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NONINSURED CORPORATE PENSION FUNDS AS A SOURCE OF FUNDS
FOR SAVINGS AND LOAN ASSOCIATIONS

DISSERTATION

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

By

Ronald Samuel Foster, B. Sc., M. B. A.

*****

The Ohio State University
1961

Approved by

[Signature]
Adviser
Department of Business
Organization
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CHAPTER I
INTRODUCTION

The rapid growth in the number and proportion of home owners in the United States is due mainly to the volume of mortgage credit which has been channeled into home financing by institutional and individual mortgage lenders. For many years, savings and loan associations have invested more in home mortgages than any other lender. At the end of 1959, savings and loan associations had $53 billion invested in home mortgages, or more than two-fifths of the total outstanding mortgages on residential real estate in the United States.¹

The extent to which these institutions can maintain or improve their position as home mortgage lenders is dependent primarily upon their ability to accumulate substantial amounts of savings or investment funds. The competition for such funds has, however, been one of the major problems of savings and loan associations.

Because of the intense competition for the savings of individuals, a number of leaders in the savings and loan

industry have expressed the viewpoint that funds accumulated in other types of financial institutions constitute an important source of funds to savings and loan associations. This idea was, for example, expressed by C. R. Mitchell, President of the United States Savings and Loan League during the year 1959, who states:

We have to improve the arrangements for channeling mortgage money from areas of ample supply to areas of scarcity. To put it another way, various pools of investment capital must be made to work in the home mortgage market in those areas that need mortgage money, using the facilities of our institutions.2

The published proceedings of the 1959 conference on Savings and Residential Financing, held by the United States Savings and Loan League in May, 1959 for fifty-two college and university educators, also suggest that other leaders in the savings and loan industry have considered the possibilities of channeling funds from other types of institutions into savings associations. At this conference, the fifty-two conferees were divided into five groups, each of which was asked to formulate and present an answer to a question which was originated by the conference leaders. A spokesman for each group reported to the assembled conferees the results of his group's deliberations and his remarks were in turn discussed by a

panel consisting of four leaders in the savings and loan industry. The first question was asked in the following form:

The tapping of new sources of funds to meet the probable expansion in the demand for home mortgages during the 1960's is a problem of a long-run concern to savings and loan executives. What can the savings and loan associations do to enhance the flow of savings to their institutions? What sources of funds seem most likely to yield substantial new savings capital? Are funds in the hands of nonsavings and loan financial institutions a potential source of savings and loan capital, or is it the general public to remain our most important source of new funds?

After a spokesman had presented a summary answer to this question, Mr. Norman Strunk, panel moderator, and executive vice-president of the United States Savings and Loan League, asked Mr. A. D. Theobald, president of the First Federal Savings and Loan Association of Peoria, Illinois, "to tell the conferees the thinking of several of us with respect to tapping other sources of capital funds." Mr. Theobald replied in the following manner:

Some of us have been giving substantial thought to various possibilities there. The pension fund is a good example, but there are other accumulations of capital which have found it difficult up until now to come into the home.

---


4 Ibid., p. 167.
mortgage field. . . . Pension funds, for example, might come into the home mortgage field through savings and loan associations by several different channels.5

Others interested in the growth of savings and loan associations have expressed similar interest in pension funds. Dr. Leon T. Kendall, economist of the United States Savings and Loan League, states:

Savings and loan managers constantly are seeking new ways and means to tap additional pools of savings funds. Pension funds are catered to because they represent a pool from which sizable amounts of funds can be secured to meet the demands of the home mortgage market of the country.6

Mr. W. Franklin Morrison, executive vice-president of First Federal Savings and Loan Association of Washington, D.C., was quoted in Burroughs Clearing House as being interested in plans under which money would be channeled from pension funds into savings and loan associations.7

In discussing ideas for increasing funds in savings and loan associations, Professor Edward E. Edwards, a well-known educator and authority on these institutions, suggests that

5 Loc. cit.


accumulations in pension funds may be channeled into savings and loan associations. He states:

If successful, this idea will make it possible for some of the billions of dollars that will be flowing into pension funds to be returned to local financial institutions... Probably neither of these proposals is likely to be as effective as some plan not yet thought of, but which someone in this business is capable of originating and developing.8

These comments indicate that savings and loan leaders and others are interested in the possibility of enhancing the flow of large accumulations of savings into savings and loan associations. These comments also suggest that savings and loan leaders have a specific interest in the ways and means in which pension funds may be channeled into these organizations.

