from 1965 to 1979, the ratio of branches to main offices rose from 1:2 to 3:1; by comparison, in 1955 there had been one branch for every ten offices. These two trends, the growth of new branches and the overall institutional consolidation, produced a nearly sixfold increase in the average size of a thrift to more than $120 million in assets in just fifteen years.29

The growth in the average thrift size, however, was not representative of the entire industry, since nearly 75 percent of all thrifts still had less than $100 million in assets, and fully 56 percent had less than $50 million. At the other end of the spectrum, the largest two hundred associations controlled 41.5 percent of industry assets. Furthermore,

twelve of the fifteen largest thrifts were headquartered in California, including the top five associations, which held a total of $50 billion in assets. This continued widening of the gap between large and small S&Ls ultimately led to the formation of specialized trade groups that focused on issues relevant only to their members. Some large S&Ls, like the $9.2 billion Home Savings of Los Angeles, even maintained their own separate lobbying presence in Washington, D.C. Such developments led William O'Connell, who was the top League official from 1979 to 1989, to say that his biggest task in leading the trade association was finding ways to "keep the business together."\(^{30}\)

Other less positive trends for the thrift industry included declining profitability and net worth. Because rising short-term interest rates produced sharp increases in the cost of funds for most thrifts, the industry net profit margin fell to between 7 and 10 percent, a large drop from the average net margin of around 25 percent recorded during the 1950s. One consequence was that more thrifts relied on cheaper advances from the home loan bank to fund operations, and by 1979 these loans accounted for nearly 10 percent of total industry liabilities, a threefold increase from twenty years earlier. An even more important consequence of the lack of strong income growth was that total capital for the industry continued to fall. Between 1970 and 1977, the ratio of regulatory

capital to total assets dropped 1.3 percentage points to 5.6 percent; by comparison, this ratio for banks fell just 0.9 percentage points to 7.5 percent over the same period.\(^{31}\)

As the industry’s capital “cushion” fell closer to the FHLBB required minimum of 5 percent, a debate developed over just what was considered adequate capital. The League wanted a general reduction in these requirements, arguing that the current rules, which dated back to the 1930s, did not reflect current financial conditions. The League thought that the definition of reserves should be expanded to include items like subordinated debt and deferred income and believed that thrifts should also be allowed to achieve the minimum reserve level in thirty, not twenty-five, years. The League maintained that, if no changes were made, thrifts would not be able to grow, which could hurt the public interest by limiting the availability of mortgages.\(^{32}\)

One solution to the problem of capital adequacy was to find ways to raise new equity, and during the 1970s the thrift industry pressed for permission to issue securities like preferred stock. Because preferred stock possessed characteristics of both debt and equity, the holders of this stock, like general debt holders, did not have voting rights. Furthermore, this type of stock required fixed dividend payments and could be retired over time by setting up a sinking fund for repayment. Similarly, like regular capital...


299
stock, the dividend payments could be deferred if there were a shortfall in profits. Moreover, in the event of a bankruptcy, these investors held a second lien on thrift assets. The main problem with issuing preferred stock was regulatory, since the FHLBB did not consider it to be true equity, and as such thrifts were unable to use this potential source of funds to help meet legal capital requirements.\(^{33}\)

Another proposed solution to the equity problem was to end the ban of conversions from mutual to stock ownership. Regulators, however, did not want to take this step because of the potential for large financial gains for insiders, and higher risk lending to raise earnings, both of which points lay behind their decision to impose a moratorium on conversions in 1963. In the early 1970s, however, observers were questioning the assumed superiority of mutual ownership, and contended that such firms were not efficiently managed and suffered from poor utilization of resources. Such critiques, combined with increased lobbying by leaders of large S&Ls, convinced Board Chairman Martin to reexamine the issue. In 1970, he allowed Citizens Federal of San Francisco, which was managed by one of his longtime friends, to convert to stock

ownership as a test case for lifting the ban. The success of this conversion led to more easing of the rules in 1973, followed by a full repeal in 1975.34

Almost immediately, S&L managers took advantage of this change, and over the next four years the number of stock S&Ls rose by more than 25 percent to 805 thrifts. One common characteristic of these thrifts was that they were all large in size, with a combined $148 billion in assets. The surge in stock conversions did not, however, mean that this form of ownership was necessarily sound, and in two separate studies the General Accounting Office uncovered instances of insider abuse with many conversions. These reports also showed that after conversion the thrifts did make riskier loans, which may explain why the aggregate reserve ratio for these S&Ls declined from 7.9 percent in 1973 to 4.8 percent by 1979. Despite such warnings, stock conversions continued into the 1980s and proved to be a major source of regulatory headaches.35


Lurching Toward Deregulation

Although S&Ls continued to experience strong growth in the 1970s, changes in the marketplace convinced both industry and government officials that the basic regulatory structure of the thrift industry needed to be reassessed. This was not the first time that thrift regulation was examined. In 1961 the Commission on Money and Credit, formed by President John F. Kennedy, had made comprehensive examinations of all major financial industries. Although the Commission produced a number of recommendations on how to improve the thrift industry, there was little effort to codify these findings into new laws, although some modest changes were made to FHLBB regulations.36

After Congress placed thrifts under Regulation Q in 1966, the Board ordered a new study of the thrift industry by Dr. Irwin Friend of the University of Pennsylvania Wharton School of Business. Completed three years later, the Friend Commission report was a massive four-volume academic work that made sweeping recommendations to improve the efficiency and scale economies of the industry. According to the report, thrifts needed more diversified asset bases, and should be allowed to make variable rate

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mortgages and hold up to 10 percent of total assets in non-mortgage products, like consumer loans or select equity investments. To improve their liability mix thrifts should offer savings instruments with different maturities and account terms, and have limited authority to hold demand deposits like checking accounts. Finally, the Friend Commission called for an end to Regulation Q, and recommended that rate controls be used only on a standby basis to alleviate tight money conditions. Despite its broad scope, the report produced little action in part because several of its recommendations mirrored what the League wanted.37

The most influential study was prepared by the President's Commission on Financial Structure and Regulation, more commonly known as the Hunt Commission after its chairman, the industrialist Reed Hunt. Released in 1972, this concise 175-page report reaffirmed the findings of the Friend Commission on how to diversify thrift assets and liabilities, and also expanded upon them by recommending S&Ls be allowed to issue credit cards, hold subordinated debt, and sell mutual funds. The report also proposed that

Congress create a new system of federally-chartered mutual savings banks to complement the system of state-chartered institutions. Finally, the Hunt Commission called for an end to Regulation Q, with the rate controls phased out over a period of two to five years.\(^\text{38}\)

The Hunt Commission Report was controversial on all fronts. The League claimed the changes represented "revolution not evolution" and would essentially destroy the separate identity of the thrift industry, while consumer groups charged that the commission did not go far enough in restructuring the financial systems. The most influential critic, however, was Rep. Wright Patman (D-TX), the powerful chairman of the House Banking Committee. Patman claimed that because the commission worked behind closed doors, its report was not in the public interest; he was also miffed that he was not consulted about the study. As a result, Patman prepared his own separate study, and the subsequent "Patman Paper" proposed far more radical changes for financial industries. These included letting federal thrifts convert to national banks, and creating a National Development Bank to make loans to small business owners during periods of tight money. Such differences of opinion, indicated that writing the Hunt Commission Report into law would be a difficult task.\(^\text{39}\)


Despite this controversy, the Hunt Commission Report became the basis of the Financial Institutions Act of 1973. The bill called for a five and a half year phase-out of Regulation Q, allowed thrifts to offer NOW accounts and invest up to 10 percent of assets in consumer loans. It also offered tax credits on real estate loans as a way to encourage thrifts to remain primarily mortgage lenders. Although this bill gave thrifts important new powers, the League refused to support it because it would end Regulation Q, and this opposition prevented the bill from moving beyond the committee. The second attempt at financial reform was the Financial Institutions Act of 1975, which virtually mirrored the earlier bill; the only substantive change allowed S&Ls to hold up to 30 percent of assets in commercial mortgages and consumer loans. Because it also mandated a five-year phase out of Regulation Q, the League refused to endorse it and although approved by the Senate, the bill quietly died in the House.\(^\text{40}\)

Following the failure of these two bills, a subcommittee of the House Banking Committee chaired by Rep. Ferdinand J. St. Germain (D-RI) looked for a new approach to financial reform. Its report, the *Financial Institutions and the National Economy Study*, or *FINE Study*, sought to create a "homogenized" financial system that would be more competitive, efficient, and better serve consumer interests. While the *FINE Study* made many of the same recommendations as previous studies on financial reform, its most radical proposals were to require thrifts to meet the same reserve requirements as banks, and create a "super-agency" combining all federal bank and thrift regulators into one body to oversee all financial institutions. The League was aghast at the *FINE Study*, especially over the proposals to abolish the FHLBB and to force thrifts to hold the same level of reserves as banks. These and other objections made the *FINE Study* appear to the League to be a report with few redeeming virtues.41

Few of the *FINE Study* proposals, however, made their way into the Financial Reform Act of 1976, which essentially mirrored the two earlier reform bills. There were, however, some concessions to the League's insistence of maintaining rate controls: this bill sought to phase out the rate differential between banks and thrifts over five years, but not for any S&Ls that held 80 percent or more of their assets in mortgage loans. Like all

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306
the previous reform measures, this one died in the committee, and for the remainder of
the 1970s financial reform did not move forward.42

The only significant financial reform measure to win approval during this decade
was the Financial Institutions Interest Rate Control Act of 1978, a relatively minor
measure. This law allowed thrifts to invest up to 5 percent of assets in land development,
construction, and/or education loans. It also raised the insurance coverage for IRA and
Keogh retirement savings accounts from $40,000 to $100,000. One reason for the
ultimate success of this bill to get through Congress was that President Jimmy Carter had
made financial reform a goal of its administration, and although the bill was far less
comprehensive than what he wanted, he supported it in order to get some form of
legislation on the books. A second reason, was that it did not tamper with Regulation Q,
which brought thrift industry support.43

Why Did 1970s Financial Reform Fail?

In many respects, the decade of the 1970s was an ideal time for League leaders
and Congress to come together and create a plan to modernize federal regulations
governing thrifts. The economy of the period proved conclusively that these associations

42House Committee on Banking, Currency and Housing Subcommittee on Financial Institutions
Supervision, Regulation and Insurance Currency and Housing, The Financial Reform Act of 1976,
hearings, 94th Congress, 2nd Session, 4, 9, 11, 16 March 1976, part I, 3-15, 216-26; Robert D. Hershey, Jr.,
“Associations, Banks Clash Over House Draft Plan” SLN 97 (April 1976), 16; “House Subcommittee Gets
SLN 97 (June, 1976), 27.

43Memorandum from Orin Kramer and Stu Eisenstat to Jimmy Carter, 9 November 1978; Banking
Reform - Banking (General); DPS Subject Files; JCPL; “New Legislation: Pulling it all Together”
SLN 100 (February, 1979), 38-42; “Congress Beats the Clock to Enact Giant Financial Bill” SLN 99
(November, 1978), 33; House Committee on Banking, Finance, and Urban Affairs Financial institutions
suffered problems when interest rates became volatile, and several independent studies showed that the system of rules put in place during the Great Depression as in dire need of updating. Despite such positive factors, there were at least three major roadblocks to getting financial reform legislation through Congress. One was the fact that although all the major reports on the S&L industry agreed on the need to diversify assets and liabilities, they had major differences about just which remedies should be pursued. The Patman Paper and FINE Study added to this confusion with recommendations which some saw as too radical.44

A second factor that contributed to the failure of these reform measures was that, despite the difficult economic conditions, S&Ls recorded gains in assets and profits in this period, indicating that perhaps the industry was not in dire trouble. The lack of a true “S&L crisis” in the 1970s is significant because throughout the history of this industry the only major legislation affecting thrifts resulted from specific crises. During the collapse of the “national” B&Ls in the 1890s, nearly every state enacted some form of thrift regulation to protect these institutions and to protect small savers. Federal thrift regulations, although first considered in 1919, did not become law until the 1930s when the Great Depression caused thousands of families to lose their homes. Furthermore,

nearly every other piece of thrift legislation passed Congress at the end of the current session, indicating the difficulty of finding consensus on key issues.\(^{45}\)

Related to this situation was the fact that Congress went through major changes in its membership during the 1970s. Following the Watergate incident, dozens of long-serving legislators either retired or were voted out of office, and this development created problems in the leadership of Congress. Patman, who opposed any efforts to give thrifts any new powers he thought were anti-consumer, was succeeded in 1974 by Rep. Henry Reuss (D-WI) as chairman of the House Banking Committee. In contrast, long-time Senate Banking Committee Chairman Sen. John Sparkman (D-AL), was less active because of his advanced age, and in 1978 was replaced by consumer-supported Sen. William Proxmire (D-WI). While the new chairmen were both experienced legislators, they did not have the same close relationships with the League that both Sparkman and Patman had possessed. This need to establish confidential lines of communications with these critical committees affected the ability to push reform legislation forward.\(^{46}\)

A third critical reason for the dearth of reform in the 1970s was the unwillingness of the League to compromise on the issue of Regulation Q. Although thrift leaders


consistently supported the idea of passing new thrift regulations, they were inflexible about any proposal to change the rate protection they enjoyed under Regulation Q. Even though the League had vehemently opposed rate controls in 1966, by the 1970s the industry had become convinced that without the rate differential thrifts would have trouble retaining funds to make home loans. According to one thrift executive, the only thing needed in order for thrifts to meet their financial role was “long-term extension of Regulation Q with a rate differential. There is no number two because the space between Q and everything else is so great.” Such devotion to this single issue and intransigence ultimately cost the League its one golden opportunity to help create a new system of thrift rules that might have reformed the industry without forcing a loss of its unique identity.47

Finally, even though the League’s formidable lobbying effort was “aggressive without being obnoxious and had one hell of a network,” by the late 1970s it was becoming more disorganized. One reason for this was the 1973 death of League Vice President Stephen Slipher who was known as the “dean of financial lobbyists,” and the 1979 retirement of Norman Strunk who had led the League for more than twenty-five years. A more critical problem, however, was the lack of consensus on reform, since large S&Ls wanted it while smaller associations strongly opposed changes. As one senator later commented, “the S&L industry was conspicuous by its inability to say what it wanted and to stand up and fight for it. In many ways it seems like the AFL-CIO and

the home builders had more to say about what was best for the S&L industry than what the S&Ls themselves did.” This inability for the League to speak with one voice not only reflected the divisions within the industry, but would be a major reason why this trade group would have troubles in the 1980s.48

Conclusions

The thirteen years following the passage of the Interest Rate Control Act of 1966 were among the most turbulent in the postwar history of the thrift industry. S&Ls faced many problems, the chief of which was contending with a slow-growth economy characterized by high interest rates and consumer prices. In response to these complex circumstances, thrift managers came up with several innovations, such as alternative mortgage instruments and NOW accounts. Despite such challenges, S&Ls continued their record of asset growth and profitability during the 1970s even though the size of the industry was shrinking. However, there were also signs of increased financial weaknesses in the industry, since reserves declined throughout the period. These and other changes in financial markets led Congress to consider modernizing the basic thrift laws. Following the preparation of a host of independent studies, Congress considered

several major pieces of reform legislation designed to help S&Ls diversify both their assets and liabilities. None of these measures won enough support from legislators and the League to become law. As a result, only one reform bill, the Financial Institutions Interest Rate Control Act, was enacted. As later events would soon prove, these failures to achieve reform in the 1970s were lost opportunities for the thrift industry.
CHAPTER 9
DEREGULATION AND DISASTER, 1979-1989

The decade of the 1980s was the most difficult and trying decade for savings and loans since the 1930s. The 1980s began poorly when the American economy, which had started to deteriorate in 1979, slid into its most serious recession after World War II. One of the most troubling aspects of the economic downturn was that interest rates had skyrocketed to unprecedented levels. For thrifts, this change caused their costs of funds to rise faster than income, resulting in industry-wide losses and failures. To help S&Ls recover, Congress passed the Depository Institutions Deregulation and Monetary Control Act in 1980, implementing the first substantive changes in thrift regulations since the Great Depression. Although the thrift industry now had additional powers, it still faced financial problems, and to correct them Congress passed the Garn-St. Germain Depository Institutions Act of 1982, which further deregulated the industry. By 1985, thrifts were again profitable as a group, but this improvement was overshadowed by an increase in individual thrift failures. Although regulators responded with several rule changes, insolvencies eventually overwhelmed the resources of the Federal Savings and Loan Insurance Corporation (FSLIC), which had to be recapitalized in 1987.

As the level of negative publicity on the thrift crisis grew, Congress intervened again with the passage of the Financial Institutions Relief, Recovery and Enforcement
Act in 1989. This law re-regulated the thrift industry, and provided a way to close down, or resolve, hundreds of failed thrifts sunk by billions of dollars in nearly worthless loans. The problems of the thrift industry also resulted in dozens of studies examining how and why the S&L debacle had occurred. Despite the turmoil of the 1980s, the thrift industry regrouped and continued to occupy a major role in American finance.¹

*Deregulating the Thrift Industry*

Although government leaders had tried to expand S&L powers for most of the 1970s, the effort to deregulate the industry gained momentum in 1979 when consumer prices began rising sharply. Although inflation had resumed in late 1978, the April 1979 announcement by OPEC to embargo oil shipments to the United States after the Iranian Revolution caused prices to soar. By the end of the year, the consumer price index had risen by a record 13 percent. Because of this increase, Federal Reserve Board Chairman Paul Volker made a major monetary policy change designed to bring prices under control. In August 1979, he announced that the Board would no longer try to control interest rates, but would instead focus on the money supply. Although this action eventually helped curb inflation, in the near term it led to financial turmoil as short-term interest rates rose to a record 15 percent by March 1980. Over the next two years these

¹The S&L crisis of the 1980s is the most thoroughly researched period of the thrift industry. For descriptions of more than 360 books academic studies and federal reports written between 1980 and 1992 on the subject see, Pat L. Talley, *The Savings and Loan Crisis: An Annotated Bibliography* (Westport, CT: Greenwood Press, 1993).
rates fluctuated between 9 and 16 percent, during which time the nation experienced its most severe recession since the end of World War II.2

Although subsequent disintermediation, in which consumers moved from funds from low-yield accounts into market rate investments, and higher funding costs that resulted from the increase in rates were important factors in creating thrift deregulation, a more pressing problem appeared when a U.S. Circuit Court ruled in April 1979 that regulators had exceeded their authority in giving banks the right to use automated electronic funds transfers (EFT) to let customers move money between checking and savings accounts. The decision came in a suit filed by consumer advocate groups in 1978 which claimed that accounts with investment restrictions discriminated against small savers. The court action threatened to end all services, like ATMs, that utilized electronic funds transfer technologies. The court, however, gave Congress until January 1, 1980 to pass laws to authorize the powers outlined in the decision. Because all financial industries used some or all of these very popular services, failure to legalize them would be disastrous.3

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After failing to fix this problem earlier in the year, both the House and Senate tackled the issue later in 1979, but each body approached it from different perspectives. In the House, Banking Committee Chairman Ferdinand J. St. Germain (D-RI) introduced a measure that essentially reinstated the powers covered in the appeals court decision, while Senate Banking Committee Chairman William Proxmire (D-WI) offered a bill that went beyond simply addressing the court decision to allow thrifts to make consumer loans of up to 10 percent of assets, offer NOW accounts, and begin a five-year phase out of Regulation Q.4

Proxmire's bill was not entirely unexpected, and the senator based it in part on the desire of the White House to secure more extensive financial reform. President Jimmy Carter had made deregulation of banking a priority, and the key objective was removing Regulation Q, which he wanted to end more "aggressively" given the rise in interest rates. Because consumer groups, like the Gray Panthers, which represented the elderly, were also demanding relief from these conditions, the Carter Administration used this development as the basis to "reform a system which has become increasingly unfair to the small saver." Proxmire likewise positioned his proposed reforms as a way to end

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“blatant discrimination against savers.” The result was that legislators succeeded in passing a substantive financial reform measure in April 1980.\(^4\)

The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) was the first significant change in financial regulations affecting S&Ls since the 1930s. Among its sweeping provisions was the right for S&Ls to offer charge cards, engage in trust services, operate statewide branches, and hold up to 20 percent of assets in a combination of consumer loans, commercial paper and corporate bonds. The law also ended interest rate ceilings over a six-year period, with the phase-out to be administered by the Depository Institutions Deregulation Committee (DIDC). Other changes included expanded authority to make acquisition development and construction loans, an end to geographic limits on service company operations, and the replacement of the statutory capital requirement of 5 percent with a range of 3 to 6 percent to be set by the FHLBB. The law also gave nationwide authorization for S&Ls to offer NOW accounts.\(^6\)

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Despite the tremendous scope of these changes, thrifts could still not make
variable-rate mortgages, or enforce due-on-sale clauses that required the repayment of
mortgages on existing homes when they were sold. Even though the original Carter
proposal for reform mentioned giving thrifts these rights in order to generate additional
income, it was not part of the final law. Consumer groups portrayed variable-rate
mortgages as “the engine of inflation [in which] lenders can exercise a ‘heads I win tails
you lose’ policy against borrowers by encouraging or discouraging variable rate
mortgages at the appropriate time.” As a result, even though legislators thought that it
was “intellectually indefensible” not to give thrifts this power, the potential political
backlash from consumer activists meant that the Carter Administration had to take the
lead on the issue. The White House, however, refused to do this because it felt that
making financial reform too broad would cost it support; it hoped instead that these
changes would come through subsequent regulations.\footnote{7}
A final provision of the DIDMCA increased the coverage for deposit insurance from $40,000 to $100,000 per account, a change that occurred without major Congressional debate and one that would later come under intense criticism as the S&L crisis deepened. This move, however, was not without precedent, since Congress had made an identical increase for the insurance of IRA and Keogh accounts in 1978. Raising deposit insurance was seen as critical in 1980 because some feared that rising interest rates might cause deposit runs by large account holders and lead to a liquidity crisis. The Carter Administration and FSLIC officials believed the increase was necessary to avert a "crisis of confidence" that could devastate the thrift industry. Consequently, while it was true that the deposit insurance change did benefit thrifts and helped them attract more funds, the increase was based on concerns about the stability of the financial system.