**Purpose of the Study**

The hypothesis of this study is that noninsured private corporate pension funds can be a source of new funds for savings and loan associations and savings and loan associations offer an investment outlet for noninsured private corporate pension funds. The over-all purpose of this study is to prove or disprove this hypothesis.

---

The more specific objectives of the study are (1) to present the essential characteristics of savings and loan associations which are requisite to an evaluation of these institutions as investment outlets for noninsured private corporate pension funds; (2) to identify the essential features of noninsured pension plans and the investment practices of noninsured private corporate pension funds which are significant to an evaluation of their investment in savings associations; and (3) to establish and evaluate ways of channeling the accumulations of noninsured private corporate pension funds into savings and loan associations.

Savings and Loan Development in the Twentieth Century

In 1900 there were 5,356 savings and loan associations in the United States with total assets of approximately $571 million, as may be observed in Table 1. At the end of 1920 there were 8,633 associations with total assets of $2.5 billion. In response to the demand for the financing of nearly seven million new housing units started during the decade between 1920 and 1930, the total assets in all savings and loan associations increased more than 250 per cent. The number of associations increased from 8,633 to 11,777 during this period, due largely to the liberal granting of charters by state supervisory authorities to organizers in many communities.
### TABLE 1

TOTAL ASSETS AND NUMBER OF ALL SAVINGS AND LOAN ASSOCIATIONS IN THE UNITED STATES FOR SELECTED YEARS, 1900-1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
<th>Assets&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
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<tbody>
<tr>
<td>1900</td>
<td>5,356</td>
<td>$ 571</td>
</tr>
<tr>
<td>1905</td>
<td>5,264</td>
<td>629</td>
</tr>
<tr>
<td>1910</td>
<td>5,869</td>
<td>932</td>
</tr>
<tr>
<td>1915</td>
<td>6,806</td>
<td>1,484</td>
</tr>
<tr>
<td>1920</td>
<td>8,633</td>
<td>2,520</td>
</tr>
<tr>
<td>1925</td>
<td>12,403</td>
<td>5,509</td>
</tr>
<tr>
<td>1930</td>
<td>11,777</td>
<td>8,829</td>
</tr>
<tr>
<td>1935</td>
<td>10,266</td>
<td>5,875</td>
</tr>
<tr>
<td>1940</td>
<td>7,521</td>
<td>5,733</td>
</tr>
<tr>
<td>1945</td>
<td>6,149</td>
<td>8,747</td>
</tr>
<tr>
<td>1950</td>
<td>5,992</td>
<td>16,846</td>
</tr>
<tr>
<td>1955</td>
<td>6,071</td>
<td>37,533</td>
</tr>
<tr>
<td>1956</td>
<td>6,136</td>
<td>42,781</td>
</tr>
<tr>
<td>1957</td>
<td>6,169</td>
<td>48,781</td>
</tr>
<tr>
<td>1958</td>
<td>6,208</td>
<td>55,139</td>
</tr>
<tr>
<td>1959</td>
<td>6,230</td>
<td>63,472</td>
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<sup>a</sup> In millions of dollars.

The depression of the 1930's had serious repercussions upon the savings and loan business. From Table 1 it may be seen that the assets of savings associations declined from a peak of approximately $9 billion in 1930 to under $6 billion in 1935. Liquidations and mergers of associations in the 1930's and early 1940's also reduced substantially the number of savings and loan associations. The impact of the depression did, however, encourage a number of significant developments which influenced the future activities of savings associations. The Federal Home Loan Bank Act was passed in 1932 to provide a central reserve credit system for savings institutions engaged in home financing. The Home Owners Loan Act of 1933 provided for the granting of federal charters to savings associations and for the creation of the Home Owners Loan Corporation to refinance the mortgage loans of distressed mortgage debtors. The Federal Savings and Loan Insurance Corporation was established under Title IV of the National Housing Act of 1934 to give insurance protection to savers.

By 1950, the number of savings associations had dropped to 5,992 while the total assets of all associations had increased to slightly under $17 billion, as may be seen in Table 1. There were 6,230 savings and loan associations in the United States at the end of 1959, or an increase of less than 6 per cent in the number of these institutions.
between 1950 and 1959. The total assets of all associations had, however, increased from approximately $17 billion in 1950 to more than $63 billion in 1959, a gain of nearly 270 per cent.