Although DIDMCA promised significant hope for all S&Ls, in the near term the industry suffered, as the national economy sank deep into a recession. Between 1980 and 1981, gross domestic product fell by 3 percent, while unemployment jumped from 7.2 percent to 8.5 percent. Housing starts plummeted in 1981 by more than 40 percent from their 1980 highs, while short-term interest rates soared to 16 percent in May 1981, up from 9 percent just ten months earlier. For the next fourteen months, these rates fluctuated between 11 and 14 percent, until finally falling below 9 percent in July 1982. While the recession technically ended in the third quarter of 1982, unemployment did not

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8 Letter from Anthony M. Frank to Stu Eisenstat, 28 February 1980; FI 5 10/78-1/20/81; WHCF: Subject File - Finance; JCPL; Memorandum from Stu Eisenstat to Jimmy Carter, 29 March 1980, memorandum from Orin Kramer to Stu Eisenstat, 2 April 1980 and memorandum from Orin Kramer to Stu Eisenstat, 14 April 1980; FI 2 2/1/80-1/4/81; WHCF: Subject File – Finance; JCPL.

The effect of persistently high interest rates on the thrift industry was exacerbated by actions to dismantle rate controls. In May 1980, just two months after passage of thrift deregulation legislation, the DIDC eliminated virtually all restrictions on money market certificates (MMCs). Ironically, the DIDC was created at the insistence of the League, which it saw as a way to ensure a smooth transition to market rates. The rapid deregulation of MMCs, which represented more than 40 percent of thrift industry deposits, shocked the League. Thrift officials appealed to the White House for aid, claiming that ending the historic rate differential on these accounts would restrict the availability of mortgage credit. The Carter Administration, which was also surprised by the DIDC action, did not, however, offer support, contending that "thrifts hadn't come to grips with the implications of deregulation."\footnote{Senate Committee on Banking, Housing and Urban Affairs, Depository Institutions Deregulation Committee, hearings to consider the actions of the Depository Institutions Deregulation Committee and S. 2927, 96\textsuperscript{th} Cong., 2\textsuperscript{nd} sess., 5 August 5, 1980, 96-9, 103-5; Memorandum from Orin Kramer to Stu Eisenstat 27 June 1980, quote and memorandum from Stu Eisenstat to Jimm Carter, 25 July 1980; FI 2 2/1/80-1/4/81; WHCF: Subject File - Finance; JCPL; Rom, Public Spirit in the Thrift Tragedy, 142-4; O'Connell, America's Money Trauma: How Washington Blunders Crippled the U.S. Financial System (Winnetka, IL: Conversation Press, 1992), 27-30; "The Thrift Crisis the Result of High Rates and Bungled Deregulation, SLN 103 (April, 1982), 44-5.}

The years 1981 and 1982 were the most difficult ones for the thrift industry since the Great Depression. S&Ls experienced nearly two years of steady disintermediation,
losing billions in savings to market-rate accounts like money-market mutual funds. These uninsured but high-yield, quasi-checking accounts, which had grown in size from $9.5 billion to $76.8 billion between 1978 and 1980, soared to $188.6 billion in 1981 and exceeded $236 billion one year later. Although thrifts did raise their own savings rates, the higher expenses were not matched with additional income, since thrifts lacked authority to make variable-rate loans and could only diversify 20 percent of their portfolios into non-mortgage assets. Furthermore, the economic “state of crisis” meant that thrifts were “not eager to jump into new fields when old-timers were already having trouble earning a profit.” The result was that between June 1980 and June 1982 the thrift industry posted net losses of more than $8.1 billion.\textsuperscript{11}

As the crisis facing S&Ls worsened in late 1981, Congress took further steps to deregulate the industry. Senate Banking Committee Chairman Sen. Jake Garn (R-UT) introduced a sweeping reform package to give both banks and thrifts additional powers and combine the FSLIC and the Federal Deposit Insurance Corporation into one agency. These changes would not only help the thrift industry, but would also advance the new Ronald Reagan Administration’s goal of creating more open financial markets. The House, however, passed a narrower bill in May 1982 written by Banking Committee Chairman St. Germain. This measure would simply shore up the net worth of insured institutions. As the session neared its end, House and Senate conferees worked

feverishly to settle their differences and produced a final bill that closely resembled the Senate version. On October 15, less than one hour before adjourning, Congress passed the Garn-St. Germain Depository Institutions Act of 1982 (Garn-St. Germain).12

Garn-St. Germain completed the process of thrift industry deregulation begun with the DIDMCA. To provide capital assistance to thrifts, the FSLIC was authorized to issue “net worth certificates” to any S&L with positive net worth of less than 3 percent of total assets. The amount they could receive varied with the level of net worth and operating losses, and even though these certificates were actually promissory notes from the FSLIC, thrifts treated them as actual capital investments by the FSLIC. The law also helped the Board assist troubled S&Ls by easing the rules covering thrift mergers and mutual-to-stock conversions. The most significant provisions of Garn-St. Germain expanded thrift asset and liability powers. To help S&Ls diversify their assets and increase their earnings potential, the law eliminated all loan-to-value ratio limits, preempted due-on-sale prohibitions, and allowed federal S&Ls to hold up to 40 percent of their assets in commercial mortgages, up to 30 percent in consumer loans, and up to 10 percent in commercial loans and commercial leases each. The law also required the Board to create a new money-market deposit account to compete with money-market mutual funds. Finally, the law called for an end to Regulation Q by January 1984,

created a new federal charter for savings banks, and allowed federal S&Ls to convert ownership and charter status freely and use the word “bank” in their corporate titles.  

Although both the DIDMCA and Garn-St. Germain gave thrifts important new powers, the circumstances surrounding the passage of these two laws were very different. Unlike the case in 1980, when consumer interests influenced much of the deregulation debate, in 1982 the thrift industry and Reagan Administration officials dominated discussions. One reason for the switch was that thrifts were actually suffering major financial problems in 1981 and early 1982, which helped unify the industry and produce strong grassroots thrift lobbying. Lobbyists in Washington, D.C. were also very effective, convincing legislators to keep the sweeping reforms even as the economic crisis facing the industry began to abate. Board Chairman Richard T. Pratt, a firm believer in the free-market approach of the White House, was also critical in shaping the measure, which some called the “Regulators’ Bill.” As a result, League executive William O’Connell claimed that Garn-St. Germain “wouldn’t have happened without trade group support and wouldn’t have passed without the support of the Reagan Administration.”

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The passage of Garn-St. Germain was not the first time Chairman Pratt made it known that he wanted to remove rules governing S&Ls. Appointed by Reagan in 1981 at the recommendation of fellow Utah resident Jake Garn, Pratt was a physically imposing academic/economist whose two-year tenure on the Board was driven by his conviction that markets, not governments, should determine the success or failure of S&Ls. Like other supporters of deregulation, he fervently believed that it was in the industry's best interest for larger, more efficient firms to swallow smaller inefficient ones and through this consolidation be able to generate higher earnings and become more diversified. Even before coming to the Board, Pratt had made his mark by pushing to end rate controls on MMCs while on the DIDC. As chairman, Pratt tried to weed out the weakest associations in the thrift industry, and between 1980 and 1982 the Board resolved more than 430 thrifts, mostly through mergers with other thrifts using FSLIC financial assistance. Up to then, the Board had resolved only 165 S&Ls in its entire history.15

Pratt focused on relaxing thrift regulations. He authorized the unrestricted use of variable-rate mortgages in May 1981, allowed broader access to brokered deposits, and worked quickly to implement the changes under Garn-St. Germain. One of his many rule changes that had unintended long-term consequences was the elimination of all restrictions on the minimum number of thrift shareholders. Instead of the required 400 individuals, of which at least 125 had to be from the "local community," the new rules

allowed just one person to own all of the stock, and specified that potential buyers could use up to 100 percent financing from the home loan bank to buy the stock, provided they pledged land or other real estate. Some critics charged that this one change was critical because it allowed thrifts to become dominated by influential people who could use S&Ls as private piggy banks.16

_The S&L Mess Begins_

While the financial troubles facing thrifts in 1981 provided the impetus to pass Garn-St. Germain, they also led to a series of regulatory decisions that influenced the course of the S&L crisis. Reeling from record industry losses, dozens of thrifts saw their net worth virtually disappear, and between 1979 and 1982 the tangible net worth to total asset ratio for the industry plummeted well below minimum regulatory standards. By 1982, more than 340 thrifts with $207 billion in assets were technically insolvent. One way regulators tried to address this problem was by reducing thrift capital requirements, and between 1980 and 1982 these rules were lowered from 5 percent of assets to just 3 percent. A second way the Board helped the industry solve its net worth problem was to let S&Ls use new Regulatory Accounting Principles (RAP) to prepare financial statements for regulators.17


Adopted in January 1982, RAP were more liberal than the Generally Accepted Accounting Principles (GAAP) used by most businesses. Under RAP, thrifts could spread the losses resulting from the sale of below-market-rate loans over several years, and boost their net worth by selling “income capital certificates” to the FSLIC. S&Ls could also revalue properties they owned to market value and use this “appraised equity capital” as their net worth. Finally, the new rules encouraged mergers by letting buyers write down low-rate loans to market value and offset the losses against the “goodwill” generated by the merger; “goodwill” was not a financial asset but an intangible asset based on items like the market recognition value for the new merged thrift. Because of these changes, using RAP to calculate net worth produced a capital ratio for all FSLIC-insured thrifts in 1982 of 3.6 percent; if tangible net worth had been used, the ratio would have been only 0.5 percent.¹⁸

While critics charged that the decisions to lower thrift net-worth requirements and RAP papered over the problems within the industry and allowed problem thrifts to grow, these decisions were perhaps inevitable, given the high interest rate environment. Because of rising rates, the value of most fixed-rate mortgages had plummeted; if they were sold, GAAP rules required S&Ls to recognize these losses immediately. As a result, GAAP encouraged thrifts to hold onto these assets in the hope that rates would fall, which would raise their market value. RAP provided an incentive for managers to

restrict their portfolios immediately as a way to improve earnings; and, while it did overstate net worth, the increase was far less than the difference between GAAP net worth and actual market net worth.\(^\text{19}\)

Another important concern for regulators was the deteriorating condition of the FSLIC insurance fund. In its first forty-five years of operations, the FSLIC had liquidated only a handful of thrifts, mostly in the mid-1960s, and had provided financial assistance to 130 mergers at a total cost of $290 million. In just 1980 and 1981, however, the FSLIC liquidated or assisted in the merger of 39 thrifts at a cost of more than $900 million; and the following year it resolved 63 S&Ls at a cost of $800 million. With a total reserve of just more than $6 billion at the start of the 1980s, resolution costs threatened to overwhelm the insurance fund. Consequently, it was not surprising that the Board was eager to forestall FSLIC assistance to troubled S&Ls.\(^\text{20}\)

The return to economic growth caused the thrift industry to show signs that the worst was over. The harsh two-year recession ended during the third quarter of 1982, and between 1983 and 1985 gross national product rose an average 8 percent per year. Short-term interest rates fell from 11.5 percent in mid-1982 to less than 7 percent by the mid-1985. These changes allowed total thrift industry assets to grow by more than 11 percent per year in 1983 and 1984, and produced a near doubling of the net income of


S&Ls to $3.97 billion. The improvements were even more dramatic for S&Ls in Texas, Florida, and California. In these states industry assets rose by an average of 26 percent in 1983 and 29 percent the following year; in Texas, forty S&Ls actually tripled in size between 1982 and 1986.21

A key reason that these thrifts expanded so rapidly lay in changes in state laws that removed virtually all restrictions on lending. In December 1982, California passed the Nolan Bill to stop massive defections of state-chartered S&Ls to the federal system, which had begun after passage of Garn-St. Germain. This law, which was essentially copied in Florida and Texas, allowed state-chartered thrifts to invest up to all their deposits in any kind of venture, including owning real estate, provided the investments were held by their service corporations, which were wholly-owned, but loosely-regulated, thrift subsidiaries. Another important factor was the Tax Reform Act of 1981 which gave generous tax incentives for real estate investments, creating a real estate building boom in the Southwest.22

As the thrift industry began to recover, the League encouraged thrift managers to take advantage of deregulation to diversify their loan portfolios away from specialized home lending. The trade association agreed with regulators that the future of the S&L industry lay in new deregulated business areas, and during the recession thrift leaders


pointed to the success several associations were having in using these powers to stay
profitable. These new lending areas, however, also required specialized knowledge and
the League advised thrifts to move cautiously when entering a field directly. One way to
develop this expertise was to lend in a niche market like commercial leasing or consumer
loans. Another way was to work with experienced lenders through the purchase of loan
participations, and in areas like commercial lending the League thought this approach
offered "big potential." To recognize the changes that deregulation promised, the League
changed its name to the United States League of Savings Institutions in 1983.23

Despite cautious statements emanating from the League, many of these fast-
growing S&Ls in the mid-1980s expanded by making higher-risk loans funded by
deposits that were unstable. This trend was disturbing, because even though Congress
wanted thrifts to diversify their assets, it still wanted them to be major providers of home
finance and serve local communities. Many "high-flying" S&Ls, however, were straying
from this mission. In 1984, S&Ls that grew by less than 15 percent annually held more
than 68 percent of their assets as residential loans, while less than 12 percent were in
commercial mortgages and other non-mortgage areas like direct equity investments. By
contrast, S&Ls that grew by more than 50 percent annually had just 53 percent of assets
in home mortgages and nearly 23 percent in newly deregulated areas. Furthermore,

23In 1982, Savings and Loan News profiled four thrifts that successfully took advantage of
deregulation, and the League praised these managers for their "aggressive" business style; by 1992, all four
thrifts had failed. "What is the Future for Savings Associations?" SLN 103 (August, 1982), 82-4; "Thrifts
Enter a New Era," SLN 103 (November, 1982), 37-8 quote 37; "Mutual to Stock Exchange Puts
Management in a Fishbowl," SLN 104 (January, 1983), 50-5; "New Commercial Lenders Swing in the
SLN 103 (August, 1982), 38-42; "A Market Driven Association Leaps into Consumer and Mortgage
(July, 1983), quote 46; "Look for a New Name," SLN 104 (June, 1983), 8.
slower growing thrifts relied on traditional retail deposits for nearly 81 percent of their funds, while the “high-fliers” obtained only 59 percent from local markets.24

Such disturbing trends, however, did not make the Board, and its new Chairman Edwin Gray, overly concerned. A San Diego thrift executive and long time friend of President Reagan, Gray became chairman reportedly because “he was supposed to be a dope and patsy” who would accept without question what the League and the Reagan Administration wanted. After taking office in March 1983, the new chairman did just that, continuing the work of his predecessor. One aspect of this work involved reducing the level of supervision over the thrift industry, and between 1981 and 1984 the number of thrift examinations fell by 26 percent. While this decline reflected the decrease in the number of S&Ls, it also occurred because there were fewer examiners. Moreover, higher than normal turnover rates in 1983 and 1984 meant that the average examiner had just two years of experience. These changes were important, since oversight should have increased, not declined, as thrifts grew in size and engaged in more complex transactions.25

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The Board changed its attitude toward oversight in 1984 after Empire Savings and Loan, a Texas thrift, failed and required the largest insurance payout in the history of the FSLIC up to that time. As discussed in a later chapter, Empire S&LA failed because of fraudulent activity by management, which shocked Gray by its extent and brazenness. Gray was also outraged by the deposit brokers who held the millions of dollars placed in FSLIC-insured accounts that Empire used to fund its growth; initially he blamed them for causing the collapse. The Board immediately began reversing the process of deregulation by imposing stricter regulatory and supervisory measures; and, although it failed to restrict the activities of deposit brokers, it did limit the amount of brokered deposits any thrift could hold to 5 percent of deposits. The Board also restricted the amount of direct investments by thrifts in equity securities and service corporations as a way to refocus the industry back toward traditional home lending. In 1986, the Board also began raising the net worth standard with the goal of reaching 6 percent of assets. Gray also authorized the hiring of 700 new thrift examiners.26

Although S&Ls attracted greater regulatory attention in 1984, the media and the public did not become greatly interested in the thrift industry until the following year. In March 1985 Home State Savings Bank in Cincinnati, with $1.4 billion in assets, experienced deposit runs after it lost more than $150 million in an elaborate government securities scam. What made this particularly significant was that Home State, like most Ohio thrifts, was insured by a private state insurance program, not by the FSLIC. As

more runs occurred, it became apparent that this private fund could not meet depositor claims, a situation that led Gov. Richard F. Celeste to order all state-insured institutions to close for five days so they could be examined and switched to federal insurance. This closing marked the first bank holiday since the Great Depression. In May, the Maryland state deposit insurance program went bankrupt when two of its thrift members with more than $1.1 billion in assets failed in quick succession.27

Cleaning Up the Mess

The thrift failures in Ohio and Maryland were not the only ones for the thrift industry in 1985, as the FSLIC resolved a total of 31 S&Ls with more than $6 billion in assets at a cost of $1 billion. While the number of these failures was not large, their size was much greater than the insolvencies of 1980-1982, and the cost of closing them equaled the total resolution costs of the previous two years. In August 1985, the federal insurance fund had fallen to $4.6 billion. Because more than 100 thrifts were insolvent but still operating, it was clear that without recapitalization the FSLIC would suffer the same fate as the two state insurance programs if these weak associations had to be closed.

As officials searched for ways to raise more money, the Board imposed a special premium on all members that raised an additional $2.1 billion by year end.28

In April 1986, the White House presented Congress with a recapitalization plan to let the FSLIC borrow $15 billion. The proposal was met, however, with no real sense of urgency, and for the next six months it meandered slowly through the House and Senate. One reason for this delay was that some legislators wanted the Board to crack down on thrift abuses before giving the FSLIC any money. Another problem was finding the necessary spending cuts required by the Gramm-Rudman-Hollings anti-deficit law to offset the $12 billion that the recapitalization plan would add to the federal deficit. On the last day of the session, the Senate sent to the House a bill it knew would not meet what the representatives wanted, but which it thought could be amended and approved. House rules, however, prohibited amendments on the last day, so the Senate quickly passed a new bill that included more of what the House wanted. Rep. St. Germain refused to consider the bill and was indignant that the Senate might "force the House into a take-it-or-leave-it position." The result was that FSLIC recapitalization would have to wait to 1987.29

As the effort to give the FSLIC more money dragged on, regulators had to allocate their remaining resources carefully, and they devised new ways to manage insolvent thrifts. As an alternative to the very expensive closure and deposit payoff


method, the Board began to rely more on arranging assisted mergers of insolvent S&Ls with healthy thrifts. It also created a management consignment plan (MCP) in 1985 to deal with thrifts whose managers would likely not obey supervisory controls. Under this plan regulators removed the thrift officers and installed a new group of managers who were “on consignment” from other nearby S&Ls. Each MCP thrift was intended to stay in this status for up to three months in order to give the FSLIC time to resolve it. However, as the number of problem cases rose, many MCP thrifts remained frozen in limbo for up to three years. The Board also formed the Federal Asset Disposition Association to liquidate loans, real estate and other assets the government acquired through thrift liquidations.\(^\text{30}\)

While the Board found new ways to dispose of failed thrifts, for those S&Ls that were considered “soon-to-fail” there was little it could do except maintain close oversight. Because these thrifts remained insured, however, they still attracted funds. Some of these S&Ls were in much more serious trouble than their financial statements indicated, but were able to hide their weaknesses from regulators in ingenious ways. Their managers sometimes traded the delinquent loans they held for the bad loans of other S&Ls, a process known as “swapping dead cows for dead horses.” Even though these transactions failed to improve the quality of the loans, regulatory accounting rules allowed managers to treat them as new assets, which gave thrifts up to six more months before they had to write them down. These and other bizarre deals led one journalist to quip that if Frank Capra made his move It’s a Wonderful Life about an S&L owner in the...
1980s, Jimmy Stewart’s speech to the angry depositors would be “Your money’s not here. Why your money’s in racehorses, a bordello in Nevada, a share in the Dallas Cowboys, a nitrogen-cooled tank filled with vials of buffalo semen, vacant shopping malls, and unneeded condominiums...”