This brief summary of the development of the savings and loan industry in the twentieth century indicates that the period since World War II has been a period of rapid growth. This industry has expanded to the point where savings and loan associations now possess total resources that rival those of other longer established financial institutions. In a study undertaken by the School of Business of Indiana University, it is estimated that savings associations will continue to expand at a rapid rate during the decade of the 1960's and that the total assets in all of these institutions will reach $165 billion by 1970. This estimate was based on a number of assumptions including the one "that associations will learn how to tap pension funds and other large pools of accumulated savings."^9

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^10Loc. cit.
Pension Funds in the United States

The term pension fund as frequently used in conversation and printed literature implies the existence of only one type of pension program. It is appropriate, therefore, to review briefly the various types of pension funds in the economy, indicate the size of the different types, summarize the forces that have contributed to their development, and estimate their future growth in order to assess the role which pension funds might be expected to play in the growth of savings and loan associations.

Types of Pension Programs

Numerous types of pension funds or programs have been established to provide old-age income maintenance. These programs may be classified as either public pension programs or private pension programs. The former are those which are administered by federal, state, or local governments. They may be further categorized as to whether or not they are contributory or noncontributory programs. Private pension programs are not administered by a governmental unit and are basically of two types, union pension funds and corporate pension funds. In only a relatively few instances, however, have union workers through group action developed their own old-age plans. In the vast
majority of cases the initiative was provided by corporate management which established a corporate pension fund.\footnote{Charles L. Dearing, \textit{Industrial Pensions} (Washington, D.C.: The Brookings Institutions, 1954), p. 30.}

Contributory pension programs require that the cost of the program be borne, at least in part, by employee contributions. Under a noncontributory plan the pensioner makes no contribution to the cost of the program. The contributory pension programs which are publicly administered include the Federal Old-Age and Survivors Disability Insurance Program, the Federal Civil Service Retirement System, the Railroad Retirement System, and state and local government retirement systems.

\textbf{Underlying Forces Behind Growth of Pension Programs}

A number of broad social, economic, and political developments are the underlying forces behind the growth of both public and private pension programs in this country, particularly in the last three decades. One of these is the spectacular increase in the number and proportion of the aged population which reflects the influence of the increase in life expectancy.\footnote{Dan M. McGill, \textit{Fundamentals of Private Pensions} (Homewood, Ill.: Richard D. Irwin, Inc., 1955), pp. 4-5.} Another development has been the decline in the proportion of employment
opportunities for the aged, due in large part to the transition from an agrarian and essentially rural economy to an industrial and predominantly urbanized economy. One aspect of this employment problem is that age 65 has been accepted as the normal retirement age. A third major development is that the difficulties of accumulating a retirement estate have been complicated by the rise in personal and corporate income taxes, the degeneration of liquid savings during the depression of the 1930's and the corrosive influence of price inflation.

Another development that has encouraged the growth of pension plans has been the changing concept of social and governmental responsibility to provide old-age support. The economic depression of the 1930's and many other social and economic developments created a feeling of individual insecurity and induced proposals for economic reform in the area of old-age income maintenance to be provided by the government. The Old-Age and Survivors Disability Insurance Program is an outstanding example. Due to the inadequacy of public old-age programs to provide sufficient benefits and the limitations of the individual approach to

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financial security, society has exerted a great deal of social pressure on the employer to provide the mechanism through which funds for retired employees can be accumulated.  

Comparative Size of Major Pension Programs

The total assets and reserves of the major types of pension programs in the United States have increased from $5.4 billion in 1940 to a total of nearly $94 billion in 1959, as may be observed in Table 2. During this period, the total reserves and assets of the major publicly administered retirement programs increased from $4.3 billion to $50.8 billion, a net gain of $46.5 billion. Of the public retirement funds, the largest is the Old-Age and Survivors Disability Insurance Trust Fund. At the end of 1959 this Trust Fund was credited with holding reserves of approximately $20.1 billion, which represents an increase of $18.1 billion when compared with 1940. The Old-Age and Survivors Disability Insurance Trust Fund has, however, declined by $2.4 billion from 1956 to 1959.

The total assets and reserves of the other major public pension programs have increased steadily from 1940 to 1959.