In January 1987, Congress considered a new bill to recapitalize the FSLIC by $15 billion. The League, which had worked hard to defeat the earlier bill, tried to delay action by putting forward a proposal that would give $5 billion to FSLIC, but which would also require regulators to use forbearance in dealing with shaky but well-managed thrifts to give them more time to recover. The League argued that understanding and patience were needed because the Board was arbitrarily enforcing its harsh new regulations, which prevented thrifts from building up reserves. Although legislators believed this argument and accepted the forbearance provision, they were still not close to a final vote. This slow pace quickened in May when the General Accounting Office released an audit of the FSLIC that radically restated the financial condition of the thrift insurer. According to this report, the thrift insurer had lost $1.1 billion in 1985 and a staggering $10.9 billion in 1986. These figures meant that instead of having $3.6 billion, the FSLIC reserve was actually in a negative $6.3 billion position. These findings created the necessary sense of urgency, and after reducing the refinancing to $10.8 billion the Competitive Equality Banking Act (CEBA) became law in August 1987.


32 The financing would be in the form of thirty-year bonds issued by the Financing Corporation (FICO) with interest paid for from future insurance premium revenue with the principle guaranteed by the twelve federal home loan banks. White, Evolution of the Thrift Crisis, 20; House Committee on Banking, Housing, and Urban Affairs, Competitive Equality Banking Act of 1987, 100th Congress, 1st Session, Report
Although CEBA reaffirmed the government’s “full faith and credit” backing of insured savings, the new law was roundly criticized because it also included regulatory forbearance, making it clear that Congress believed that the Board was acting too harshly. Still, legislators thought that by passing the CEBA they had ended the S&L crisis. Over the next two years, however, their confidence waned as thrifts again began losing money. After being profitable for four years, the industry lost $7.8 billion in 1987 and a stunning $12.1 billion in 1988. Unlike the situation in 1981 and 1982 when nearly all thrifts lost money, this most recent downturn was concentrated, as more than two-thirds of all S&Ls were in fact showing profits that totaled $6.6 billion and $5.6 billion in 1987 and 1988, respectively. Losses for the remainder of the industry, however, totaled $14.4 and $18.6 billion. Given this huge gap in performance, many legislators feared that thrifts would continue to fail.33

At the same time, Congress began to doubt that the Board was managing this situation properly. Shortly before the CEBA became law, M. Danny Wall, a staff director for Sen. Jake Garn, became the new FHLBB chairman. Unlike Gray, Wall had no prior experience in finance and lacked an analytical knowledge of the thrift industry. He was also a natural optimist. He did not hound legislators for new regulatory authority, but assured them that everything was under control. Like all previous Board chairmen, Wall underestimated the cost of the S&L crisis, and as estimates of this cost, from independent agencies like the Congressional Budget Office, soared he lost

33White, The S&L Debacle, 137, 149; NCFIRRE, Origins and Causes of the S&L Debacle, 60-1; Savings Institutions Sourcebook, ’89, 52.
credibility with Congress. Eventually, some legislators and staffers on Capitol Hill began to refer to the Board chairman as M. Danny Isuzu (after the chronic liar on a television commercial) or as M. Danny Off-the-Wall.\textsuperscript{34}

One sign of the perceived mismanagement of the S&L crisis was the way in which the Board disposed of failed thrifts. Because the CEBA limited FSLIC borrowings to $3.75 billion per year, regulators needed cost-effective ways to liquidate thrifts quickly. One solution was the “Southwest Plan,” used to consolidate and package insolvent Texas S&Ls for sale to the highest bidder. To minimize cash needs potential buyers received incentives, including lucrative tax benefits, from the Board; and in 1988 the FSLIC disposed of 205 thrifts with nearly $101 billion in assets using the Southwest Plan at a cost of $27.1 billion. Although the Board considered this plan a smart way to stretch thin resources, it was seen as a give-away, especially because some acquirers were very wealthy individuals. It was also criticized because the FSLIC divided many of the failed thrifts into “good” banks, which held current assets and were sold, and “bad” banks that held delinquent loans to be disposed of later by the FSLIC. Although this practice was used during the Great Depression and was part of the FSLIC resolution effort since 1985, its inclusion in the Southwest Plan reinforced the growing belief that the thrift tragedy was in reality a government bail out.\textsuperscript{35}


In late 1988, public scrutiny of the thrift industry increased after the publication of several popular books that detailed the seamier aspects of the crisis. These accounts typically focused on the activities of a handful of S&L executives, most of who first entered the industry in the 1980s and were the antitheses of the traditional conservative thrift leaders. These flamboyant managers included Stanley Adams of Lamar Savings and Loan in Austin, Texas, who filed for an application to open a branch on the moon, and Don Dixon of Vernon Savings and Loan in Dallas, who used bank funds to buy a private plane in order to conduct “market studies” of world-class restaurants in France. Dixon also had his bank pay for $1.8 million in luxury cars, and a $2 million beach house, which cost an additional $200,000 to furnish ($36,760 was spent for flowers). By the end of the decade both these S&Ls were insolvent. Lamar Savings and Loan cost more than $2 billion to clean up, while at the $1.7 billion Vernon Savings and Loan, 94 percent of its loans were nonperforming.36

The most egregious displays of excess, however, involved Edwin T. McBirney of Sunbelt Savings in Dallas. McBirney bought Sunbelt in 1981 when he was 31 years old, and within four years he had expanded it from $90 million in assets to more than $3.2 billion. Nicknamed “Gunbelt” Savings for its reckless lending, the thrift was notorious. “Fast Eddy” McBirney negotiated so many multibillion-dollar deals on the tablecloth of his favorite Dallas eatery that the owner began covering the table in paper. McBirney spent lavishly on parties held at his palatial home, traveled in a chauffeured limousine,

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and used his thrift’s fleet of seven planes to take frequent trips to Las Vegas. All of these costs were paid for by Sunbelt. Stories like these incensed Americans, and when Congress held hearings on S&L fraud in 1990, a banner hung over the Senate committee that read “When are the Savings and Loan Crooks Going to Jail?”

As more thrift scandals appeared, including the one involving Lincoln Savings and Loan owner Charles Keating and five senior senators (the “Keating Five”), a groundswell of public and political indignation finally helped end the S&L crisis. Shortly after taking office, President George Bush submitted a plan to clean up the S&L mess, which included spending $50 billion to resolve the remaining insolvent thrifts and abolishing both the FHLBB and FSLIC. To deflect criticism that this was a bail-out of the thrift industry, a “healthy part” of this money would be repaid with an increase in thrift insurance premiums from 8.33 cents per $100 of insured deposits to 20.83 cents. Although the League tried to modify this program and reduce its severity, attitudes were so negative that the Financial Institutions Reform, Recovery & Enforcement Act of 1989 (FIRREA) became law with almost no changes.

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FIRREA marked the beginning of an effort to re-regulate the thrift industry. Called by some an “Act of Anger,” the law provided funds to the Justice Department to assist in the prosecution of S&L crimes and created a temporary agency, the Resolution Trust Corporation (RTC), to dispose of assets held by insolvent thrifts. It also required the FDIC to insure both banks and S&Ls by forming two new reserves, the Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF). Finally, the law replaced the Board with the Office of Thrift Supervision (OTS), which would establish meaningful net worth requirements and regulations for the thrift industry. These requirements included new capital standards that were to be equivalent to those for national banks. Moreover, the definition of regulatory capital was tightened so that including goodwill as new worth ended in 1994. A significant new rule also required all S&Ls to meet a “Qualified Thrift Lender Test” that forced them to hold at least 70 percent of assets in areas related to residential real estate by 1991. If a thrift failed this test, it had to convert to a state or national bank charter.39

As was true throughout the S&L debacle, the actual cost of closing hundreds of insolvent thrifts was far more than imagined, and the RTC, whose motto was “Resolving The Crisis, Restoring The Confidence,” required far more than the $50 billion allocated to complete its mission. When it ended operations in December 1994, the RTC had resolved 747 thrifts with $403 billion in assets. The ten largest S&L failures, all of which involved fraud, held assets of $112 billion. Altogether, a total of 1,245 S&L with

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more than $620 billion in assets failed between 1980 and 1989. The federal government
spent $161.4 billion between 1980 and 1995 to resolve these thrifts, and this figure is not
final because the RTC transferred billions in failed thrift assets to the FDIC when it
closed. According to a 1990 Congressional Budget Office report, an additional $300
billion would be required from 1991 to 2000. It also estimated that $60 billion of the
actual resolution costs resulted from regulatory forbearance required under CEBA.\textsuperscript{40}

A final casualty of the S&L crisis was the industry trade association, the United
States League of Savings Institutions. By 1989, the reputation and image of the League
was severely tarnished because of its role in seeking broad deregulation and delaying re-
regulation. As a result, the trade group lost political influence and members including
the largest thrift, Home Savings of Los Angeles. Finally, in 1991, just one year shy of its
100\textsuperscript{th} anniversary, the League announced its merger with the National Council of Savings
Institutions. Because this was the same group that had split from the League in 1942
over differences in trade association management, the decision to merge was awkward,
but seen as necessary to give both groups the chance to rehabilitate their images. Also,
with headquarters in Washington, D.C., the union would help rebuild the political power
of the two groups. The merger was completed in December, and the Savings and

Community Bankers organization, now called America’s Community Bankers, serves as the trade association for 2,055 thrifts and savings banks.¹

**Explaining the Collapse**

Following passage of FIRREA and creation of the RTC, Congress passed the Crime Control Act of 1990, which mandated that the National Commission on Financial Institution Reform, Recovery and Enforcement (NCFIRRE) identify the causes of the S&L crisis and make recommendations to prevent future debacles. Although industry observers and financial experts had chronicled the collapse for years, NCFIRRE’s report completed in 1993 neatly summarized the major issues.²

One problem was the economic structure of the thrift industry. From the 1830s to the 1970s, S&Ls were specialized financial institutions that used short-term variable-rate deposits to make long-term, fixed-rate mortgages. When deregulation created an openly competitive market, income generated by fixed-rate mortgages could not keep pace with the variable-rate savings interest expenses. This problem of institutional rigidity was exacerbated by the second major cause of the S&L crisis, high and volatile interest rates. Significantly, this problem affected both assets and liabilities. Because the rapid increase in rates caused the market value of most S&L fixed-rate loans to plummet, if thrifts wanted to sell them to raise funds they would have to incur significant losses. More

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importantly, rising rates caused intense savings disintermediation. Because of the Regulation Q rate controls, thrifts lost billions of dollars in deposits as consumers moved to market-rate investments. This situation continued even after thrifts received the authority to pay higher rates in 1980, since the added expense resulted in operating losses that eroded net worth and increased the potential for insolvency.43

A third reason for the S&L debacle lay in the nature of thrift deregulation, since the initial Congressional legislation did not adequately allow thrifts to match higher expenses on savings with higher income from loans. While Garn-St. Germain tried to rectify this imbalance, the changes were too broad and put in place so quickly that many thrifts had little time to gain expertise in these fields in order to make a smooth transition from the traditional focus on residential lending. The fourth factor contributing to the thrift tragedy was the overall reduction of regulatory oversight. The relaxing of dozens of thrift rules, including changes in the ownership of S&Ls, by the Board under Richard Pratt made it easier for thrift managers to dodge regulatory scrutiny, or use a S&L for their own personal gain. Other actions, such as the reduction of minimum capital requirements, while designed to give thrifts more time to return to financial health perversely caused problem situations to worsen. The NCFIRRE report was especially


343
critical of the decision to use of RAP, since it reduced the safeguards that had restrained risky lending behavior.44

A fifth reason why the S&L collapse was so large was the availability of deposit insurance, which some analysts saw as the main cause of the problems in the 1980s. Congress created deposit insurance in the 1930s to improve public confidence in banks and thrifts and prevent deposit runs. Both the FDIC and FSLIC accomplished these goals, and during the 1980s there were virtually no deposit runs. The problem with deposit insurance was that because account holders believed their funds were totally secure they did not impose any discipline on how these funds were used, with the result that lenders sometimes made very risky loans using a strategy of “heads I win, tails you lose.” That is, if the loan works the thrift makes money, if the loan goes bad insurance covers the losses. This risk increases as the S&L investors’ equity in a thrift declines. To reduce this “moral hazard” risk, the government had to assume the role of at-risk investors and demand lender accountability and control of risk-taking behavior. Under deregulation, however, political leaders wanted to reduce supervision, which often meant that the Board allowed troubled thrifts to remain open even though they were insolvent; this problem was magnified by the policy of regulatory forbearance.45


Related to the issue of moral hazard was that of fraud. While illegal activities clearly caused some S&Ls to go under, identifying the extent and financial cost of these abuses is difficult to determine, in part because it few people agree on what separates true white-collar crime from bad business judgment. Some researchers, who have looked at only instances of clear criminal misconduct, estimate that fraud represented just 3 percent of the cost of resolving the S&L crisis. Others, who define criminal activities as anything that violates a banker’s fiduciary responsibility, claim that fraud accounted for 33 percent of this cost. The NCFIRRE, which ruled out fraud as the major cause of the S&L crisis, estimated that fraud accounted from 10 percent to 15 percent of the clean-up cost. Despite this relatively low figure, the perception that fraud was important continues because, according to one official, “it is the easiest thing to focus on and understand.”

A final factor that caused the failure of S&Ls was that many thrift lenders lacked the experience or knowledge to evaluate properly the higher risks associated with lending in deregulated areas. This factor is applied to any S&L that made secured or unsecured loans that were not traditional residential mortgages, since each type of financing entails

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unique risks that require specific skills and expertise on how to identify and mitigate. Lending outside of the normal market territory added an additional layer of risk, especially since officers often relied on the judgment of others to help make these loans. These factors meant that bad loans, and in turn thrift failures, could easily result from well-intentioned decisions based on incorrect information.  

Conclusions

While the steady failure of thrifts attracted the most national attention during the 1980s, not all industry developments were negative, as seen in Table 9.1:

<table>
<thead>
<tr>
<th>Year</th>
<th>S&amp;L Failures</th>
<th>Assets (000,000)</th>
<th>Year</th>
<th>Total S&amp;Ls</th>
<th>Industry Assets (000,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983-5</td>
<td>137</td>
<td>$39,136</td>
<td>1983</td>
<td>3,146</td>
<td>$813,770</td>
</tr>
<tr>
<td>1986-7</td>
<td>118</td>
<td>$32,248</td>
<td>1985</td>
<td>3,274</td>
<td>$1,109,789</td>
</tr>
<tr>
<td>1988</td>
<td>205</td>
<td>$100,705</td>
<td>1988</td>
<td>2,969</td>
<td>$1,368,843</td>
</tr>
<tr>
<td>1989</td>
<td>327</td>
<td>$135,245</td>
<td>1989</td>
<td>2,616</td>
<td>$1,186,906</td>
</tr>
</tbody>
</table>


Table 9.1: Thrift Failures and Assets / Total Thrifts and Assets - 1980 to 1989

A review of the S&L fortunes reveals two very important trends, the first of which involves the way in which thrifts failed. Between 1980 and 1983, most S&Ls failed because of losses sustained after interest rates rose sharply and the nation entered a recession. Many of these insolvencies were mutual S&Ls, primarily because these thrifts had historically low levels of reserves, which, of course, made them more susceptible to sudden losses. Unlike the case during the first round of insolvencies, the failures between 1985 and 1989 resulted from poor asset quality, not economic conditions. Similarly, even though many of the problem loans were made between 1983 and 1985, the use of RAP accounting prevented their detection by regulators until much later. Finally, these later thrift failures were larger in size, involving thrifts with an average of $467 million in assets. Between 1980 and 1984, the average thrift failure had only $302 million in assets.48

An examination of the thrift failures of the later half of the 1980s reveals that a disproportionate number had state charters, were stock organizations, and had grown faster than the rest of the industry between 1983 and 1985. Similarly, their asset portfolios had higher-than-average percentages of land loans, commercial mortgages and direct equity investments, activities that were all made possible by deregulation. While fraud was not cited as the main reason for these failures, those cases involving suspected regulatory violations and fraud were among the costliest to the deposit insurance fund. Finally, the surge in failures in 1988 and 1989 did not indicate a sudden deterioration of

48Managing the Crisis: The FDIC and RTC Experience, 9
these thrifts, but the inability of the FSLIC to close them earlier in the decade when they made most of their high-risk loans.\textsuperscript{49}

The second major trend of the 1980s was that even as thrift failures and asset losses mounted, the industry continued to expand and, more importantly, to consolidate. By 1989, the average thrift held assets of $454 million, and 278 associations had more than $1 billion in assets. Despite these changes, the industry remained dominated by smaller thrifts, as more than 60 percent of all thrifts had less than $100 million in assets; 35 percent had under $50 million in assets. While this gap made it harder for the League to speak with one voice on industry issues, the ability of small thrifts to stay profitable and coexist side-by-side with large, diversified associations indicates that there was no one clear path to success during the decade of deregulation.\textsuperscript{50}

In addition to detailing how and why thrifts failed in the 1980s, scholars have also identified reasons that the majority of all thrifts survived the debacle. Because associations of all sizes, organizational structures, and lending patterns failed in this decade, these studies have focused on finding traits these thrifts shared in order to reach broad generalizations about these "survivors." Many were federally chartered mutuals that generally grew at or below the rate of overall industry expansion. Their asset portfolios had a high percentage of traditional residential mortgages, most of which came from their local market territories; and they relied mostly on retail deposits to fund these

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\textsuperscript{50}Savings Institutions Sourcebook '89, 46-50; The U.S. Savings Institutions Directory (Chicago: Rand McNally & Co., 1989), R46-R48
\end{flushright}
transactions. They also typically avoided high-risk lending activities and had few direct real estate investments.\(^{51}\)

Although it is not surprising to see that many of the “survivor” characteristics were the opposites of those for the “failures,” these studies do not conclude that the basic principle of deregulation was wrong, since the majority of thrifts examined actually used many of the lending powers authorized by reform. The analyses do show, however, that successful S&Ls combined traditional thrift activities with broader financial services to achieve modest and sustainable growth. What is particularly interesting about the traits of S&Ls that survived the 1980s is that they often restricting their activities to local markets and focused on meeting member needs.