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<td>Old-Age and Survivors</td>
<td>2.0</td>
<td>9.4</td>
<td>13.7</td>
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<td>State and Local Government</td>
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<td>9.2</td>
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<td>13.5</td>
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<td>Federal Civil Service</td>
<td>0.6</td>
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<td>4.1</td>
<td>6.0</td>
<td>6.4</td>
<td>7.1</td>
<td>7.8</td>
<td>8.7</td>
<td>9.8</td>
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<td>Railroad Retirement System</td>
<td>0.1</td>
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<td>2.6</td>
<td>3.4</td>
<td>3.6</td>
<td>3.7</td>
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<td></td>
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<tr>
<td>Total</td>
<td>5.4</td>
<td>24.1</td>
<td>36.8</td>
<td>61.4</td>
<td>67.6</td>
<td>74.1</td>
<td>80.7</td>
<td>87.1</td>
<td>93.6</td>
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<sup>a</sup>Figures for state and local government employee retirement funds for 1940 and 1947 are the amounts at the end of fiscal year falling in the calendar year.

The total assets of all state and local government retirement funds have increased from $1.6 billion in 1940 to approximately $17.2 billion during this period, a net gain of $15.6 billion. The total reserves of the Federal Civil Service Retirement System have increased from approximately $600 million in 1949 to $9.8 billion in 1959 while the total reserves of the Railroad Retirement System have increased from $1 million to $3.7 billion during this period.

As may be seen in Table 2, at the end of 1959 the total assets in all private corporate pension funds amounted to $42.8 billion. The assets in these funds are larger than any other type of retirement program and are only $8 billion less than the combined assets and reserves in all the major public retirement programs in this country. The rate of growth of private corporate pension funds from 1940 to 1959 also has been much faster than that of the combined assets of all the public programs during this period. While the combined assets and reserves of the latter have grown from $4.3 billion in 1940 to $50.8 billion in 1959, the total assets of all private corporate pension funds have increased from $1.1 billion to approximately $42.8 billion during the same period.

Analysis of Table 2 also clearly illustrates that in comparison to the assets or reserves of any one of the
other major retirement programs, the most rapid growth during the 1950's was shown by private corporate pension funds. The assets of the latter at the end of 1959 amounted to slightly less than four times the comparable 1950 figure.

Factors in Recent Growth of Corporate Pension Funds

Within the broad framework of the underlying forces discussed above, analysis of the rapid growth of corporate pension plans in the past decade reveals that a number of other factors have been at work. In a report on welfare and pension plans the subcommittee of the Senate Committee on Labor and Public Welfare includes the following among the main reasons for the recent growth of corporate pension programs:

1. Wage stabilization controls during and since World War II
2. Federal tax policy during and since World War II
3. Pressure from organized labor

Wage and Salary Stabilization Controls

The Wage and Salary Stabilization Act of 1942 restricted employers from increasing wages and salaries

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during the remaining World War II period. While employers were unable to increase directly the compensation of their employees, the provisions of the Act defined wages and salaries as not including various fringe benefits such as pension benefits.

An employer was, therefore, given an opportunity to attract desirable applicants and hold employees against offers of higher pay elsewhere by contributing to an employees' retirement fund. As a result, the wage stabilization program provided a significant stimulus for the rapid extension of pension plans during World War II. During the Korean Conflict wage and salary-stabilization controls were again put into effect and significantly affected the development of pension plans.

Federal Tax Policy

The Revenue Act of 1942 is often cited as the primary stimulant to the creation and rapid growth of corporate pension plans. The basic provisions of this Act constitute what is virtually the present law under which pension plans are taxed.

Benefits of qualification. Pension plans which meet the requirements of the Internal Revenue Code derive several major benefits of favorable tax treatment. First, an employer's contributions to the fund are deductible as ordinary and necessary business expenses. Second, the
income earned on the fund established under the plan is exempted from federal income taxation. Third, participating employees are taxed only when the benefits actually are distributed to them, presumably during a period of lower income and a resulting lower tax liability. A fourth benefit, added by the 1954 Code, is that the amount payable to a deceased employee's beneficiary which is attributable to the employer's contribution is exempt from federal estate tax.

On the plans which do not qualify for exemption, the contributions of the employer are immediately taxable to the employees, provided the employees' interests are nonforfeitable. If the employees' interests are nonforfeitable, the employer's contributions are deductible by the employer. If the employees' interests are forfeitable, the employees are not taxed until they receive the benefits and, curiously enough, the employer's contributions are not deductible as ordinary expense in any year.