One explanation for this determination of some thrifts to “stick to the knitting” even as others diversified is that many S&Ls still in operation are among the oldest in the industry. In Illinois, where the number of S&Ls fell by more than 45 percent between 1984 and 1994, more than half of the thrifts still operating were founded prior to World War I. In Ohio, where the number of thrifts declined by 25 percent during the same ten-year period, nearly 90 percent of those in business in 1998 were founded in the nineteenth century. Similarly, the overwhelming majority of these thrifts have fewer assets than the average S&L. Such a large number of small associations with long-term operating histories indicates that these associations had developed proven business practices based on all types of economic conditions, which likely helped them in dealing

with the challenges of deregulation. These characteristics for success were especially true for Medford Cooperative Bank, which is discussed in detail in a later chapter.\textsuperscript{52}
CHAPTER 10

FRAUD, FORBEARANCE AND FAILURE:
THE CASE OF EMPIRE SAVINGS & LOAN ASSOCIATION

One of the most oft-cited reasons for the failure of thrifts in the 1980s was management fraud. The focus on white-collar crime, however, produces a misleading picture about why thrifts failed, since most insolvencies resulted from a variety of factors. One of the most important of these factors was negligence on the part of regulators to intervene in a timely manner. This problem is well illustrated in the case of Empire Savings and Loan Association of Mesquite, Texas (Empire S&LA), which failed in 1984 directly as a result of massive insider fraud. This one-office thrift made millions in loans for the construction of condominiums in an area outside Dallas, and within a matter of months grew from an institution possessing $13 million in assets to one having more than $330 million in assets. This growth caused thrift managers and their associates to become fabulously rich—the envy of the entire industry. This success was not based on prudent lending practices, but instead resulted from abuses, the most grievous of which was the way thrift insiders conspired to inflate the value of the land for which they made loans. Ironically, these activities attracted the attention of regulators, and almost from the start the regulators had some knowledge that Empire S&LA’s management was engaged in fraud.
Despite such early warnings, regulators failed to act quickly to end abuses, in part because of weaknesses in their enforcement powers and in part because of bureaucratic inertia. The result was a thrift failure that was at the time the largest in the history of the thrift industry – an important example of how complex economic, political and business forces could combine to produce problems for thrifts in the 1980s. No single factor brought down Empire S&LA.¹

The Story of Failure

Although the failure of Empire S&L in 1984 led to the largest payout of insured deposits in the then-fifty-year history of the Federal Savings and Loan Insurance Corporation (FSLIC), the S&L had humble beginnings. Organized in 1973 as Town East Savings and Loan, the thrift operated out of a nondescript office located in a strip shopping center in Mesquite, Texas, a suburb east of Dallas. Only $13 million in size, Town East served its 2,000 local depositors with traditional thrift products including mortgages, car loans and term certificates of deposits (CDs). As a state-chartered and federally-insured institution, the thrift was under the oversight of both the Texas State Banking Commission and the Federal Home Loan Bank Board (FHLBB), but like most small associations it attracted little regulatory attention. Finally, unlike traditional S&Ls,

¹This chapter is based on my Masters of Business Administration thesis at the University of Texas at Austin titled “The Failure of Empire Savings and Loan Association of Mesquite Texas” completed in August 1985, and my paper “Fraud, Forbearance and Failure: The Failure of Empire Savings and Loan Association of Mesquite, Texas” delivered at the Southwest Social Science Association conference on March 12, 1996 at Houston TX.
Town East was a privately-held stock corporation controlled by a handful of investors not mutually-owned by its members.\(^2\)

In March 1982, Spencer Blain, who was the president of First Federal Savings and Loan Association of Austin came to Mesquite to become the majority owner of Town East S&L. Blain was a respected Texas thrift executive, and during his ten years in the industry had served as a director of the Federal Home Loan Bank in Little Rock, Arkansas, vice chairman of the executive committee of the Federal Home Loan Mortgage Corporation Advisory Board, and president of the politically powerful Texas Savings and Loan League. Blain was credited with making First Federal into a highly profitable S&L; and, although his departure was unexpected, many people assumed he left because he wanted to run his own association, something that was not possible at the mutually-owned First Federal. By August 1982, Blain had acquired 67 percent of the stock of Town East and renamed it Empire S&LA.\(^3\)

Because of his reputation, regulators viewed this move by Blain as positive; but even at this early date there were signs that his new S&L might become a problem institution. Federal regulations required the Board to give prior approval for any change


in the ownership of a thrift, but Blain simply ignored this requirement. This step should have automatically prevented him from acquiring Empire’s stock and becoming chairman, but rather than blocking the change, the Board simply notified Blain of the regulatory violation by mail and requested he submit the necessary application for retroactive approval. After seven months of repeated requests, in March 1983 Blain finally asked for Board approval for the change of ownership. By that time, however, he had already implemented the business plan that would make Empire S&LA one of the fastest growing financial institutions in the country, and ultimately one of its costliest thrift failures.4

Blain acquired Empire S&LA primarily because he wanted to transform the thrift from a marginally profitable association into an industry leader by using several of the new powers allowed by deregulation. Under his plan, Empire S&LA would make short-term loans to acquire raw land for the development and construction of condominiums.5 While finding borrowers who wanted to live in the condominiums would have been ideal, the majority of the loans actually went to investors who intended to profit from the resale of the units. To fund these acquisition, development and construction (ADC) loans Blain intended to use brokered deposits, made possible by a market that had grown significantly


after deregulation removed many of the rules restricting their use. This money would be held in the form of federally-insured $100,000 short-term certificates of deposits known as jumbo CDs. After selling the condominiums to the final home owners, Empire S&LA intended to refinance the ADC loans with long-term mortgages, which would then be sold to the Federal National Mortgage Association, with the proceeds used to pay off the CDs as they matured. Blain thought it would take two to four years to complete this cycle, after which he would let his S&L shrink in size while retaining large profits for himself.

To make this plan work, Blain needed a suitable region to build condominiums, and he found it east of Dallas along Interstate-30, between Interstate-635 and Lake Ray Hubbard. Known locally as the “I-30 Corridor,” this ten-square-mile stretch of land had a number of characteristics that made it ideal for residential development. It was an easy and direct commute to downtown Dallas, was close to recreation and shopping, and was large enough and sufficiently undeveloped to support the level of activity envisioned by Blain. While the I-30 Corridor was a good location for construction, ensuring the success of the projects Empire S&LA would finance required using real estate developers experienced in designing, building and marketing this type of housing.

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6In the 1980s deposit brokers used sophisticated computer programs to track CD interest rates and terms at institutions across the country and electronically transfer funds in exchange for CDs that they then sell to individual investors. David Cates, “The Case for Brokered Deposits,” United States Banker 95 (May, 1984), 46-8; Sanford Rose, “In Praise of Brokered Deposits,” The American Banker, 20 March 1984, 1.

7Blain also formed a non-regulated subsidiary, Statewide Service Corporation, to assist in the lending process and also generate additional income for the thrift. Hearings on FHLBB Supervision of Empire S&LA, 151-2; Day, S&L Hall, 148; Pusey, “Fast Money and Fraud,” 35; Atkinson and Maraniss, “In Texas, Thrifts went on a Binge of Growth,” 1.

The main developer of the Empire S&LA projects was Danny Faulkner, a Mississippi native who had dropped out of school after the sixth grade and who was unable to read or write. Faulkner came to Dallas in the early 1970s where he began a house-painting company, through which he met insurance executive Ken Murchison. The millionaire Murchison was taken by the folksy manner of the illiterate house painter and helped him expand his business to such an extent that by the end of the decade Faulkner was looking for ways to invest his growing wealth. He was one of the first to build condominiums near Lake Ray Hubbard, and their quick sale convinced him to expand his holdings in the area. Faulkner also made an investment in Town East Savings and Loan; and in 1981, when its president decided to leave, he convinced Blain to become the new executive officer. Faulkner even provided Blain with a $850,000 loan to acquire a controlling interest in the thrift. In addition to Faulkner, the other key figures in the I-30 Corridor were Clifford Sinclair, a former National Home Builders Association "Salesman of the Year" with only a limited background developing condominiums, and Jim Toler, a former mayor of Rowlett, Texas, who had no real estate experience.9

Within months of Blain's acquisition of Empire S&LA, the once barren I-30 Corridor was teeming with construction crews throwing up condominiums. While most

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of these projects were fairly small in size; some, like The Park, a 3,100-unit development, were miniature cities. Empire S&LA provided the majority of the millions in loans that financed this flurry of building, and the result was significant growth for the thrift, as seen in Table 10.1:

<table>
<thead>
<tr>
<th>(000)</th>
<th>12/31/81</th>
<th>6/30/82</th>
<th>12/31/82</th>
<th>6/30/83</th>
<th>12/31/83</th>
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<td>$27,471</td>
<td>$85,064</td>
<td>$257,904</td>
<td>$437,228</td>
</tr>
<tr>
<td>Less: LIP *</td>
<td>(2,738)</td>
<td>(11,584)</td>
<td>(29,990)</td>
<td>(81,343)</td>
<td>(105,745)</td>
</tr>
<tr>
<td>Total Assets</td>
<td>16,958</td>
<td>31,436</td>
<td>67,690</td>
<td>178,461</td>
<td>332,512</td>
</tr>
<tr>
<td>Broker Deposits</td>
<td>1,206</td>
<td>14,574</td>
<td>48,437</td>
<td>139,054</td>
<td>291,410</td>
</tr>
<tr>
<td>Net Worth</td>
<td>781</td>
<td>838</td>
<td>2,068</td>
<td>8,201</td>
<td>11,695</td>
</tr>
<tr>
<td>Interest Income</td>
<td>587</td>
<td>924</td>
<td>2,815</td>
<td>11,510</td>
<td>16,068</td>
</tr>
<tr>
<td>Fee Income</td>
<td>49</td>
<td>301</td>
<td>1,516</td>
<td>4,021</td>
<td>5,270</td>
</tr>
<tr>
<td>Net Income</td>
<td>16</td>
<td>56</td>
<td>1,230</td>
<td>6,133</td>
<td>3,495</td>
</tr>
</tbody>
</table>

* Loans in Process
Source: Financial Statements of Empire Savings and Loan Association of Mesquite, Texas (Federal Home Loan Bank of Dallas, unpublished document), 1-2

Table 10.1: Financial Statistics for Empire Savings and Loan Assn. - 1981 to 1983

By December 1983, just eighteen months after taking control of Empire S&LA, Blain appeared to have engineered a financial miracle in Mesquite. Each month, the net loan portfolio and level of brokered deposits at the one-office thrift rose at average rates of 82 percent and 105 percent, respectively. While such stunning growth seemed highly unusual, the fact that both net income and net worth also soared made it appear as if the
expansion was being managed properly. The growing equity appeared to mitigate the fact that Empire S&LA made more condominium loans than any bank in Texas and convinced some that deregulation was indeed working.\textsuperscript{10}

As the size of the I-30 projects expanded, Empire S&LA began to bring other thrifts into these transactions, both to reduce its concentration of loans to individual developers and to generate additional fee income. While dozens of financial institutions nationwide took part in the I-30 Corridor loans, five Texas S&Ls – Bell Savings & Loan of Belton, First Savings & Loan Association of Burk Burnett, Investex Savings in Tyler, State Savings & Loan in Lubbock, and Lancaster First Federal Savings & Loan – held the largest participations and accounted for nearly half of the more than $750 million invested in the region. This business resulted in the rapid growth of these five associations: in just six months the assets of Bell S&L rose 350 percent to $77 million, while Lancaster Federal grew an astounding 610 percent to $101 million. Finally, the success of Empire S&LA garnered national recognition when the trade publication \textit{National Thrift News} named it the top-rated institution for 1983.\textsuperscript{11}

While large fees and high interest rates were important reasons these lenders were eager to work with Empire S&LA, another was the fact that the Texas thrift industry was

\textsuperscript{10}One reason why net worth did not rise as fast as net income was because Blain and others at the thrift rewarded themselves for their success with large bonuses and other financial perks. \textit{Financial Statements of Empire Savings and Loan Association}, 1-4.

facing hard times following the collapse of regional economy after several years of strong growth. In the late 1970s, the Texas economy boomed because of a surge in oil and gas prices tied to the OPEC oil embargo in 1979. Business leaders were convinced that energy prices would stay high, and this assumption had prompted banks to make millions in oil production and real estate loans. By 1981, however, oil prices had returned to their pre-embargo levels, and this drop caused many over-extended firms to default on their loans. In such depressed lending conditions, the fact that Empire S&LA found a way to grow profitably convinced many that Blain had found the way to achieve long-term success.\(^{12}\)

Some lenders also wanted to become involved in the I-30 Corridor because they were clearly awed by increased wealth and conspicuous consumption of Blain and his associates. Among the gifts the chairman gave himself were a $1.1 million condominium at the posh Colorado ski resort of Steamboat Springs and a luxurious blue Rolls Royce. Faulkner indulged in an even gaudier display of wealth, owning luxury cars, jets, and helicopters. He also gained a reputation for giving away money to friends and strangers. Faulkner often left $100 tips at the small neighborhood diner where he arranged many of the condominium projects, and he gave away dozens of Rolex watches and stick-pins with a diamond encrusted letter “F” as tokens of his appreciation. For his son’s wedding he hired the Tulsa Symphony Orchestra to perform the theme from “Rocky” at the reception. He even built a billboard along I-30 near his projects proclaiming that "Danny

\(^{12}\)Pusey and Harlan, "Condo Land Deals Price Spiral Probed," 1; *Hearings on FHLBB Supervision of Empire S&LA*, 131; Albert and Ringer, “Questions Raised by ’Penn Square of Thrifts’ Gets Scrutiny in Congressional Hearing Today," 12; Bowman Interview; Law Interview; Day S&L Hall, 146-7.
Faulkner Welcomes you to Garland." Despite such ostentatious displays, Faulkner also contributed money to a variety of charities; and his down-home manner led one person to describe him as "a good-old boy from Mississippi whom everyone likes."

While Empire S&LA was amazing industry observers, and Blain and Faulkner were living the high life, regulators were also finding out that all was not well at the thrift. In October 1982, federal regulators began a regular, periodic supervisory examination of the thrift, which they finished in December. While the final report noted the high income and net worth of the S&L, it also detailed several improper lending practices, such as the absence of borrower equity from most of the loans. In addition, Empire S&LA had committed dozens of rules violations involving loan documentation because its financial records were in disarray. Finally, the report provided information on a September 1982 sale of land by Blain, which he had bought just six months earlier for $1.6 million, to an associate of Faulkner for $16 million. Because Empire S&LA financed all these transactions, the examiners thought that this transaction was a conflict of interest violation.

Given these findings, the examiners called for, and FHLBB rules required, that immediate supervisory action be taken against the thrift. However, because Empire

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13Eric Miller, "Trouble in Dannyland," D Magazine (February 1984), 111-3; Beil Interview; Atkinson and Maraniss, "In Texas, Thrifts went on a Binge of Growth," 1; Pusey, "Fast Money and Fraud," 33; Day, S&L Hell, 147; Beil Interview.

14The report also uncovered a profit-sharing agreement between Blain and Statewide Service Corp. that entitled Blain to receive a $250,000 bonus. Although regulators later struck this down, the directors of Empire voted to give their chairman a Christmas gift in the same amount. Hearings on FHLBB Supervision of Empire S&LA, 191-251.
appeared financially healthy, the Board choose not to meet with Blain, but rather followed
its normal bureaucratic procedure of resolving problems by mail. In January 1983, the
Board sent a letter asking Blain how he planned to correct the problems cited in the
examination and after receiving no response sent additional letters in February and
March. Blain finally replied to the original request in April with a non-informative letter
that indicated he was working to correct the issues raised in the report. Regulators later
characterized this response as a "kiss-off."15

As the FHLBB was trying to get Blain to address the problems raised in its
examination, the accounting firm Coopers & Lybrand was completing its own audit of the
thrift, an examination needed to prepare year-end financial statements for regulators.
Beginning in September 1982, it took ten months for auditors to sift through loan
documents that were now in a marked state of confusion. Their report not only confirmed
many of the findings from the earlier audit, but also cautioned that the financial condition
of Empire S&LA was in fact grossly overstated. Because few of the ADC loans made by
the thrift had any borrower equity, the accountants contended that these transactions were
actually investments, and asserted that any fee income received should be recorded only
after the properties had been sold to the final owners. Since this up-front income
represented the bulk of the earnings for Empire S&LA, the Coopers & Lybrand

15Allen Pusey and Christi Harlan, "Dallas Appraisal Firms Probed in Condo Deals," The Dallas
Morning News, 30 December 1983, 10, 12; Nauss, "Inside View of Empire," 18; U.S. Congress, House,
Report on the Federal Home Loan Board Supervision and the Failure of Empire Savings and Loan Association
19.
recommendation would result in a significantly weaker financial condition for the thrift. The Board, however, was reluctant to act on this recommendation, in part because it was based on definitions of loans and investments that the accounting profession itself did not completely agree upon. This lack of consensus, combined with the fact that Empire S&LA was complying with existing FHLBB accounting rules, led the Board not to press for any changes.¹⁶

In May 1983, regulators received additional evidence that Empire S&LA was engaging in unsafe business practices when Texas regulators completed their own supervisory review of the thrift. This third audit in less than nine months revealed that Empire S&LA was mired in deep financial trouble, and this conclusion caused Texas Savings and Loan Board Commissioner L. Linton Bowman III to arrange a meeting between himself, Blain and FHLBB Chairman Edwin Gray at the annual Texas Savings and Loan League convention in June. Although this was the first time Gray learned about Empire S&LA, even before the meeting took place he realized that this institution was indeed a special thrift. Blain met Gray at the airport in his Rolls Royce, and on the drive to the convention the Board chairman asked the thrift executive how he could afford such a luxury car. Blain simply responded “We’re just very profitable down here in Texas.”¹⁷


The June 1983 meeting produced the first substantive regulatory action designed to reign in Blain and his thrift. Texas regulators entered into an agreement with the executive to allow them to supervise the thrift for the next three months, while federal regulators decided to order another audit of the thrift. This special limited examination was completed in October, and it showed that Empire S&LA was hopelessly entangled in a web of mismanagement, featuring loan records that had not been maintained or updated for months. Furthermore, the examiners found that many of the loans were grossly overstated because they were based on artificially inflated land values. Although the report gave the thrift its lowest possible rating and strongly recommended immediate supervisory action, the Board demurred and instead ordered new appraisals of the I-30 Corridor properties to determine the accuracy of these new findings.18

By the end of 1983, however, it was a virtual certainty that this thrift was going to fail. Because it relied on short-term jumbo CDs to fund its short-term ADC loans, Empire S&LA needed a steady stream of condominium sales to pay off these obligations as they matured. By one estimate, a minimum of 200 units had to be sold each month to meet these cash needs. An average of just four condominiums sold each month, and this low sales rate highlighted a basic flaw in Blain's original plan to expand his thrift. Because the I-30 Corridor was only ten square miles in size, experts estimated it could absorb only 75 new condominium units per month. A healthy level of units on the market at any one time was 675, or approximately a nine-month supply. Blain and the project

developers apparently ignored these factors since in just over two years they built more than 2,000 units and had permits to construct an additional 4,000 units. To make matters worse, other developers entered the region to build condominiums, which according to one city official, "spread like brush fire." By the end of 1983, cities along the I-30 Corridor had issued more than 30,000 condominium permits, which one research firm estimated was enough to supply demand for the next twelve years.19

While this "condo glut" posed obvious problems for Empire S&LA, the situation worsened in November 1983 when The Dallas Morning News ran the first in a series of articles detailing over-building in the Lake Ray Hubbard area. This adverse publicity depressed sales even more, so that by January 1984 just 779 of the thousands of completed units built were occupied. Entire projects were totally vacant. The lack of sales meant that Blain did not have the funds needed to pay off the short-term CDs as they matured, and by early 1984 the thrift faced a liquidity crisis, which it narrowly averted after Faulkner agreed to pay off $32 million of these obligations. Also, the inability to refinance the ADC loans meant that Blain could not sell them to the Federal National Mortgage Association, which refused to buy them because of their high risks. Furthermore, since few of the investor/borrowers for these loans had the financial ability to repay them, Empire S&LA was forced to write them off as they matured. As a result,

even though the thrift continued to lend money, the level of nonperforming loans soared. By year-end 1983 more than $8.4 million in loans were in default or foreclosure.\textsuperscript{20}

As the situation at Empire S&LA grew bleaker, federal regulators at the regional home loan bank in Dallas finally intervened. In December 1983, the supervisory staff made criminal referrals to the U.S. District Attorney's Office concerning the September 1982 land transaction involving Blain, and ordered Empire S&LA to stop accepting brokered deposits. On January 5, 1984, the FHLBB issued a temporary cease and desist order that prohibited further lending, and directed the FSLIC to try to arrange for a merger between Empire S&LA and another institution. Three days later, Texas regulators moved in and assumed control of the thrift, although they still allowed Blain to remain as chairman. By the end of the month, after determining that a merger was impractical, the Board formally removed Blain from the management of Empire S&LA; but, incredibly, it did not close the thrift because it thought that it needed still more evidence that the thrift was in danger of becoming insolvent.\textsuperscript{21}

On March 14, 1984, the appraisers assigned to revalue the I-30 Corridor projects presented their findings to the Board, and their report included a videotape filmed from an airplane of the condominium projects financed by Empire S&LA. The tape showed

\textsuperscript{20}Albert and Ringer, "Questions Raised by 'Penn Square of Thrifts' Gets Scrutiny in Congressional Hearing Today," 22; \textit{Hearings on FHLBB Supervision of Empire S&LA}, 22, 72, 120, 153; Andrew Albert and Richard Ringer, "Regulators Evaluating Empire's Costs," \textit{The American Banker}, 26 March 1984, 1; Bowman Interview.

hundreds of acres of vacant condominiums, many of which were partially built, falling apart, or the victims of arson. The scene so shocked the Board that, Gray said later, "I couldn't believe what I was seeing. It was like a pornographic movie. I had to turn away." The Board immediately declared Empire S&LA insolvent, and the next day federal regulators descended on it in such numbers that one thrift executive commented, "it wasn't so much an examination as it was an invasion. We didn't have that many people in Normandy on D-Day." Shortly afterward, the FSLIC began paying off insured depositors – payments which eventually exceeded $273 million, making Empire S&LA the largest thrift failure in the history of the thrift deposit insurance program to that time.\(^2\)

**Identifying the Factors of Failure**

A month after regulators closed Empire S&LA, a House of Representatives subcommittee began hearings seeking to determine why the thrift failed. While it was clear that management fraud caused the collapse, legislators wanted to know if any other factors played a role in the failure. Their investigation led the subcommittee to conclude that regulators also played a major role by not properly monitoring the thrift. Even though he was loathe to admit it, Board Chairman Gray eventually agreed with this assessment, conceding that "the manner in which this case was handled by the regulatory apparatus, was deficient in a number of ways." He even speculated that had regulators acted quicker Empire S&LA "would not have failed and possibly it could have been

saved.” Despite this admission of guilt, regulators claimed that the real reasons for the collapse were fraud and the fact that Empire S&LA had access to an unlimited supply of money from deposit brokers who used federal deposit insurance to protect themselves against losses.23

Although deposit brokers had worked with thrifts since the 1950s, in the 1980s they came under increased scrutiny because of the perception that they were engaged in what some considered unethical practices. Because deposit brokers primarily looked for high rates when selecting a financial institution for investment, it was common for them to move their money whenever rates changed. This threat of sudden withdrawals, regulators charged, caused thrift managers to find ways to keep rates high, which resulted in making riskier loans that would generate sufficient income. Despite this increased risk, brokers protected themselves by only opening accounts that qualified for deposit insurance, a task made easier by the 1980 increase in the coverage amount from $40,000 to $100,000. Regulators alleged that this was exactly what happened in the case of Empire S&LA, since just 3.7 percent of its accounts were not covered by deposit insurance, even though 85 percent of total deposits came from brokers. According to Gray, the use of brokered deposits was a "spreading cancer on the federal deposit insurance system."24

23Report on FHLBB Supervision of Empire S&LA, 41, 43; Hearings on FHLBB Supervision of Empire S&LA, quotes 121.