**Genesis of tax treatment.** Prior to 1926, before the enactment of any legislation directed specifically at private pensions, reasonable payments made by an employer as pensions to retired employees or as contributions to pension trusts to fund current pension liabilities were usually deductible as ordinary and business expense for
tax purpose.\footnote{Dearing, op. cit., p. 285. See also McGill, op. cit., p. 19.} Payments to a trust to fund liabilities for past service credits or to place the trust on a sound financial basis were, however, not deductible. Moreover, the income of a trust, formed as part of the pension plan, was currently taxable to the employer, employees, or the trust, depending on the provisions of the trust instrument.\footnote{Committee on Federal Taxation, Federal Bar Association, "Pension, Annuity, Profit-Sharing and Stock Bonus Plans," Practical Aspects of Federal Taxation, Pt. 17 (1946), pp. 2-3.}

The Revenue Act of 1926 provided that the income earned on pension trusts established for the benefit of employees was exempted by statute from current taxation. This Act also specifically provided that employer contributions to pension trusts and the income earned by these trusts would not be taxable to the beneficiaries until actually distributed.\footnote{Revenue Act of 1926, Sec. 219 (f): 44 Stat. 33.} The Revenue Act of 1928 extended the deductibility feature of employer contributions by permitting an employer to take deductions for reasonable amounts paid into a qualified trust for the purpose of past service liabilities.\footnote{Revenue Act of 1928, Sec. 23 (q): 45 Stat. 802.}
This brief summary of early tax laws suggests that if any impetus was given to the adoption and growth of corporate pension funds by the Internal Revenue Code of 1942, it was due not to the fact that these funds were accorded favorable tax treatment for the first time beginning in that year. Whatever power was exerted in the development of pension funds by the tax laws after 1942 may be attributable mainly to the following two factors which are interrelated:

1. The requirements which a corporate pension plan must meet to qualify for favorable tax treatment were tightened up in the Revenue Act of 1942.

2. The schedule of high corporate income tax rates during and since World War II coupled with tax reductions for employer contributions to pension funds permitted the establishment and growth of these programs at low effective cost.

Requirements for qualification. Prior to the Revenue Act of 1942, it had been possible for a corporation to establish a pension fund which could qualify for favorable tax treatment if it were created for the exclusive benefit of some or all of the employees. This offered highly paid corporate executives a legal basis for establishing a

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20 Dearing, op. cit., p. 286.
plan for themselves as a tax-avoidance device without extending the same privilege to other large groups of employees. The requirements for the qualification of pension funds set forth in the Internal Revenue Code, as amended in 1942, discouraged this practice. These requirements, which have been carried over into the 1954 Code, include the following:

1. The plan must be for the exclusive benefit of the employees or their beneficiaries, and it must be impossible for any part of the fund or income to be diverted to any other use prior to the satisfaction of all liabilities.

2. The plan must cover either a prescribed percentage of employees or a classification of employees found by the Commissioner of Internal Revenue not to be discriminatory in favor of officers, shareholders, supervisors, or highly compensated employees.

These requirements made it impossible for highly paid executives to secure the advantage of a tax deductible pension plan for themselves without making the same provisions for the rank-and-file employees. This was undoubtedly effective in converting what would otherwise have been tax-advantage plans for members of a select management group into plans which covered a much greater number of people.

Tax rates. The level of regular corporate income tax rates that has prevailed since the enactment of the Revenue Act of 1942, in conjunction with the excess-profits taxes
which were also in effect during the periods from 1940 to 1945 and 1950 to 1953, has stimulated the establishment and growth of corporate pension plans. During this period of high corporate profits and high corporate income tax rates, employer contributions to a qualified pension plan have been deductible as expense before arriving at the net profits on which the tax rate is based. This tax saving has reduced the effective cost of a pension plan to a corporation.

Pressure from Organized Labor

A third generally acknowledged force in the rapid expansion of pension plans has been the attitude and pressure exerted by organized labor. The issue as to whether or not pensions fall within the area of mandatory collective bargaining did not rise in any acute form until 1946. This question arose initially out of a union grievance filed with the National Labor Relations Board in 1946, alleging that the unilateral action of the Inland Steel Company in enforcing a policy of compulsory retirement at age 65 constituted a breach of a general labor contract governing separation from service. The Inland Steel Company had refused to negotiate with the union about the compulsory retirement of employees on the ground that

\[21\] Dearing, op. cit., p. 43.
this particular matter was an essential part of the company's pension plan and that pension plans did not come within the scope of collective bargaining.