Outside industry experts, however, strongly disagreed with these arguments, and contended that they obscured the real reason why thrifts failed. According to one banking analyst, "the emphasis on brokered deposits as some sort of major cause of bank failure is simply misleading. Mismanagement is the cause of bank failures." Several brokers who worked with Empire S&LA also told legislators that "on paper the thrift looked very well. But we weren't actually given enough information to make a proper evaluation, so we didn't know all their problems." Based on this testimony, the subcommittee concluded that deposit brokers were not to blame for the problems with Empire S&LA, and in its final report virtually exonerated their activities, saying that "brokered deposits were not the proximate cause of Empire's failure. Brokered deposits did indeed provide additional fuel, but the fire had been raging, and was not originally ignited by the brokered funds."

The Role of Fraud

Although brokered deposits did "provide additional fuel" for Empire S&LA, the basic reason why the fire began lay in broad and systemic corruption inside and outside

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Some critics of deregulation also contend that increasing the level of coverage aided in the size of thrift failure was also erroneous, since under current rules depositors could qualify for coverage using a variety of account options. Similarly, even if the insurance ceiling was not increased, depositors would have had to only open two and a half times the number of accounts to still funnel the same amount of money into a thrift. Managing the Crisis: The FDIC and RTC Experience, (Washington, D.C.: Federal Deposit Insurance Corporation, 1998), 210-11; National Commission on Financial Institution Recovery, Reform and Enforcement, Origins and Causes of the S&L Debacle, (Washington, D.C.: USGPO, 1993), 6, 35-7; Andrew Albert and Richard Ringer, "Some Brokers Shunned Empire But Others Fueled Its Growth," American Banker, 23 March 1984, 1; Jay Rosenstein, "Gray Says Linkage Exists Between Money Brokers and Failures," American Banker, 20 March 1984, 12; Hearings on FHLBB Supervision of Empire S&LA, quote 24; Report on FHLBB Supervision of Empire S&LA, quote 48.
the thrift. One aspect of these unethical practices involved how the thrift abused what were otherwise acceptable lending practices. For example, while it was common for lenders to include up-front fees as part of the loan amount, in the case of Empire S&LA these fees were more than 400 percent higher than normal, which in turn greatly increased the size and risk of these loans. The thrift also followed slipshod loan closing procedures involving the omission of required disclosure documents, and the outright alteration and falsification of other loan materials. While this was done to hide illegal activities, it was also necessary to allow Empire S&LA to close loans rapidly, often at all times of the day and night. According to one investor, “it was not unusual to drive by and see the lights on in the office past midnight, with people inside signing papers and eating pizza.”

The most serious instance of fraud, however, involved how developers deliberately inflated land prices as a way to reap significant profits for themselves. They did this by using a real estate technique known as a “land flip,” which involves the multiple sale and resale of land within a short period of time, often between buyers and sellers who know each other. While land flipping is uncommon but legal if done over a period of months or years, along the I-30 Corridor developers often sold land among themselves several times in just a matter of hours. Furthermore, since the land price increased with each transaction, when these paper-shuffling exercises ended it was common for the final sales price to have risen by more than 800 percent over the original

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26 The senior broker of the Dallas Title Company which closed most of the Empire S&L was also a director of the thrift. Albert and Ringer, "Questions Raised by 'Penn Square of Thrifts' Gets Scrutiny in Congressional Hearing Today," 12; Pusey and Harlan, "Condo Land Deals Price Spiral Probed," 1; Law Interview; Hurlbut, Nauss and Silverstein, "Loan Inquiries Glut Stifle Ray Hubbard Condo Boom," 27-8; Nauss, "Inside View of Empire," quote 10.
acquisition cost. In one such series of land flips, a sixty-acre tract of land was resold ten times among seven individuals in one afternoon; the price of this raw land rose from $1 per square foot to over $6 per square foot. Since Empire S&LA financed each flip, these transactions produced huge paper profits.27

After inflating the price of land, developers subdivided the parcels into small tracts, which were then sold to outside investors unaware of the land flips. This process of “slicing the pie” into smaller pieces both concealed the flips and allowed the developers to realize the actual profits of their flipping. Again, Empire S&LA financed these transactions, which produced millions more in fee income. Since dozens of borrowers were now involved in these deals, the thrift could finance an entire project while still complying with federal regulations that restricted the number of loans a thrift could make to one individual. Although the final borrowers generally did not question these transactions, some worried that they might not be able to repay their loans, especially because these debts often exceeded their actual net worth. Thrift lawyers typically told them that “if worse came to worst, [they] could always declare bankruptcy.” Finally, signing bonuses of between $21,000 and $43,000 per loan alleviated any lingering concerns. As one borrower later said, “they hit you in a place one would like to think is not vulnerable — they hit you right in your greed.”28

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28 Similar payoffs were made to other thrifts that made loans in the I-30 Corridor with participation bonuses sometimes exceeding $500,000. Bowman Interview; Pusey and Harlan, "Condo Land Deals, Price Spiral Probed," 1, 10, quotes 10.
As outrageous as the land flips were, regulators initially had trouble uncovering
them, because the developers found a way to make the inflated land values appear to
reflect actual market conditions. They did this by using independent appraisers who
followed the standards established by the two leading appraisal societies, the Society of
Real Estate Appraisers (SREA) and the American Institute of Real Estate Appraisers
(AIREA). According to these groups, a properly prepared appraisal should use three
different valuation methods: the cost approach, income approach and sales comparison
approach. The sales comparison approach, which is the most accepted way to determine
values for condominium and land sales, uses the sales prices of at least three comparable
properties to determine the value of the subject property. While the definition of a
comparable property is open to personal judgement, the AIREA and SREA require an
appraiser to take into account the location, sales date, and physical similarities when
choosing a comparable. The appraiser should then make adjustments based on any major
differences and provide an explanation for each change.29

While using multiple approaches to arrive at a real estate values is one aspect of
the appraisal process, another equally important consideration involves evaluating
whether or not the proposed use for the property represents its "highest and best use."
For development properties like those in the I-30 corridor, the recommended way to
determine the highest and best use is with a feasibility analysis in which the appraiser
compares a proposed project to existing and competitive projects in the surrounding area.

29American Institute of Real Estate Appraisers, The Appraisal of Real Estate, 8th ed. (Chicago:
American Institute of Real Estate Appraisers, 1983), 11-2, 210, 435.; R. A. Rhodes, Valuation of Chandler's
Landing Marina, Lake Ray Hubbard Texas, (unpublished manuscript), 1, 2, 4.
It takes into account demand and supply projections, the expected absorption rate for the development, as well as development constraints such as zoning and location. These various valuation techniques and methods of analysis make an appraisal not just a report on market values, but a way to answer questions on the economic feasibility of a project, and its compatibility with the surrounding community.\textsuperscript{30}

While virtually anyone can prepare an appraisal, the most highly regarded reports are from appraisers certified by the AIREEA with the designation of “Master Appraisal Institute,” or MAI. These appraisers must meet the highest professional, educational and ethical standards of the AIREEA. The MAI designation “mean[s] as much in real estate appraising as CPA does in accounting and MD does in medicine.” Despite all the efforts to make appraisals unbiased and reliable, their final values are still estimates, which can vary based on different assumptions; as one appraiser wryly admitted, “the only true value is a hardware store.” This inherent flexibility makes appraisals open to influence, and critics charge that anyone can "buy" an appraisal, or that an MAI appraisal is in reality "Made As Instructed.” Still, the overall integrity of appraisers is high, and many outside institutions place ultimate faith in the these people to make unbiased valuations. As one thrift president noted, "If you can’t trust an MAI appraiser, who can you trust?\textsuperscript{31}

\textsuperscript{30}Hearings on FHLBB Supervision of Empire S&LA, 130-3, quote 131; Byrl Boyce and William Kinnard, \textit{Appraising Real Property} (Lexington, MA: Lexington Books, 1983), 109; David C. Lennhoff, "What’s All the Ruckus Over R-41b?" \textit{The Appraisal Journal} 52 (July 1984), 444.

\textsuperscript{31}American Institute of Real Estate Appraisers, \textit{Standards of Professional Practice} (Chicago: American Institute of Real Estate Appraisers, 1982), quote Section 1; Interview with Dr. Terry Grissom, MAI SREA, Associate Professor of Real Estate, University of Texas at Austin, Austin, Texas, by the author 15 November 1984, quote; Pusey and Harlan, "Dallas Appraisal Firms Probed in Condo Deals," quote 1.
Given the importance of this certification to lenders, Empire S&LA used only MAI appraisers to make more than 90 percent of all the valuations in the I-30 Corridor. To ensure these reports supported the inflated values created by the land flips, the developers paid cash bonuses to the appraisers and let them invest in the properties they were evaluating. As a result, it was not surprising that the appraisers ignored most of the professional ethics guidelines, as well as several federal regulations. Most of the sales comparables bore little resemblance to the subject, and the appraisers rarely adjusted their valuations to reflect these differences. If any adjustments were made, they were seemingly done at random with no supporting documentation. Despite such sloppy procedures, the signature of an MAI appraiser on each report gave them an air of legitimacy, which “any S&L would accept and rely on . . . as gospel.” Unfortunately, over time these honest appraisers used these fraudulent valuations as comparables to determine the value of properties unrelated to the thrift scandal, which resulted in “a vicious cycle in which the inflated appraisal supported an inflated loan for an inflated land sale. And soon those land sales were used as comparables for other sales.”

Despite such systematic fraud, Blain testified that he was not to blame for the failure of his thrift, but rather it was due, he claimed, to the overall decline of the Dallas real estate market. His only fault, he said, was succumbing to the “boom psychology” that pervaded the region. Blain also blamed the massive construction in the I-30 Corridor

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by developers not associated with Empire S&LA for depressing sales and asserted that without this additional activity he would have been able to meet his goals. Furthermore, if regulators had been willing to work with him instead of “inducing a destructive process, all the tragic consequences of Empire’s liquidation might have been avoided.” Blain’s arguments were echoed by others who participated in the projects. The president of Bell S&L addressed the issue of high fees noting that the deals were not out of line with market condition. Regulators instead ignored this since it “made more sense for [regulators] to say ‘look at how greedy they were.’ Yes they were good deals and good offers, but that’s what the deals were making at the time. The point was if you take everything out of context it looked crazy.”

The Role of Regulators

Although the fraud that permeated the activities at Empire S&LA was sufficient to cause the insolvency, the subcommittee also found that the magnitude of the crisis was heightened by the lack of timely regulatory intervention. In their defense, regulators claimed that it was hard to reign in the thrift because at the time it appeared to be the model of success. As Bowman stated, “the biggest problem we were faced with was that at least on paper - and as a matter of fact according to the National Thrift News - [Empire S&LA] was a leader in the industry . . . . This makes it that much more difficult for us to walk in the front door and say ‘I’m sorry Number 1, but we’re going to close you down.’ So we felt we had to develop a fairly complex set of evidence to allow us to go into court

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33Nancy L. Ross Empire Chairman Denies Wrongdoing in Collapse,” The Washington Post, 26 April 1984, C13; Hearings on FHLBB Supervision of Empire S&LA, 155-61, quotes 161; Law Interview, quote.
and defend our position.” Ironically, one reason that Empire S&LA could appear to be the model of sound health was that it complied with regulatory rules regarding the distinction between loans and investments.34

As the 1982 Coopers & Lybrand examination revealed, the main reason Empire S&LA appeared financially strong was that it classified its real estate transactions as loans, which allowed it to boost profits with fee income earned when the loan was made. In reality, nearly all of these loans were really investments since the borrowers made no equity contributions; nor did they intend to occupy the properties upon completion. Consequently, the thrift should have deferred its fee income until after the units were sold, a change that would have dramatically reduced earnings and net worth. The Board, however, faced a dilemma, since dozens of thrifts, including many in poor financial condition, used the exact same accounting procedures as those followed by Empire S&LA. As a result, if it forced this one thrift to make changes, every association would have to change, thereby increasing the number of problem institutions and the potential for more failures. To avoid putting pressure on the deposit insurance fund, regulators took refuge in the indecision within the accounting profession on this issue as a way to delay their own action.35


The subcommittee found this position inexcusable, and lambasted regulators for what it characterized as a "Catch-22." Its final report contended that regulators used circular logic in dealing with Empire S&LA, noting that "so long as the association showed steady earnings and high net worth, the regulators would not [move in a] supervisory or regulatory action. The association would continue to show high earnings and net worth if it took fees and points on real estate activities up front, simply because it characterized these activities as loans rather than investments. It remained for the regulators to intercede and break the cycle. . . . It should not have taken the accounting profession's lead for the agencies to be able to distinguish between a loan and an investment." While this indictment of the Board for not setting clear rules that defined the difference between loans and investments was specifically for the failure of Empire S&LA, it could also have been applied elsewhere, since loose regulatory accounting principles helped hide the true financial conditions of other failed thrifts.36

The lack of attention to detail became even more apparent when subcommittee members asked why regulators did not identify any of the unusual trends based on the repeated audits of the thrift. As financial analysis experts later noted, if regulators had reviewed their own reports of Empire S&LA and compared them to the performance figures of similar thrifts in its peer group, several inexplicable contrasts between the failed thrift and other associations in terms of the growth rates, financial ratios, and loan yields would have been very apparent, as seen in Table 10.2:

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<td>(%)</td>
<td>Empire S&amp;LA</td>
<td>Peer Group</td>
<td>Empire S&amp;LA</td>
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<tr>
<td>Chg. Mortgages</td>
<td>276.7</td>
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<td>Chg. Total Assets</td>
<td>170.7</td>
<td>9.6</td>
<td>327.3</td>
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<tr>
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<td>14.4</td>
<td>(19.3)</td>
<td>593.2</td>
</tr>
<tr>
<td>Net Inc./Net Worth</td>
<td>28.7</td>
<td>(37.4)</td>
<td>1,186.4</td>
</tr>
<tr>
<td>Fee Income/GOI *</td>
<td>22.4</td>
<td>3.3</td>
<td>26.3</td>
</tr>
<tr>
<td>Loan Yield</td>
<td>11.23</td>
<td>10.66</td>
<td>25.83</td>
</tr>
</tbody>
</table>

* Gross Operating Income
Source: *Financial Statements of Empire S&LA*, 3-4

Table 10.2: Peer Group Analysis for Empire Savings and Loan Assn. - 1981 to 1983

One of the most revealing trends from this comparison between Empire S&LA and other thrifts that were both similar in size and location is the extremely large increase in total mortgages and assets, especially between June 1982 and June 1983. While these trends were unusually high, because net worth also rose, again at a rate well above that of the peer group, it is understandable that Empire S&LA might escape close regulatory scrutiny. The more revealing trend was the high percentage of total income that came from up-front fees and other one-time payments. This should have caused regulators to question if the high earnings growth was sustainable. Similarly, the loan yield, which was more than double the rate for other thrifts between 1982 and 1983, is an indication that the loans made by Empire S&LA were higher risk than traditional mortgages. These statistics, which were just a portion of the dozens available on this thrift, were all signs that at the very least that Empire S&LA was an unusual institution.
The most remarkable aspect of these comparisons was that they were all taken directly from reports generated by the FHLBB. Unfortunately, the computers used by regulators were not programmed to analyze data in a way that would provide early warnings of potential problems. Similarly, while manual analysis of these reports was possible, supervisors had little time for this, because of the lack of personnel and the large number of problem institutions they had to contend with in the early 1980s. Therefore, it was not surprising that as long as the thrift reported positive net worth and net income regulators did not investigate any further. For the subcommittee, this set of circumstances provided further evidence that federal regulators were not being proactive in preventing problem situations.37

Legislators also bemoaned the bureaucratic inertia that gripped regulators. For example, it took seven months for the Board to resolve the change-of-control rule violation by Blain when he first acquired Empire S&LA, and it took nearly a month for the 1982 federal examination of the thrift to be mailed from Dallas to Washington, D.C. Similarly, when Coopers & Lybrand conducted their audit, they filed more than seven deadline extensions with the Board, each of which was approved "in a stylized bureaucratic fashion." A related problem cited by the subcommittee was that the FHLBB was inefficiently organized, because the people who examined the thrifts were managed from Washington, D.C. while their supervisors reported to the regional home loan banks.

37Hearings on FHLBB Supervision of Empire S&LA, 33-7; Report on FHLBB Supervision of Empire S&LA, 39; Financial Statements Empire S&LA, 1-2

378
This arrangement, legislators charged, led to confused and incomplete lines of communication that allowed problem thrifts to fall through the cracks.\textsuperscript{38}

In addition to the lack of communication within the FHLBB system, there was a communication gap between federal officials and state regulators. For example, the Board did not learn about the supervisory agreement Texas regulators had with Blain until after it closed the thrift. The most embarrassing moment, however, occurred in January, 1984. As regulators were ready to move against Blain and Faulkner, the Office of the Comptroller of the Currency inexplicably approved Faulkner's application to buy a controlling interest in the First National Bank of Garland. According to Bowman, "the day [Faulkner] bought the bank, it was announced in the paper and everybody went crazy. They called us and said are you telling me the Office of the Comptroller of the Currency did not trade information with the FSLIC. That's exactly what I told them. Then I got a call from the Comptroller's office in Dallas saying can't you start talking to us on a regular basis and I said sure. I'm still waiting to hear from them."\textsuperscript{39}

Finally, regulators working on Empire S&LA were affected by bad timing. Just as the thrift began to grow, the regional home loan bank responsible for thrifts in Texas, Arkansas, Louisiana, and New Mexico began the process of relocating its offices from Little Rock to Dallas. Curiously, there were no operational reasons for making this move, and it occurred primarily because the Texas Savings and Loan League used its political


\textsuperscript{39}Bowman Interview, quotes; Sizemore, ``Bowman Ready to Go After Troubled Texas Thrifts,'" 33.
leverage in Congress to give its state the bank headquarters it thought it deserved. The move was a disaster, as only 20 percent of all bank employees went to Dallas. More importantly, of the nearly fifty supervisory agents who worked in Little Rock, only two were at the new headquarters. Unfortunately, these two agents were still responsible for overseeing the work of 116 examiners and activities of 510 thrifts that comprised this district. The result was a huge backlog of review and oversight cases that meant that only the most serious problems received attention. Consequently, because Empire S&LA seemed healthy, it was understandable that the supervisors gave it little attention.40

The Aftermath

Following the closure of Empire S&LA in March 1984, federal regulators had to sort out the mess the thrift had created. Their main task involved finding ways to dispose of thousands of condominiums, many of which were only partially complete or vandalized. Because new appraisals of these projects showed that their actual values were as little as 2 percent of the original valuations, the FSLIC would lose millions if it tried to auction them off in their “as is” condition. As a result, the government invested thousands to improve these properties, and by 1986 had converted 1,900 of these units into a small leasable city, with an additional 1,000 units in the process of rehabilitation. The FSLIC, however, also razed hundreds of units considered beyond repair; and this

activity was followed closely by journalists, including the television show 60 Minutes, which aired a segment on the I-30 Corridor in late 1984.41

A second consequence of the Empire S&LA failure was its impact on the thrifts it worked with. While dozens of associations across the country had to write off all or portions of their investments in the I-30 Corridor, seven thrifts failed directly as a result of this lending. These included all five of the Texas thrifts that had the largest loan exposures, and the cost of bailing them out exceeded $360 million. A third result from this fiasco was an effort by regulators to crack down on deposit brokers. Despite the virtual absolution of brokers’ activities by the House subcommittee, federal thrift and bank regulators still wanted to tighten rules regarding their operations. In March 1984, they issued new rules that required all brokers to register with the FDIC and limited the amount of money any one broker could place in a financial institution to $100,000. The Securities Industries Association challenged these rules and three months later a federal judge ordered them repealed. The FHLBB sought legislative controls on brokers with the Financial Services Competitive Equity Act, but when this bill failed to pass Congress the Board finally decided to abandon the issue.42

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The final chapter in the Empire S&LA saga involved prosecuting the people involved in the failure. By the end of 1985, federal officials had brought to trial more than ninety people and forty-eight corporations associated with the I-30 Corridor projects. They secured convictions in nearly every case. In October 1987, a federal grand jury handed down an 88-count indictment for racketeering and conspiracy against Blain, Faulkner, Toler, and Sinclair. After the first trial in 1989 resulted in a hung jury, Sinclair reached a plea bargain agreement with prosecutors, and based on his testimony a second jury found Blain, Faulkner and Toler guilty on nearly all counts in November 1991. Blain and Faulkner received twenty-year sentences each, and were fined $22 million and $40 million, respectively. Toler received a ten-year sentence and $38 million fine. A 1995 civil suit against Faulkner resulted in an additional judgement of more than $340 million in damages. All told, these legal actions were one of the most successful prosecutions against criminal financial activity in the history of thrift regulation.⁴³

A more positive outcome of this saga was its effect on strengthening the basic tools regulators used to deal with wayward thrifts. The most important change involved expanding the definition of “unsafe and unsound practices” under which the FHLBB

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382
could issue temporary cease-and-desist orders. Although Congress created this power to help the Board swiftly end certain practices without actually closing a thrift, it could only use an order to stop practices that would likely cause an insolvency. Since none of the rules violations exposed in the repeated audits would have directly threatened the financial condition of Empire S&LA, regulators needed more evidence to justify issuing a cease-and-desist order against Empire S&LA. Even after the August 1983 examination revealed unsafe and unsound practices, the Board thought it had to prove these practices would lead directly to a failure, which led to a two-month delay that allowed Empire S&LA to make an additional $50 million in loans. To prevent this in the future, Congress broadened the use of cease-and-desist orders to include instances of incomplete and inaccurate record keeping at a thrift or any of its unregulated subsidiaries.  

A second positive result from the Empire S&LA experience was that Board Chairman Gray began to press for a more vigorous regulatory approach toward the thrift industry. After seeing the videotape showing the waste caused by this S&L, Gray became a convert of re-regulation and lobbied both the White House and the industry to accept tighter regulations. In both areas, however, his efforts fell on deaf ears; as Gray stated at the time, “we have a major crisis here, and I can’t get anyone’s attention.” One reason for this lack of support was that within the White House several close associates to President Reagan, including Treasury Secretary Donald Regan, disliked Gray and criticized him for

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"Although the Board could issue a permanent injunction to end virtually any type of thrift practice, the fact these orders often involved a trial meant they were slow to take effect. Noble, “Empire Savings of Texas is Shut Down,” Sec. D, 4; Albert, “Panel Blasts Bank Board over Empire Failure,” 3; Hearings on FHLBB Supervision of Empire S&LA, 97; Report on FHLBB Supervision of Empire S&LA, 7-8, 36-7, 52."
not supporting the free market spirit of the administration. From the thrift industry, leaders of many large thrifts contended that Gray was an alarmist who exaggerated the magnitude of industry problems. One of the people who wanted Gray to tone down his proposals was Charles Keating whose own thrift, Lincoln Savings & Loan, would become the one of the largest thrift failures in history.45

Conclusions

The case of Empire S&LA is a prime example of how criminal activities that enriched a handful of people both within and outside a thrift sometimes led to a failure costing taxpayers millions. Like other failures involving fraud, the rise and fall of this Texas thrift was remarkably short. Empire S&LA began as Town East Savings and Loan in 1973, and for eight years it remained a small association that served local customers. In early 1982, Town East became Empire S&LA after Spencer Blain became the majority shareholder. His main objective was to make the thrift an industry leader. Blain wanted to increase lending for the acquisition, development and construction of condominium projects outside Dallas. Teaming up with developers, Blain quickly put his plan into operation and soon Empire S&LA was on its way to become one of the fastest growing thrifts in the country. The prosperity of this thrift, however, was illusory as examiners and accountants found out during their periodic reviews of its financial statements.

Despite indications of malfeasance, regulators were slow to react to the problems. At both the state and federal levels, officials had several opportunities to limit the

activities at Empire S&LA, but in each instance failed to act decisively. In March 1984, just eighteen months after Blain took control, regulators finally closed the thrift down, but by then it had become so large that the payout of insured deposits by the FSLIC was the largest in the history of the agency up to that time. Immediately following the collapse, Congress held hearings to determine exactly why this thrift had failed, and its investigation revealed how a variety of forces can often combine to cause financial ruin.
CHAPTER 11
SUCCESS THE OLD-FASHIONED WAY:
THE CASE OF MEDFORD COOPERATIVE BANK

In contrast to the case study of Empire Savings and Loan Association of Mesquite, Texas, an analysis of Medford Co-operative Bank\(^1\) (MCB) provides an instructive example of how many thrifts survived the era of deregulation. MCB, like hundreds of savings and loans, began business in the late-nineteenth century with the mission of helping people of modest means save for the future and become homeowners. Located in a suburb of a large urban center, this small association grew steadily, and over time developed a conservative business style that made it appear stodgy and resistant to change. While such characteristics were positive attributes that benefitted MCB through the 1960s, by the 1970s some within the thrift saw them as liabilities.

Nevertheless, MCB dealt remarkably well with the challenges of the 1980s. The main reason that it thrived when others failed is that management found ways to incorporate change while at the same time adhering to its traditional focus of serving its local community. This practice of “sticking to the knitting” meant that MCB’s management was conservative but open to innovation, provided such changes complemented existing business lines and enhanced customer service. Furthermore,

\(^1\)Massachusetts savings and loan associations are known as cooperative banks.
when it did enter into new business areas, the thrift did so cautiously, which gave it the opportunity to evaluate the results. In the 1990s, MCB made a number of significant changes, including conversion to a stock association and expansion into commercial lending, but the outlook of its leaders did not change. They remained focused on serving the financial needs of the community, a tradition MCB had been following for over a century. While MCB may seem unique, a closer examination of the thrift industry shows that dozens of S&Ls followed a similar path to success.²

The Setting of Medford Co-operative Bank

The town of Medford, Massachusetts, the home of the Medford Co-operative Bank, was founded in 1630 and has deep roots in American history. Organized as the seventh town in British North America, Medford is located on the rolling and wooded countryside on the Mystic River about five miles from Boston. For more than two centuries, Medford thrived on its renowned shipbuilding and rum-distilling industries, and in 1852 it became the home of Tufts University. The town was also the site of several contributions to Americana, including the song “Jingle Bells” by James Pierpont and the poem “Over the River and Through the Wood” by abolitionist Lydia Child. Although Medford attracted many upper-class residents from Boston who lived in large

²Thomas J. Peters and Robert H. Waterman, Jr., In Search of Excellence: Lessons from America's Best-Run Companies (New York: Warner Books, 1982), 15. This chapter is based on material obtained from MCB and its employees. All bank prepared financial statements and directors’ meeting manuscripts are located at the main office of MCB at 60 High St., Medford, MA. Interviews with key personnel were conducted by the author at the bank offices, and all relevant material from these conversations is in the possession of the author.
summer retreats along the Mystic River, it was essentially a quiet rural community whose population through the mid-nineteenth century never exceeded 5,500.³

Medford began to change in the 1860s following construction of a streetcar line that connected it to Boston. Such affordable transportation led more middle-class Bostonians to move away from the urban center and into suburbs like Medford. The result was that between 1870 and 1890 Medford’s population more than doubled to 11,200. Fifteen years later it exceeded 22,000. By 1930, the number of residents leveled out at just over 60,000, a figure that would not change much for the next sixty years. Significantly, many of the new Medfordites were working-class Irish and Italians who had jobs in Boston. Although this population growth helped make Medford a true bedroom community for the larger city, the town still maintained a strong separate identity. A number of small manufacturers and service companies had offices in Medford, and its economic base received a major boost with the opening of the regional Lawrence Memorial Hospital in 1965. At the same time, this new source of stable employment reflected the fact that the local population was aging rapidly.⁴

The Beginnings of the Medford Co-operative Bank

In May 1886, forty-five leading citizens from Medford and Boston founded the Medford Co-operative Bank as the thirty-ninth thrift in Massachusetts. MCB had many

³Carl Seaburg and Alan Seaburg, Medford on the Mystic, (Medford, MA: s.n., 1980), 3-4, 100, 104, 114.

characteristics common to nineteenth-century thrifts. It was a mutual association that helped people acquire homes and save for the future by issuing series of shares, each worth $200, each twice each year, which members paid for in monthly installments. A board of directors elected by the members approved all loans and set general business policies. The only paid employee of MCB was its secretary and treasurer, Medford retailer James Sturtevant, who along with his wife managed the day-to-day activities of the bank. Membership was open to both men and women, and the majority of these people came from Medford and the surrounding communities of Arlington, Malden, and Somerville. 

Members met the first Wednesday of each month at a rented room in the Legion of Honor Hall for the regular “sale” of money. Prospective borrowers submitted bids on the interest rates and premiums they were willing to pay for loans, and prior to disbursing funds a Security Committee of thrift directors evaluated the “characters” of the borrowers, and inspected the property, a process that took up to three months to complete. Share and loan payments were due monthly; and, depending on the rate of dividends, shares and loans matured within five to eight years. Despite the tedious loan approval process and lack of formal office space, the new cooperative was a financial success and grew quickly, as seen in Table 11.1:

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389
<table>
<thead>
<tr>
<th>Year</th>
<th>Members</th>
<th>Chg./Yr.</th>
<th>Assets</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1888</td>
<td>320</td>
<td>---</td>
<td>$28,883</td>
<td>---</td>
</tr>
<tr>
<td>1895</td>
<td>576</td>
<td>11.4%</td>
<td>$264,421</td>
<td>116.5%</td>
</tr>
<tr>
<td>1900</td>
<td>645</td>
<td>5.9%</td>
<td>$362,038</td>
<td>7.4%</td>
</tr>
<tr>
<td>1905</td>
<td>915</td>
<td>8.3%</td>
<td>$593,548</td>
<td>10.2%</td>
</tr>
<tr>
<td>1910</td>
<td>1,401</td>
<td>10.5%</td>
<td>$842,717</td>
<td>8.4%</td>
</tr>
</tbody>
</table>


Table 11.1: Medford Cooperative Bank, Members and Assets - 1888 to 1910

By the early 1910s, MCB had become a profitable and healthy mid-sized institution. After expanding rapidly during the economic boom that preceded the depression of the mid-1890s, growth became more uniform. Similarly, management followed conservative lending practices, as evidenced by the absence of any loan defaults for the first ten years of operations. One reason for this superior performance might be that many of the borrowers were more well-to-do, since the average MCB mortgage was more than what the typical working-class home of the period cost. Another reason may be that loans were often made on the “character” of the borrowers, not just financial considerations. Personal relations between management and members were very strong, and the Board did not see the need to have any written lending policies, a practice that would continue into the 1980s. Interestingly, many MCB members used the bank as a
way to save for the future, since the ratio of borrowers to total members did not exceed 5 percent until the mid-1910s. Such considerations may also explain why MCB’s reserve ratio, which was just 0.93 percent in 1895, actually fell to 0.43 percent by 1910.6

Like other thrifts, MCB used very little outside advertising to solicit business, but instead relied on word-of-mouth advertising from existing shareholders to attract new members. In fact, its first publicity campaign did not occur until 1914, and consisted of a mass mailing and a display at the new moving picture theater. This low-key approach to business carried over into MCB’s physical presence: aside from the monthly meeting, the only way for members to make payments was to visit Treasurer Sturtevant at his home on one of the two days each week that he accepted money. While Sturtevant was not a trained accountant, during his twenty-five years with the bank he kept meticulous records in a general ledger using a double-entry system that he balanced each business day. Sturtevant finally resigned as treasurer, at the suggestion of the Board, after the state mental hospital found him to be permanently incapacitated.7

Growth Brings Change

As MCB matured as a financial institution, it began to adopt more formal business procedures. By the start of World War I, MCB had moved into a spacious office on the
top floor of the new Medford Trust Building in downtown and was open every business
day. The bank began making loans at rates set by the Board, and had reduced the time
between loan approval and disbursement to a matter of days. Although it did not have
any branches, customers were allowed to make payments at one of several retail stores in
South Medford, West Medford, and Boston that were owned by an MCB shareholder.
MCB also adopted the use of matured shares, which allowed members to keep their
money in the thrift after paying for their original shares in full.®

Like many thrifts in the late nineteenth century, as MCB grew in size, its leaders
became involved in state banking affairs. Although Massachusetts cooperatives were not
seriously affected by the "nationals" crisis of the 1890s, their leaders, like thrift
executives across the country, realized that they needed a state trade association to protect
their business interests. In 1888, they formed the Massachusetts Co-operative Bank
League as a way for members to exchange ideas, to improve their financial education,
and to "assist in any needed legislation" that would support the industry. Although MCB
joined the state league in 1890 and was active in trade group functions, its and lobbying
efforts. In contrast to the strong participation in state affairs, MCB was reluctant to join
the national trade association, believing like many other small thrifts that this group did
not have a critical role in its affairs.®

®Oreb M. Tucker Three Score and Ten Years: A History of Seventy Years of Co-operative Banking
in Massachusetts (Boston: Central Co-operative Bank, 1948), 88, 95; DMM 1886-1902, 241; DMM 1902-
1912, 94; Directors Meetings Minutes April 10, 1912 to October 8, 1924 (unpublished manuscript,
Medford Cooperative Bank, Medford MA) [hereafter DMM 1912-1924], 84, 93; Fifty Years of Service, 12.

®MCB first joined the League in 1927 shortly after it began admitting thrifts as members, but quit
and rejoined several times over the next fifty years. DMM 1886-1902, 82; Tucker, Three Score and Ten

392
By the 1920s, the rising population of Medford had attracted several new financial institutions to the area. In addition to two banks, Medford Savings and Medford Trust, both of which had been in business since the mid-1800s, the town received two new thrifts, the Hillside-Cambridge Co-operative Bank and West Medford Co-operative Bank, as well as branches of several Boston banks. Although competition rose sharply, MCB management refused to match the more liberal practices of these newer thrifts, since MCB consistently paid lower dividend rates than the competition while charging loan rates that were just above the market. Such conservative policies, however, did not cost the cooperative much business, and from the mid-1910s to the end of the 1920s MCB recorded solid growth, as seen in Table 11.2:

<table>
<thead>
<tr>
<th>Year</th>
<th>Members</th>
<th>Chg./Yr.</th>
<th>Assets</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1915</td>
<td>2,069</td>
<td>8.9%</td>
<td>$1,310,678</td>
<td>11.1%</td>
</tr>
<tr>
<td>1920</td>
<td>2,579</td>
<td>4.9%</td>
<td>$2,267,404</td>
<td>14.5%</td>
</tr>
<tr>
<td>1925</td>
<td>3,856</td>
<td>9.9%</td>
<td>$4,209,021</td>
<td>17.2%</td>
</tr>
<tr>
<td>1930</td>
<td>4,746</td>
<td>4.6%</td>
<td>$5,911,327</td>
<td>8.0%</td>
</tr>
</tbody>
</table>


Table 11.2: Medford Cooperative Bank, Members and Assets - 1915 to 1930

*Years Ago, 120-35, quote 124.*
This fifteen-year period was the first time of sustained and exceptional growth for MCB. The thrift surpassed $1 million in assets in 1913, and in less than fifteen years it had grown fivefold. This expansion came from meeting local loan demand, with more than 90 percent of all mortgages going to Medford residents. Furthermore, nearly a third of all borrowers were women. The co-op continued to improve customer service by opening three distinct bank branches in the Medford area. Despite these changes, MCB continued to follow conservative policies designed to improve its financial condition. Because the Board had raised the amount of profits paid into reserves from 1 percent to 5 percent, the reserve ratio rose sharply from its prewar lows to 4.94 percent by 1930, which was close to the state minimum of 5 percent. Similarly, the bank continued to attract long-term savers as members, as evidenced by the rise in value of matured shares from $33,200 in 1915 to $1.79 million in 1930. 

Another important achievement for MCB during this period came when the thrift acquired its own office building. In 1924, the Board decided to follow its own advice of “owning their own home” and began the search for a suitable location. In 1929, they purchased property on Medford Square in the heart of downtown and hired an architect to design a new building that would reflect not only the heritage of Medford but also the

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ideals of home ownership. The design chosen was a two-story red brick Georgian structure with fireplaces at either end. Not only was the new office functional and large enough for future growth, but it was inviting to customers, a trait not common to traditional bank buildings. Construction began the following year; and in 1931, when the thrift industry celebrated its centennial, MCB moved into its new home.  

Amid this success, there were signs, however, of potential problems, especially in terms of increased loan delinquencies and foreclosures. While it was true that the quality of MCB’s loan portfolio was high, with an average annual loan loss during its first forty-five years of just $30, the thrift also saw more members becoming borrowers. Between 1920 and 1928, the ratio of borrowers to total members rose from 16 percent to 36 percent, and many of these new borrowers appeared to be higher risks, since the proportion of loans more than six months past due increased from less than 0.2 percent to almost 1 percent of total loans. At the same time, foreclosures represented by real estate owned, which historically were virtually nonexistent, rose to about 0.6 percent of total assets. While these changes likely resulted from an over-extension of credit, especially to developers, their sudden increase at the end of the decade indicated market weakness that would worsen as delinquencies rose.  

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Dealing with the Great Depression

Although the 1930s began for MCB on a positive note with a gala celebration marking the opening of its new offices, the decade would prove to be one of the most challenging in its history. By late 1930, the Great Depression was having an effect on the Medford area, and one reason MCB began construction of its new office that winter was to help reduce local unemployment. As more people succumbed to these “hard times,” bank directors tried to help its members cope with “loan reduction” agreements that allowed borrowers to apply the value of unpledged shares they owned against the balance of their mortgages. Approved for use by the Massachusetts legislature in 1930, these agreements were a way to reduce the level of chronic loan delinquencies; but, since borrowers also had to subscribe to new shares as part of these agreements, they were not true debt forgiveness.\(^{13}\)

In October 1931, MCB faced a major crisis when one of its depository banks, Medford Trust, experienced a run on deposits that forced it into voluntary liquidation. This closure posed a number of problems for the thrift. Not only did MCB face the risk of losing more than $100,000 in deposits it held at Medford Trust, but the loss of consumer confidence spread to MCB itself as over the next six months members withdrew more than $600,000. While such runs usually ended in failure, MCB survived in part because it maintained depository relationships with large Boston banks that gave it access to the funds needed to meet any withdrawals. Still, the experience was very trying

\(^{13}\)Fifty Years of Service, 20-2.
for the Board, and several directors were bitter that some members had little faith in the
strength of their association. A second impact of the Medford Trust closure on MCB was
that it led to the resignation of several directors who served on the boards of both
institutions. These resignations occurred after several local stock brokers were indicted
for securities fraud; and while none of these directors was implicated, they likely left to
avoid tainting the reputation of MCB.14

While the closure of Medford Trust was traumatic, MCB faced other persistent
problems associated with the Great Depression. Like all lenders, MCB wrestled with
the problem of loan delinquencies, which peaked in early 1933 at 5 percent of total loans,
as well as foreclosures, which hit their high at the end of that year. Significantly, the
experiences of MCB in both these areas were superior to those of the thrift industry as a
whole, indicating that management worked with borrowers to find ways to help them stay
current on their mortgages. In general, the Board was reluctant to foreclose on a
borrower, not simply out of compassion for the home owner, but because doing so would
cause the thrift to acquire a property it would likely be unable to resell. Foreclosure,
however, did occur; and between 1932 and 1940 the book value of real estate owned by

14Following lawsuits filed by Medford Trust shareholders, the bank president was convicted of
fraud in 1932. "Medford Trust Company Closed by Request of Its Board of Directors," Medford Mercury,
7 October 1931, 1; "Declare No Loss Will be Sustained by Depositors of Medford Trust Company,"
Medford Mercury, 8 October 1931, 1; DMM 1924-1932, 353, 439, 451-3, 462, 628; Fifty Years of
Service, 17.
the bank grew from more than $240,000 to $750,000, which was equal to 25 percent of its total mortgage portfolio.\textsuperscript{15}

This high level of real estate held by the thrift eventually led state regulators in 1940 to order it to reduce its backlog of properties. The Board formed a new department to dispose of these assets, and within two years the level of real estate owned fell by more than 90 percent. While it did recover 88 percent of the original book value of these assets, MCB still had to absorb a $108,000 write-off, which reduced its equity by half. Remarkably, the thrift was in such good financial condition that even after this loss its reserve ratio was still well above state requirements. One reason was that the Board adopted very conservative policies that included slashing its dividend rate, closing branch offices, and freezing employees' salaries. As a result, the bank posted profits each year during the 1930s. The Board even paid out extra dividends in November 1932 and February 1933, decisions likely designed to help shareholders endure the hardest period of the depression.\textsuperscript{16}


The success MCB had in dealing with the challenges of the Great Depression was not unique among Massachusetts cooperatives, and in fact only 18 percent of all of the state's thrifts failed between 1927 and 1933. One reason for this low rate of failure was that the state trade association found ways to aid its members. In 1931, it created the Bay State Trust which pooled money from its members in a fund that was available to the contributors for liquidity needs. The next year, the trade group proposed that the state create a central bank that would provide loans for all cooperatives, much like the Federal Home Loan Bank. While state regulators supported this plan, most state thrifts opposed it for many of the same reasons they opposed a national thrift reserve bank. The cooperatives, however, embraced the idea after the state bank commissioner threatened to double the minimum reserve requirement if the central bank were not formed.\footnote{DMM 1924-32, 378, 439, 462.}

In March 1932, the state legislature created the Cooperative Central Bank (CCB), and within a year more than 80 percent of all cooperatives, including MCB, were members. Like the federal home loan bank, the CCB provided an invaluable source of liquidity to its members, especially when President Franklin D. Roosevelt declared a national bank holiday in March 1933. When this crisis passed a few weeks later, Massachusetts was one of the few states in which every thrift was allowed to reopen. A second program that benefitted cooperatives was the creation of a state share insurance fund in 1934. Like the CCB this initiative was supported by the state trade association and generally opposed by individual thrifts. Despite these divisions, the state created the
insurance program, which produced an almost immediate restoration of public confidence in thrifts, thereby limiting the potential for disastrous deposit runs.  