This grievance was acted upon in 1948 by the National Labor Relations Board, which ruled in effect that the Labor Management Relations Act of 1947 imposes a duty upon employers to bargain with representatives of their employees on the subject of pensions. This decision was based on the premise that pensions were both "wages" and part of the "conditions of employment" as defined in the statute and therefore an appropriate subject for collective bargaining. Upon appeal by the Inland Steel Company in 1949, the Seventh Circuit Court of Appeals upheld the view of the National Labor Relations Board.

A number of other events were also important in establishing the collective bargaining pattern for the great mass of organized labor. In 1946 an agreement between Secretary of the Interior, Julius Krug, and John L. Lewis, President of the United Mine Workers, provided for a welfare and pension fund for workers in the bituminous coal industry. On September 10, 1949, the board of inquiry appointed

22 Inland Steel Company v. United Steelworkers of America (CIO), 77 NLRB 4 (1948).

by President Truman to resolve the union-management dispute in the steel industry filed a report recommending that pension benefits be incorporated in any collectively bargained settlement of the steel strike. Shortly after this report was filed, the Ford Motor Company signed an agreement on pensions with the United Automobile Workers, and Bethlehem Steel followed almost immediately establishing the pattern for pension coverage to become the subject of collective bargaining on a massive scale.

**Types of Private Corporate Pension Funds**

Private corporate pension funds may be categorized in several ways but a common and extremely useful classification of these funds is based upon the medium of funding. Medium of funding refers to the organization or type of organization through which pension benefits are provided. On this basis corporate pension funds may be broadly classified as insured funds and noninsured funds.

An insured fund is one in which an insurance company is selected by the sponsoring employer to underwrite the

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benefits of the plan. The pension fund contributions are made to the insurance company and are applied as premiums under an individual insurance or annuity contract issued on each employee eligible to participate in the plan or under various forms of group annuities. Regardless of the form of contract used, all benefits for which premiums have been paid are guaranteed by the insurance company. In insured pension funds, the pension assets are commingled with the other assets of the insurance company and invested along with funds from other sources in a single portfolio.

In a noninsured pension fund, the contributions to provide pension benefits are deposited with a trustee, who invests the funds, accumulates the earnings, and pays benefits to eligible employees in accordance with the pension plan which is made a part of the trust indenture. The fund is usually administered by a bank or trust company, but the assets of the trust fund are not commingled with other assets of the bank or trust company. Under some plans, a board of trustees or an individual trustee, and not a bank or trust company, administers the fund. Under the non-insured funds, which are also sometimes referred to as "self-insured" funds or "trust" funds, an actuary determines the contributions needed to finance the benefits to be provided under the plan. The trustee invests the accumulated funds according to the terms of the indenture in a
reasonable and prudent manner, but provides no guarantee with respect to preservation of principal or rate of investment earnings. The benefit payments are made from the trust fund. If the sums in the trust fund should prove inadequate to pay these payments, the deficiency would have to be made up by the employer, if at all.

Relative Size of Insured and Non-insured Corporate Pension Funds

The size of noninsured corporate pension funds and insured corporate pension funds can be compared in terms of number of plans, number of people covered, amount of benefit payments, number of beneficiaries, amount of contributions, and other such measures. The most meaningful comparison of these two types of private corporate pension funds for the purpose here is, however, the one based on the total assets in each type.

As may be seen in Table 3, the book value of the total assets in all private corporate pension funds increased from $11.1 billion in 1950 to $42.8 billion in 1959. In 1950 the amount of assets in insured funds was slightly greater than the total assets in all noninsured funds. The assets of the latter have, however, increased from $5.5 billion in 1950 to a figure of $25.3 billion in 1959 or a net gain of $19.8 billion. Insured funds during the same period, increased from $5.6 billion to $17.5 billion.
Not only have noninsured funds grown at a faster rate than the insured type, but the former had approximately 50 percent more assets than the insured funds at the end of 1959.