*Maintaining Conservative Business Practices*

The impact of the Great Depression on MCB's management was profound, and even after prosperity returned in the 1950s the bank still followed very conservative policies. One reason was that most of bank directors of the late 1920s and 1930s were still with MCB some thirty years later. In fact, during its first sixty years of existence MCB had just three presidents and four treasurers, and most of the directors served well into their seventies. The influence of these "survivors of hard times" in setting business policies is evident in the slow growth of MCB from 1935 to 1955, as seen in Table 11.3:

<table>
<thead>
<tr>
<th>Year</th>
<th>Members</th>
<th>Chg./Yr</th>
<th>Assets</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1935</td>
<td>3,510</td>
<td>(5.1%)</td>
<td>$5,041,591</td>
<td>(2.9%)</td>
</tr>
<tr>
<td>1940</td>
<td>3,419</td>
<td>(0.5%)</td>
<td>$4,586,491</td>
<td>(1.8%)</td>
</tr>
<tr>
<td>1945</td>
<td>3,321</td>
<td>(0.5%)</td>
<td>$3,653,749</td>
<td>(4.0%)</td>
</tr>
<tr>
<td>1950</td>
<td>3,484</td>
<td>0.9%</td>
<td>$3,612,761</td>
<td>(0.2%)</td>
</tr>
<tr>
<td>1955</td>
<td>5,468</td>
<td>11.3%</td>
<td>$5,262,186</td>
<td>9.1%</td>
</tr>
</tbody>
</table>


Table 11.3: Medford Cooperative Bank, Members and Assets - 1935 to 1955

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During World War II, MCB did not experience as great a surge in savings as the thrift industry as a whole, and in fact during the war years deposits declined by an average of 3.5 percent per year. The main reason for this drop was that MCB kept dividend rates low, not only because the state bank commissioner had requested in 1942 that all thrifts reduce their rates, but also because of the wartime restrictions on home building. When the lack of lending opportunities ended by 1946 and most thrifts grew rapidly, MCB continued to show anemic loan growth. During the last half of the 1940s, the Board rejected dozens of loan requests as being too risky, and most business came by way of traditional word-of-mouth referrals as opposed to formal advertising. Instead of aggressive lending, MCB kept its dividend rates low and focused on rebuilding reserves depleted by the losses on asset sales in 1942. As a result, even though assets did not rise significantly, the reserve ratio for MCB did, jumping from 8.1 percent in 1935 to more than 14.5 percent by 1950, which was nearly three times the state-required minimum.¹⁹

While these conservative business policies caused MCB to miss out on the initial postwar housing boom, they did not mean that the thrift was unwilling to change. The Board adopted several new lending products, including the direct-reduction mortgage,

flexible mortgages, and home-improvement loans. MCB was also a fairly active lender under the Veterans Administration loan program. To better correlate lending risks with loan returns, management began using a sliding scale for interest rates based on the quality of the borrower and/or property. By the mid-1950s, business had increased to such an extent that MCB hired its first new employees in nearly twenty years. The Board even considered microfilming bank records, not as a way to improve efficiency, but as a precaution against an attack on America by a foreign power.²⁰

*Change Brings Growth*

As MCB moved into the 1960s, some on the Board began to see the continued conservative attitudes of its directors and managers as a potential liability to the long-term growth of the thrift. Two significant changes, however, prevented MCB from becoming a staid institution. The first was the departure of most Board members who had served since the 1920s and 1930s, which created an opportunity to bring in a younger generation of bankers. Among the new directors were John Hand, a former Massachusetts state bank examiner, and Robert Surabian, a Medford retailer and real estate investor, both of whom came to MCB in 1967. By the early 1970s, Hand was the executive vice president of MCB in charge of daily operations, while Surabian was the first chairman of the board and one of the main architects of long-term strategic planning.

²⁰ Like many savings and loan associations, MCB avoided making FHA loans because of they typically earned lower interest rates than conventional mortgages. *Massachusetts Cooperative Bank News* n.v. (July 1967), 1-2; *DMM 1941-1949*, 1742, 1779, 1754, 1853, 1867-8, 1941; *Directors Meetings Minutes June 8 1949 to October 9 1957* [hereafter *DMM 1949-1957*] (unpublished manuscript, Medford Cooperative Bank, Medford MA), 2085, 2382, 2422; *Fifty Years*, 17-21; Alan Seaburg, *Medford Cooperative Bank: 100 Years of Service to the Community* (Medford MA: s.n., 1986), 27
for the thrift. While these new officers brought a youthful exuberance to MCB, they were still committed to the bank’s traditional goals of sound home finance, serving the local community, and focusing on customer service.

The second major change came in 1970 when MCB acquired West Medford Cooperative Bank, a smaller association, but one with a more progressive management team than the older thrift. West Medford Cooperative had been organized in the 1920s, and by 1965 had grown to more than $4.59 million in assets with nearly 3,000 members. During the previous decade, it had experienced solid loan growth of nearly 8 percent annually, in part because it advertised more aggressively than MCB and paid higher dividends. Despite this, the smaller cooperative had a solid financial condition with a strong reserve ratio of 6.9 percent. The acquisition came after months of overtures by MCB, and it was by all accounts a friendly combination in which members from both cooperatives served on the new Board. The acquisition led MCB to modernize its management structure in order to better delegate authority within the larger institution and improve business development. It created the new title of Chairman of the Board, as well as four new vice president and four new assistant treasurer positions. Women would fill all of the new assistant treasurer posts.

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22 West Medford spent an average of 54 cents per $1,000 in assets on advertising, while MCB spent only 27 cents per $1,000. *DMM 1967-1974*, 3005, 3127, 3145-7, 3333; Annual Report of the Commissioner of Banking, *Section A, 1960*, Public Document no. 8 (Boston: Commonwealth of Massachusetts Banking Commissioner, 1960), 96; *Report of the Commissioner of Banking, Section A*,
While men held the top management positions at MCB, as in thrift industry in general, women were also an integral part of MCB's workforce. Most female employees were tellers, but because MCB promoted from within, women also could become managers. The first was Assistant Treasurer Olivia Crocker in 1948, followed by Cecilia Hussey as treasurer in 1962. Three years later, Hussey became a director and was the first woman in Medford to serve on any bank board. Despite these opportunities, MCB, like other businesses, also had a "glass ceiling" that kept women from ascending to high office. An example of this came in 1972 when the Board refused to promote Assistant Treasurer Lorraine Silva, who had first joined the bank in 1948, to bank treasurer because "they did not think a woman should be there." They instead hired a less qualified man, who ironically came under the supervision of Silva when the Board decided to make her vice president six years later, the first women to hold such a position in Medford.\(^{23}\)

**MCB Under John Hand**

The changes in the Board, combined with the benefits of the acquisition of the West Medford Cooperative Bank, helped MCB record rapid growth in the 1960s and 1970s, as seen in Table 11.4:

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<table>
<thead>
<tr>
<th>Year</th>
<th>Members</th>
<th>Chg./Yr.</th>
<th>Assets</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>n/a</td>
<td>---</td>
<td>$6,867,116</td>
<td>6.1%</td>
</tr>
<tr>
<td>1965</td>
<td>4,866</td>
<td>---</td>
<td>$8,555,015</td>
<td>4.9%</td>
</tr>
<tr>
<td>1970</td>
<td>7,250</td>
<td>9.7%</td>
<td>$14,759,381</td>
<td>14.5%</td>
</tr>
<tr>
<td>1974</td>
<td>9,340</td>
<td>5.7%</td>
<td>$23,520,464</td>
<td>11.8%</td>
</tr>
<tr>
<td>1979</td>
<td>n/a</td>
<td>---</td>
<td>$51,169,264</td>
<td>23.5%</td>
</tr>
</tbody>
</table>


Table 11.4: Medford Cooperative Bank, Members and Assets - 1960 to 1979

During the late 1960s and 1970s, MCB experienced its most significant growth since the 1920s, a remarkable performance given the unevenness of the American economy of this period. The main reason for this expansion was that MCB modernized its lending policies to become a more aggressive financial institution. Like most New England thrifts in the 1970s, MCB began making personal loans for cars and education, and introduced new savings options like NOW accounts. The bank significantly increased advertising, with expenditures on promotions rising from the 27 cents per $1,000 in assets in 1965 to 84 cents per $1,000 in assets by the mid-1970s. The more aggressive business posture did not, however, weaken the financial condition of the thrift.
Although the reserve ratio for MCB fell from 8.9 percent in 1965 to 6.3 percent by 1977, it was still well above the legal minimum of 5 percent.24

Although MCB became a more "modern" thrift during the late 1960s and 1970s, it still retained its old-fashioned commitment to personal service and customer contact. Tellers typically knew the members by name, and it was common for people to line up in order to speak to their favorite teller. Executive Vice President John Hand worked closely with bank customers and had the authority to approve most non-mortgage loan requests. He also participated actively in community affairs, and in 1972 the Medford Chamber of Commerce named him "Man of the Year." His direct contact with the members was so strong that some people in Medford began to call MCB "John Hand's Bank." Lorraine Silva was also an important figure in Medford, earning accolades from community leaders. Within the MCB, Silva and Hand encouraged an informal family-like work environment that caused bank employees to refer to them as "Ma and Pa."25

Surviving Deregulation

During the 1980s, America's volatile economy and the effects of deregulation took a large toll on all financial institutions in Massachusetts. Between 1980 and 1991, fifty-one banks with more than $33 billion in assets failed, while eight federally-chartered


25Interview Deborah McNeill, senior vice president and treasurer, Medford Cooperative Bank, Medford, MA, by the author, 15 August 1998; Interview Henry Sampson, Vice President, Medford Cooperative Bank, Medford, MA, by the author, 15 August 1998; Silva Interview; "Bank Officer and Civic Activist is Retiring," Medford Mercury, 31 May 1991, 1, 8; Seaburg, Medford Cooperative Bank, 21.
thrifts with $6.9 billion in assets went under. These failure rates were the ninth and eighteenth highest, respectively, in the country. At the same time, the number of state-chartered thrifts shrank from 134 in 1978 to just ninety-five twelve years later. Despite this carnage, MCB managed to survive the decade in fairly good shape. One important reason for this survival was its continued focus on traditional home lending and conservative business policies. Throughout most of the decade, MCB invested between 15 and 20 percent of all funds in government securities, and it adopted new technologies like electronic funds transfer services after they had proven their worth in the marketplace. This conscious decision to “stick to the knitting” seemed unusual given the opportunities afforded by deregulation. They were part of the broader management philosophy of doing what the bank did best.²⁶

One reason for this conservative business attitude was that even though many of the new managers like Hand and Surabian wanted MCB to be a modern institution, they were still strictly “old school” bankers. They believed that their cooperative should only add services that would complement existing mortgage business, and they specifically avoided high-risk fields like commercial lending and out-of-state loans. Old-fashioned referrals continued to be a major source of business for most of the 1980s. Furthermore, even though Board membership had changed in the 1960s, a third of the directors still

²⁶MCB bought its first automated teller machine 1984, and joined an automated clearinghouse in 1989; prior to then the bank manually deposited its funds with other institutions. DMM 1974-1980, 3937; Directors Meetings Minutes June 25, 1980 to February 26, 1986 [hereafter DMM 1980-1986] (unpublished manuscript, Medford Cooperative Bank, Medford MA), 4075-6, 4152-3; Surabian Interview; McNeill Interview; Interview Ralph Dunham, chief financial officer and executive vice president, Medford Cooperative Bank, Medford, MA, by the author, 14 August 1998.

407
serving were old enough to remember the Great Depression, and this memory helped reinforce the idea that MCB was “Medford’s Community Bank.” As Surabian noted in 1983, although there was “a change in the philosophy of some thrift institutions . . . to serve businesses and commercial enterprises, our main business is still lending to home buyers.”

One sign of this enduring commitment to the ideals of individual thrift was the creation of the Educational Cooperative Bank at Medford High School in 1985. Formed with the assistance of the Medford school system, this first-of-a-kind Massachusetts bank was a branch of MCB that served both the student body and faculty. It also had its own separate charter. Run entirely by Medford high school students supervised by a MCB employee, the Educational Cooperative Bank allowed students to receive academic credit as well as hands-on work experience. The bank also helped teenagers develop the habits of thrift, budgeting skills, and the responsibility for paying back loans. Praised by community leaders, its number of student-members grew steadily, and the institution earned profits for the school while creating a potential pool of future MCB employees.

With a deliberate focus on serving the community and conservative lending, MCB continued to grow and remain financially healthy in the 1980s, as seen in Table 11.5:

\[ \text{Table 11.5:} \]

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\[ ^{27} \text{DMM 1980-1986, 4153 quote 4413.} \]

\[ ^{28} \text{MHS, Medford Coop are Banking on Student's Ability, Medford Mercury, 10 October 1985, 1, 8; Sampson Interview; Silva Interview.} \]

408
### Table 11.5: Medford Cooperative Bank, Members and Assets - 1980 to 1990

Despite the continued financial improvements for MCB during the decade, there were still times of near-panic within the thrift. Like nearly every thrift, the unprecedented increase in interest rates in the early 1980s caused MCB to post net losses. Although year-end losses in 1981 and 1982 were only $77,741 and $99,067, respectively, from June 1981 to June 1982 the thrift had a total deficit in excess of $300,000. According to Surabian this period was "one the most difficult . . . since the thirties," and management responded by cutting expenses, increasing fees on bank products, and making more loans that paid market rates, like personal loans and adjustable-rate mortgages made possible by deregulation. Significantly, the bank did not pursue the high earnings potential afforded by commercial lending, as a result of a learning experience. In 1984, MCB did participate in a commercial loan to renovate a downtown office building, but when the

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets (000)</th>
<th>Chg./Yr.</th>
<th>Reserves (000)</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>$51,989</td>
<td>---</td>
<td>$2,811</td>
<td>---</td>
</tr>
<tr>
<td>1985</td>
<td>$71,718</td>
<td>7.5%</td>
<td>$3,700</td>
<td>6.3%</td>
</tr>
<tr>
<td>1988</td>
<td>$87,396</td>
<td>7.2%</td>
<td>$6,292</td>
<td>23.2%</td>
</tr>
<tr>
<td>1990</td>
<td>$96,538</td>
<td>5.2%</td>
<td>$7,478</td>
<td>9.4%</td>
</tr>
</tbody>
</table>

project encountered problems in finding tenants the loan had to be restructured. This sour
experience led the Board to avoid all other commercial loan opportunities.\(^\text{29}\)

Another major problem for MCB came in 1986 when a jump in Massachusetts
thrift failures threatened the liquidity of the state deposit insurance fund, which in turn led
the state bank commissioner to order all cooperatives to apply for membership in a
federal deposit insurance program. MCB decided to join the FDIC, but because its
reserve ratio was below the 7.5 percent reserve level required by the federal agency, the
bank had to take out a $1.4 million loan from the CCB, which it added to reserves to meet
FDIC reserved requirements. Although embarrassed by this lack of financial cushion,
especially because management had worked hard to build reserves over the years, MCB
was able to repay the CCB loan and meet FDIC reserve regulations by the early 1990s.\(^\text{30}\)

Another impact of events of the 1980s on MCB was the rise in loan delinquencies,
and to deal with this management followed the practices it had used in the 1930s of
working closely with past-due borrowers to help them make payments. This policy of
“compassionate collections” was possible in part because the bank still made many loan
decisions based more on the quality of the borrower than on the underlying collateral; in
fact, up to the late-1980s MCB did not require appraisals or title insurance. This
“character lending” was possible because of the close ties between the bank officers and

\(^{29}\text{DMM 1974-1980, 3936-7; Medford Cooperative Bank Financial Statements, 1980; Medford
Cooperative Bank Financial Statements, 1970; Medford Cooperative Bank Financial Statements, 1988;
DMM 1980-1986, 4075, quote 4152.}\)

\(^{30}\text{Surabian Interview; Capital Assistance Agreement between Medford Cooperative Bank and the
Cooperative Central Bank, February 28, 1986 (unpublished financial document); Massachusetts
this community. Most directors still knew bank customers personally, and Lorraine Silva, who became a director in 1983, said she could not walk down the street without meeting at least a dozen people she knew, many of them borrowers from MCB. Given this close connection with the community, it was not surprising that many MCB borrowers felt like part of a family.\textsuperscript{31}

\textit{Restructuring the "Family Business"}

The big event of the 1980s was the celebration of MCB's 100th anniversary in 1986, and the similarities between this and its 50th anniversary are remarkable. Both involved lavish affairs attended by local dignitaries, both occurred during periods of modest recovery from crisis situations, and both preceded major changes in how MCB was run. By the late-1980s, the last of the bank directors to join in the 1950s had retired, and the Board was dominated by younger more "business-minded" individuals. Furthermore, Board service was no longer considered "a privilege" and rubber stamp for officer decisions, but rather a job that required an understanding of how banks worked. One result of having a more financially astute Board was the realization that MCB needed to maintain more sophisticated financial systems.\textsuperscript{32}

In 1988, Ralph Dunham joined MCB as its first chief financial officer, and one of his first tasks was to formalize bank procedures. Under John Hand, MCB's management was highly centralized, with literally every piece of paper passing over his desk. Ledgers

\textsuperscript{31}Silva Interview, Surabian Interview, McNeill Interview, Sampson Interview.

\textsuperscript{32}Surabian Interview.
were still posted by hand, and no real financial monitoring existed. While this may have worked for a $25 million institution in the 1970s, by the end of the 1980s MCB was approaching $100 million in assets, and the inefficiencies of such informal procedures were beginning to show. Among the changes Dunham put in place were: a budget, the use of ratio analysis to measure productivity, asset and liability tracking reports, and increased use of computers. Surabian and the Board also began annual strategic planning reviews to chart a long-term course of the bank, and they encouraged employees to take more courses offered by the state thrift trade association. 

While mostly beneficial, these changes also had some costs, such as a decrease in responsibilities as jobs became more specialized. In the past, tellers “wore many hats” and had to know about all bank products and be able to give some advice to members, but by the 1980s their duties were much more narrowly defined. Another casualty of change was the bank’s informal culture. Although management still treated employees like family, the atmosphere was different from when “Ma” Silva and “Pa” Hand had run things. In the “old days” work schedules were flexible, and it was common for the bank to celebrate any occasion with parties. By the end of the 1980s, with the bank having to monitor costs and raise reserves, these practices had to go. Finally, a more competitive environment contributed to the need for greater financial discipline. From 1975, when

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just fifteen banks had a presence in Medford, the number of financial institutions making
loans in the local market had doubled every ten years, and totaled sixty by 1995.34

_Expanding MCB Under Robert Surabian_

The final break with the past came in 1991 when Hand retired as executive vice
president, and Surabian became president and chief executive officer. Like Hand, the
new CEO was active in the community and committed to keeping MCB a local
institution. While he wanted to preserve the elements that had made MCB successful in
the past, Surabian was also aware that the thrift needed to expand its business in order for
it to survive as an independent entity into the next century. This idea of combining new
and old ideas played itself out in the decision to expand the bank's offices. MCB had
operated in the same building since the 1930s, and by the 1980s it needed more space to
house all its operations and a workforce that had grown from six in 1970 to sixteen by
1985, and that would rise to forty-five by 1995. Although there was controversy as to
how best to expand, in the end the Board found a design for a new addition that met the
demands of the future while preserving the architectural integrity of the past.35

Another set of changes MCB had to contend with was increased scrutiny from
officials seeking to "re-regulate" the thrift industry following the abuses of the 1980s.
Among the dozens of new rules MCB had to comply with was a state requirement that it
adopt and follow formal lending procedures. For MCB's managers, this meant an end to

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34Surabian Interview

35"Interest of city at heart of Chamber honoree," _Medford Transcript_, 23 March 1992, 1, 5; McNeill Interview; Surabian Interview; Silva Interview.
their traditional policy of "character loans," which they believed made perfect business sense because they knew most of the applicants personally. Although both customers and employees resented the change, it did improve the ability to collect statistical data on the loan portfolio. The 1990s also brought increased pressure on thrifts to demonstrate how they served low-income borrowers, and the bank responded with its "first time home buyer plan," which met with broad acceptance from community leaders.36

The 1990s also represented a crossroads for MCB in that the thrift could no longer rely solely on Medford for future growth. One sign of this change was the decision to enter commercial lending in 1993. Although this move represented a major departure from MCB's traditional ways of doing business, the Board still followed a conservative approach to this type of lending, hiring skilled lenders and limiting new business to borrowers, most of whom were small family-owned firms, from its existing service territory. By June 1998 MCB's commercial loan portfolio had risen to more than $29 million. Loan quality remained high, reflecting management's commitment to "keeping our risk low and our standards high." Finally, the Board decided to extend its territory to include communities to the north and west of Medford, and in 1998 MCB opened a branch in Lexington, and a second branch in Arlington three years later.37

The most significant change for MCB, however, was its conversion from mutual to stock ownership. Because the bank was entering new fields that required more funds

36Surabian Interview; Sampson Interview; DMM 1991-1995, 5673, 5898.

than could be obtained from its members, the Board had to find a new financing source. Although MCB began selling loans to the Federal National Mortgage Association in 1983, Surabian kept these transactions to a minimum because he knew MCB members wanted their loans to be serviced by their bank. While issuing stock to the public raised a number of potential problems, such as the loss of local control, the benefits of conversion, including more funds for technology-based services, was appealing. After wrestling with the issue of stock conversion for nearly a decade, the Board agreed to make the change in May 1997. In January 1998, MCB formed a holding company, Mystic Financial, and in its initial public offering raised more than $25.7 million.\(^{38}\)

These various policy decisions and changes in business directions had a major impact on MCB operations, as seen in Table 11.6:

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets (000)</th>
<th>Chg./Yr.</th>
<th>Reserves (000)</th>
<th>Chg./Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>$96,538</td>
<td>---</td>
<td>$7,748</td>
<td>---</td>
</tr>
<tr>
<td>1995</td>
<td>$124,966</td>
<td>5.8%</td>
<td>$10,366</td>
<td>6.7%</td>
</tr>
<tr>
<td>1998</td>
<td>$199,049</td>
<td>19.7%</td>
<td>$36,127</td>
<td>82.2%</td>
</tr>
<tr>
<td>1999</td>
<td>$215,214</td>
<td>8.1%</td>
<td>$34,052</td>
<td>(5.8%)</td>
</tr>
</tbody>
</table>


Table 11.6: Medford Cooperative Bank, Members and Assets - 1990 to 1999

\(^{38}\)Surabian Interview; Dunham Interview.
During the early part of the 1990s, the bank experienced many of the same problems it encountered a decade earlier. A slump in the high-tech sector of the economy caused the number of past due loans held by MCB to rise sharply, to $3.75 million in 1990, a troubling increase given that an internal study showed the bank could only absorb $500,000 in loan losses before violating reserve regulations. The Board created a "watch list" committee of directors to monitor specific troubled loans and the first policies for managing foreclosed real estate. These actions, combined with an improving economy, helped MCB weather this crisis, and by 1998 nonperforming loans had shrunk to $154,000. The stock conversion also caused reserves to rise, and by 1999 MCB's reserve ratio was a healthy 12.8 percent. At the end of the twentieth century and 114 years of operations, MCB was by most standards a modern financial institution offering a wide array of consumer and business banking services, as well as electronic banking products like ATM, debit cards, and on-line banking. Despite its expansion, the thrift remained a conservative institution committed to meeting the needs of the local community, reflecting a desire to be "big enough to serve, small enough to care."³⁹

Conclusions

The dominant reason Medford Cooperative Bank operated successfully for more than a century lay in its conservative style of management and its commitment to serving

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the home financing requirements of the local community. Since its inception in the late
nineteenth century, MCB maintained close ties to Medford and surrounding communities.
MCB was able to gain the support of residents by focusing on their financial needs. As a
result, MCB quickly became known as “Medford’s Community Bank.” The managers of
the bank were critical in building this close relationship with the community, and it was
common to find MCB management taking active roles in civic affairs. In fact, over the
years three bank directors were mayors of Medford.

MCB management followed a conservative lending style that centered on
promoting thrift and home ownership. From its founding, the leaders of MCB were
unwilling to compromise these values simply to generate business, especially if risky
business might impair the financial condition of the institution. This pattern of “sticking
to the knitting” appeared repeatedly in how management set dividend policies, its wait-
and-see attitude on non-mortgage related lending, and its refusal to follow blindly
practices set by competitors. Furthermore, when major business changes did come in the
1990s, management followed a deliberate strategy of bringing in experienced lenders and
“testing the waters” before making a large financial commitment to these new areas.

One reason that management was so conservative was that so many of these
people had been with MCB for decades. Since its founding, MCB has had just eighty-
eight directors, and their average tenure was twenty-two years. One director served for
fifty-four years, while only two held office for less than one year. MCB also has had
only ten presidents, each of whom was with the bank for an average of seven years.
These long years of service resulted in management stability and produced a “long-term
memory" that clearly affected business decisions. When management change did occur, the turnover was gradual since only about a third of the Board retired in any given decade. This situation allowed the new members to learn from the older ones the traditional management style MCB had developed over the years.

The way in which MCB was managed was a key determinant in helping make it a profitable institution. Like hundreds of other thrifts, MCB followed a course of serving the local community with financial products tied to long-term saving and housing. This focus on helping people acquire the habit of thrift and become homeowners was why the savings and loan industry came to be back in the early nineteenth century, and support the idea that there is still a place in an increasingly complex financial world for community bankers and specialized home lenders.

To evaluate whether the experience of MCB was unique among thrifts, an examination of when all thrifts currently in operation were founded is instructive. As of 1998, 62.4 percent of all thrifts across America were formed during or before the Great Depression, and more than 40 percent of them began business prior to 1920. Furthermore, the vast majority of these thrifts had less than $100 million in assets, and were located in small towns. Even in states like California and Texas, which saw hundreds of S&Ls fail in the 1980s, these small community-focused associations continue to operate. While it is inappropriate to draw too broad a conclusion from this summary review, the success of so many small S&Ls is not a fluke and likely reflects
their insistence on adhering to many of the traditional business practices that made them prosperous in the first place.\textsuperscript{40}

CHAPTER 12
THRIFTS, BUSINESS, AND POLITICS

The history of the American savings and loan industry from 1831 to 1989 is essentially a story of how local institutions worked to help working-class and middle-class men and women become homeowners. The industry achieved this goal because thrifts required their members to adhere to the basic principles of mutual cooperation and systematic savings in order to make mortgages. Thrift leaders considered their nascent institutions to be part of a movement designed to improve peoples' lives, and the simplicity of how these associations operated helped them spread across the country. By the 1880s, S&Ls had become so numerous that they formed trade organizations, first at the state and local levels, followed by a national trade association. The thrift business prospered in the early twentieth century, but like most industries suffered serious losses during the Great Depression. Even in the 1930s, though, some progress occurred, as Congress enacted the first federal thrift laws. A high point for the S&L industry came after World War II, when the demand for housing resulted in strong expansion and profitability. In the 1960s and 1970s, however, increasing divisions within the thrift industry, combined with economic uncertainties and competition, fueled the effort toward deregulation in the 1980s. While the thrift industry experienced significant upheaval during this decade, it ended the twentieth century stronger in assets (albeit
fewer in numbers) than at any point in its history. Consequently, even though the history of American thrifts is one of essential continuity, it was permeated by crises of image, competition, and government involvement.

My analysis of how the S&L industry developed over the past 150 years provides insights into many of the broader changes in American business, politics, and society. The history of America’s thrift industry encompasses both pre-industrial and post-industrial aspects of business development, since thrifts rely on both interpersonal relationships and innovations afforded by technological change. The growth of S&Ls in the late-nineteenth century, the 1920s, and the 1950s also reflects changes associated with industrialization, urbanization, increased consumerism and general overall economic prosperity. The development of state and federal thrift regulation likewise sheds new light on how business and government interacted in support of economic and social objectives. Similarly, the participation of different groups of Americans in S&L activities shows how inclusive these institutions were in a time when white men tended to dominate most fields of American business. Finally, a review of the 1980s from an historical perspective shows that even though this decade was an unsettling time for all thrifts, it was far from unique.

*Thrifts as an Industry*

The first major observation of the thrift industry is that savings and loans rely on business characteristics that were common during pre-industrial America. The basic way most S&Ls attract business is through personal interaction with customers, and it is common for customers to know officers personally, since there are few managerial
hierarchies. In addition, sophisticated accounting systems and operating procedures are not required for most thrifts to be successful. Furthermore, because there are few significant legal or financial barriers to entry, there are thousands of individual thrift institutions, the majority of which serve narrowly-defined markets.¹

As thrifts expand in size or diversify into fields beyond residential finance, the requirements for success change. Larger S&Ls often need management hierarchies to coordinate information flows, as well as more specialized reporting systems. Scale economies can also be achieved in areas that require computer technologies, like data processing, and electronic funds transfers. Aside from these gains in operating efficiency, large S&Ls do not have other significant inherent advantages over smaller thrifts, in part because financial services businesses are labor intensive. Consequently, it is possible for small thrifts to compete effectively along side the largest institutions.²

A defining characteristic of the thrift industry was that for most of its history the majority of all S&Ls were mutual organizations owned by their members. Traditionally, people joined thrifts by subscribing to shares that they paid for over time in monthly installments. Thrifts made home loans to members with this money, and profits from these operations were redistributed to these same members. Another key trait of S&Ls


²The changes in the requirements for financial success as firms grow in size was common in other industries. See Alfred D. Chandler, Jr, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, MA: Belknap Press, 1977)
was that through the 1930s thrift leaders considered their firms to be part of a movement, not an industry. The main reason for this attitude was that S&Ls drew members from the working class, and relied on these people to adhere to the principles of systematic savings and mutual cooperation in order to be successful. Such traits separate thrifts from other financial institutions as well as most other American businesses.

*The Role of the Trade Associations*

A second element of the thrift industry history is the importance that trade associations played in shaping the identity of S&Ls as home lenders, and fostering overall industry growth. Although state trade groups appeared in the late 1880s, it was the creation in 1893 of a national trade association, the United States League of Savings and Loan Associations, that was most significant. Appearing during the “nationals” crisis of the 1890s, the League was an informal organization made up of state leagues, and through the 1920s it only sought modest changes in thrift practices. This lack of strong initiative changed in 1929 when the League hired Morton Bodfish as its first executive manager. Bodfish created an organizational structure that allowed the trade association to be more proactive in finding solutions to issues affecting the industry. At the same time, the admission of individual thrifts as members transformed the League from a collegial group of top executives into a more broad-based business organization.

From the 1930s through the 1960s, the League was the dominant force within the thrift industry. It took a leading role in establishing business standards for all thrifts in areas like accounting, real estate appraisal, and financial management. The League also created formal education programs for thrift employees, a step that significantly
improved the professional image of the business. All of these activities were important in helping thrifts become more organized as financial institutions and better able to serve their customers. While trade associations in other industries did similar work for their members, the League was particularly effective in part because of its long-term, stable leadership. Between 1929 and 1979, just three people served as the head of the League, and other senior officials often served for as long as thirty years. This continuity of leadership was important for strategic planning, as well as building close relationships between the thrift industry and government.

While professionalizing and standardizing business practices was important in the development of America’s thrift industry, the most critical function of the League lay in protecting and promoting the role S&Ls had as providers of mortgages and depositories for consumer savings. One way the League achieved this goal was by securing favorable state and federal laws for its industry. It also worked with trade groups in other housing industries to provide input on the design and construction of new homes. To increase public recognition, the League built an image for the industry that emphasized how S&Ls helped average Americans become home owners simply by acquiring the habit of thrift. Combined, these tactics not only resulted in greater growth and operational freedom for S&Ls, but also reinforced the position of the League as the thrift industry leader.

The role of the League in the thrift industry was similar to that held by trade associations in other industries, like textiles and trucking. One goal of trade groups in all these industries was to protect and promote their business through inter-industry cooperation, as well as government regulation. An important difference, however, was
that the League actively encouraged the formation of new firms, especially federal S&Ls, whereas other trade groups often tried to erect entry barriers in order to enhance the prestige of their respective industries. Another characteristic of thrift trade associations is that they operated at the national, state regional, and local levels. Furthermore, even though the membership of the national trade group included the largest and most influential thrifts in the country, most S&Ls considered participation in state and local trade groups as more important, an attitude that reflected the local nature of their business.\footnote{For the development of trade groups in the textile industry, see Louis Galambos, *Competition & Cooperation; the Emergence of a National Trade Association* (Baltimore: Johns Hopkins Press, 1966). For trade association activities in trucking see William R. Childs, *Trucking and the Public Interest: The Emergence of Federal Regulation, 1914-1940* (Knoxville: University of Tennessee Press, 1985).}

*Thrifts in America’s Political Economy*

The third major theme of the history of S&Ls is the involvement of the federal government in shaping their development. Initially, thrifts were not subject to many state laws, primarily because governments considered them to be semi-philanthropic, not-for-profit businesses. This attitude changed, however, following the rise and fall of fraudulent “national” thrifts, and by the end of the nineteenth century nearly every state regulated S&Ls to some degree. Significantly, thrift leaders helped draft many of these laws, in part because they usually established minimum standards for operations, which would help improve public confidence in the industry. Although there was little
uniformity between the various state laws, the net effect of government regulation was that it both protected consumer interests, and promoted the thrift business.4

As was true with state regulation, when the federal government considered regulating thrifts the League took an active role in the design of these laws. By 1935, Congress had created a credit reserve bank, a system of federal charters, and a deposit insurance program, all of which mirrored similar programs for commercial banks. Although some thrift executives resisted these changes, the League realized that greater federal government involvement in S&L affairs would amplify many of the same positive effects for the industry that had occurred at the state level. These included greater access to low-cost funds, more uniform financial safety standards, and the formation of new federal S&Ls in areas poorly served by other lenders. Finally, the thrift industry became involved in affecting the direction of government policy in related areas, like direct federal assistance in housing and residential finance.

The nature of government oversight of the thrift industry resembled the pattern of regulation in other industries. The structure of thrift regulations was designed to fit the specific characteristics of this industry. Because they were home lenders, thrifts received preferential tax-treatment and other benefits to ensure the continued availability of mortgage finance. Similarly, because this is a specialized type of lending, federal officials often worked closely with thrift leaders in the design of industry regulations.

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4The lack of uniformity in state regulation was also a problem for the railroad industry, and contributed to the formation of federal rules. See K. Austin Kerr, American Railroad Politics, 1914-1920; Rates, Wages, and Efficiency (Pittsburgh: University of Pittsburgh Press, 1968).

426
Such close relations, however, were often criticized as not being in the public interest and cited an example of how a regulated business could "capture" the regulator.\(^5\)

The work of trade associations and government in the development of the thrift industry also supports the paradigm known as the "organizational synthesis." This school of thought emphasizes the importance of a wide variety of organizations, ranging from labor unions to professional organizations, in mediating among individuals in the United States. A key assertion of the organizational synthesis is that in many aspects of American life, face-to-face contact among individuals has given way to contacts between organizations. This is true in the case of thrifts, since the League was the focal point for contacts within the thrift industry, other housing industries and the government as early as the 1890s. Furthermore, without these organizations, S&Ls likely would have remained a loosely-allied movement of small businesses for much longer than actually was the case.\(^6\)

*Helping Americans Become Homeowners*

A fourth significant theme of the thrift industry was its role in raising the level of home ownership in America, especially following the Second Industrial Revolution. While thrift leaders advocated home ownership by the working class as a way for these people to escape the hazards of paying rent to landlords, their main focus dealt with the

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ways in which owning a home provided moral and spiritual benefits. According to League leaders, owning a home instilled personal pride and responsibility, fostered greater community participation and an increased interest in good government. Similarly, home ownership produced stronger, healthier families, and was the ideal environment to instill morals in children. Finally, according to thrift leaders owning a home was a sign of national patriotism, a theme expressed best in the official motto of the League — "The American Home. The Safeguard of American Liberties."

The main way thrifts encouraged people to become homeowners was by making it easier to finance the purchase of a house. From the beginning of the industry, S&L home mortgages were long-term and repaid in equal monthly installments, a loan structure that was superior to all other forms of finance available from other lenders. In the 1880s thrifts made mortgages that calculated the monthly interest payment based on the loan balance, so that as the principle declined the amount borrowers paid in interest also declined. This innovation created the modern amortizing mortgage, which was used exclusively by some S&Ls for nearly fifty years until the federal government adopted it in the 1930s for its housing programs. By the 1950s, this consumer-friendly thrift loan was used by nearly all mortgage lenders.

This affordable form of finance was especially important in the growth of suburbia after World War II. Although suburbs were common to most American cities by the 1920s, they became the dominant form of residence for the middle class in the 1950s when the increase in families associated with the "baby boom" produced an unprecedented demand for housing. Between 1950 and 1975, the thrift industry provided
more than 40 percent of all home mortgages in the country, and this availability of affordable credit helped transform America from a nation of renters to one where nearly two-thirds of all households own their own home. This dominance of S&Ls in residential finance resulted from the industry’s constant effort to refine its loan products in order to make it easier for consumers to achieve this element of the American Dream.

*Thrifts and Society*

The fifth major aspect of the development of the thrift industry was its social inclusiveness. Women played an important role in the thrift business, and were active participants in individual S&Ls as early as the 1880s. This involvement, which was well before women first entered commercial banking, reflected how women used their traditional leadership role in home affairs to gain a greater role in the financing of homes. By the end of the nineteenth century, nearly a third of all thrift members were women, and they were often treated on an equal basis with male members. Women also were top managers of several thrifts, organized their own associations, and held leadership posts within the trade associations.  

Ethnic Americans were another part of society to make a major contribution to the expansion of the thrift industry. Ethnic-owned S&Ls were common in cities like Chicago and Cincinnati, and their members not only used them to acquire houses, but to signify their desire to become like other Americans since they equated home ownership with citizenship. Another reason why thrifts were so popular with ethnic Americans was because they were neighborhood-based, and easy to organize and operate. The League,

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which encouraged women to be more involved in thrifs, also supported greater ethnic involvement in S&Ls, not only as a way to boost membership, but also to help the country deal with many of the problems associated with immigration and urbanization.

African-Americans also participated in the thrift industry, although their work was more akin to their experiences in other financial industries. During the years of segregation in the South, African-Americans formed S&Ls to serve their communities, much as was the case in minority-owned banks and insurance companies. When blacks migrated to cities in the North and West, African-American S&Ls grew rapidly, and were so active in residential finance for minorities that they formed a trade group to promote their interests. One significant aspect of African-American involvement in S&Ls, however, was that as early as the 1890s several associations were biracial, a trend that was extremely rare in other financial industries.

*The 1980s in Historical Perspective*

Finally, a complete history of the thrift industry sheds new light on the S&L crisis of the 1980s. Although this period is the most thoroughly discussed and analyzed aspect of the thrift industry, only a few authors place the events in any historical context. As a result, the multitude of errors in the literature on the thrift tragedy tend to distort the true significance of the decade on the industry. As this history proves, the 1980s were not unique, but was similar to the “nationals” crisis of the 1890s, which also resulted in thrift failures and a decline in public confidence in the industry. Furthermore, S&Ls were not the only financial institutions to have problems in the 1980s. Commercial banks, which failed by the thousands during the Great Depression, also underwent major consolidation
during the decade. Between 1980 and 1994, more than 1,600 commercial banks, equal to nearly 12 percent of the industry total, required some form of government assistance, and of these the ten largest bank failures controlled more than half of the $303 billion in assets held by all the insolvent thrifts. Despite the scope of these problems, the commercial banking industry did not receive nearly as much attention as thrifts, in part because of the role white-collar crime had in the failure of several high-profile thrifts.

A final observation on the 1980s is that despite the turmoil of this period, the S&L industry continued to thrive. One reason for this success is that many thrifts in business today remain focused on mortgage lending, or have expanded slowly into allied fields. Furthermore, the majority of these thrifts are small, community-oriented institutions that rely on the close relationships that existed between management and members to find solutions to their financial problems. While the image of the Bailey Bros. Building and Loan in the movie *It's a Wonderful Life* seems to be an anachronism in the modern business world, the reality is that hundreds of thrifts are still managed by hundreds of George Baileys who follow the same principles that caused the thrift industry to appear in the first place.

The history of the American savings and loan industry offers a number of important insights into business history, the development of home lending, the work of trade associations, government/business relations, and the roles different segments of society played in financial industries. Thrifts began with the specific objective of helping working-class people acquire homes. They did this by providing affordable mortgages that their members repaid over time in installments. The success of this approach to
home lending caused people from different ethnic backgrounds, races, and genders to join these mutually-owned associations. By the turn of the century, thrift leaders had formed a national trade association, and this organization proved to be critical in professionalizing and standardizing S&L business procedures. This group also was important in government-business relations and helped secure regulations that both protected and promoted the business interests of the industry. While S&Ls have not always enjoyed success, and in fact experienced their worst economic performance in the 1980s, they remain an important element of consumer and residential finance.
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