**TABLE 3**

BOOK VALUE OF TOTAL ASSETS OF ALL INSURED CORPORATE PENSION FUNDS AND NONINSURED CORPORATE PENSION FUNDS IN THE UNITED STATES AT YEAR END FOR SELECTED YEARS, 1950-1959 (BILLIONS OF DOLLARS)

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<th></th>
<th></th>
<th></th>
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</thead>
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<td>Insured</td>
<td>$5.6</td>
<td>$10.0</td>
<td>$11.2</td>
<td>$12.4</td>
<td>$14.0</td>
<td>$15.5</td>
<td>$17.5</td>
</tr>
<tr>
<td>Noninsured</td>
<td>5.5</td>
<td>12.2</td>
<td>14.2</td>
<td>16.6</td>
<td>19.3</td>
<td>22.1</td>
<td>25.3</td>
</tr>
<tr>
<td>Total</td>
<td>$11.1</td>
<td>$22.2</td>
<td>$25.4</td>
<td>$29.0</td>
<td>$33.3</td>
<td>$37.6</td>
<td>$42.8</td>
</tr>
</tbody>
</table>


**Estimated Future Size of Noninsured Funds**

Noninsured private corporate pensions funds have shown such rapid growth in recent years that the future magnitude of their asset accumulations has become a matter of increasing importance. A thorough attempt to predict the future size of these funds, although it would be of great importance and value, is impossible within the scope of this study. The potential growth of these funds is, however, directly pertinent to the hypothesis established. It would,
therefore, seem appropriate to indicate the future size of noninsured private corporate pension funds as projected by several serious students of the subject.

During the New York State Insurance Department hearings on pension funds in 1956, Adolf A. Berle, Jr., noted that estimates of the figure at which private corporate pension funds would level off ran from an optimistic $214 billion to a conservative $60 billion. Mr. Berle's own estimate was that all corporate pension funds would amount to approximately $80 billion by 1975. He did not enumerate all the factors that he considered in this estimate but indicated that this sum might be equally divided between the noninsured and insured funds.

By 1957 considerably more data on the size of corporate pension funds had become available and the Chief Statistician of the Securities and Exchange Commission, Vito Natrelli, estimated that the assets of all private corporate pension funds would total more than $85 billion in 1965 and

26 Public Hearing, Welfare and Pension Funds, New York State Insurance Department, 1956, Statement of A. A. Berle, Jr., Exhibit 1, p. 7. (Mimeographed.)

27 Statistics which have since become available indicate that the noninsured funds are increasing more rapidly than the insured funds. Note figures contained above in Table 3, p. 27.
the assets of the noninsured funds would amount to $29.2 billion at the end of 1960 and $51.7 billion at the end of 1965.  

A more recent estimate of the size of pension funds has been made by Father Paul P. Harbrecht. Based on what he calls conservative assumptions, Father Harbrecht estimates that the assets of noninsured private corporate pension funds will reach a total of $47.3 billion at the end of 1965, which will represent approximately 60 per cent of the $79 billion of the assets in all private corporate pension funds at that time. He also estimates the assets for all noninsured private corporate pension funds will total $84 billion by the end of 1970, or about two-thirds of the $126 billion aggregate which he estimates for all private corporate funds at that time. Based on more liberal assumptions, he projects the total assets for the noninsured funds to $52.7 billion at the end of 1965 and approximately $89 billion at the end of 1970. According to these estimates, the assets of noninsured pension funds would range between $47.3 billion and $52.7 billion at the end of 1965 and between $84 billion and $89 billion at the end of 1970.

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30 Ibid., p. 245.

31 Ibid., pp. 245-46.
Scope and Limitations of the Study

Savings and loan associations were selected for study to the exclusion of other types of financial institutions for several reasons. One, the relative size and comparative rate of growth of savings associations places them among the most important types of financial institutions in the economy. Two, it appears that the demand for home mortgage funds will be substantial in the future. According to the study prepared by the School of Business of Indiana University, for example, the total outstanding residential mortgage debt in this country will increase from $157.2 billion in 1960 to $310 billion in 1970.\textsuperscript{32}

This estimate is based on a projected increase in the total population, number of non-farm households, number of people employed, output per employed person, annual income per household, family expenditures for housing, and the assumption that improvement in the quantity and quality of housing will continue to be the broad objective of federal housing legislation.\textsuperscript{33}

As indicated above, savings and loan associations are the most important suppliers of home mortgage funds. If the estimate of home mortgage debt proves to be sufficiently

\textsuperscript{32}United States Savings and Loan League, \textit{The Next Decade}, \textit{op. cit.}, p. 20.

\textsuperscript{33}Ibid., pp. 10-21.
accurate and the demand for home financing is to be met by private enterprise, savings associations will need substantially more resources to help meet the nation's demand for home financing funds. The frequent suggestion that some of these resources can be provided by channeling accumulations from pension funds into savings and loan associations is another reason for investigating both the latter and pension funds in this study.

The noninsured private corporate pension fund was selected for investigation from among several other types of retirement funds for two additional reasons. One, they presently hold a greater amount of assets and are growing at a faster rate than any other type of pension fund. Two, they have much greater freedom of investment choice than any other type of pension fund. Insured private corporate pension funds were excluded from the study because the contributions to these funds are not segregated but are commingled with the general funds of life insurance companies and invested as part of a single portfolio.

The noncontributory public pension programs were excluded because there is no semblance of a reserve fund. The contributory public pension funds which are administered by the federal government are excluded from the study because legally there is little choice in the investment of these funds which are credited to trust funds in the United
States Treasury. To a lesser but still significant degree there is relatively little freedom of choice in the investment of the pension funds of state and local governments. These funds have, however, acquired substantial amounts of corporate debt securities in recent years. While excluded from this study, they may be a proper subject within the sphere of channeling funds into savings and loan associations. Private pension funds developed by unions are excluded because of their relative unimportance in terms of number and size.

The study is, therefore, limited in scope to investigating whether or not the funds in noninsured private corporate pension funds can be channeled into savings and loan associations. It will not be within the scope here to consider whether or not such funds can be channeled into these institutions by the investment of pension funds in any form of investment instrument sold by the Federal Home Loan Banks or in any institution created by the Federal Home Loan Bank Board, other than federally chartered savings and loan associations.

Definitions Used in the Study

In the course of a discussion on a technical subject, it is often considered helpful to define certain terms which may otherwise be subject to varied interpretations. It is
appropriate, perhaps, to define many of these terms as they first appear in the body of discussion in order to provide greater clarity and continuity of thought. For the sake of brevity of words, certain recurring terms are defined in the following manner for the purpose of this study:

1. A "savings and loan association" or "savings association" is a financial corporation which accepts funds primarily in the form of savings from individuals and other sources and invests these funds principally in monthly payment loans for the construction, purchase, refinancing, or repair and modernization of homes. These terms shall be used also to include those financial institutions known as "building and loan associations," "building associations," "homestead associations," and "cooperative banks."

2. A "pension plan" is any form of retirement plan which is established and maintained primarily to provide systematically for the payment of definitely determinable benefits to employees over a period of years after retirement. A plan is, however, not a pension plan if it provides for the payment of benefits not customarily included in a pension plan such as layoff benefits or benefits for sickness, accident, hospitalization, or medical expenses. A pension plan specifically excludes any form of profit-sharing, stock bonus, thrift, savings, supplemental
unemployment benefit, deferred compensation, or other type plan in which benefits cannot be actuarially predetermined.

3. "Pension" or "pension benefits" shall mean benefits payable in accordance with the terms of a pension plan to or for the benefit of a participant.

4. A "participant" is an employee or other person who is covered under the terms of a pension plan.

5. A "pension fund" is a fund which is established by a private corporation in accordance with the terms of a pension plan and which is administered by a trustee. Except where the textual matter clearly indicates otherwise, the term shall exclude insured funds, funds created by unions to provide benefits to members, and all the funds which are administered by federal, state, or local governments.

6. "Trustee," "pension trustee," or "pension fund trustee" shall mean a bank or trust company acting in a fiduciary capacity in the administration of a noninsured pension fund. The term shall also include individuals acting in such capacity except where it is clearly indicated otherwise or where the term "bank trustee" is used.

7. "Pension trust," "pension trust fund" "noninsured pension fund," "noninsured fund," or "noninsured trust," shall mean a trust fund created by a private corporation pursuant to the terms of a pension plan and administered by a trustee.
8. An "insured fund" or "insured pension fund" is a fund which is established by a private corporation in accordance with the terms of a pension plan and which is administered by a life insurance company.

Sources of Material

Essentially three types of information have been employed in the analysis which follows. A careful and extensive search of the literature has been made with special emphasis placed upon the writings of leaders in the savings and loan industry and the writings of pension fund administrators. To supplement this material interviews were conducted with executive officers of the United States Savings and Loan League and the Ohio Savings and Loan League, with executives of savings and loan associations, and with leading noninsured pension fund administrators in Boston and New York. Finally, several different statistical studies and surveys have been drawn upon heavily at various places in the study. These include the studies of the following organizations: (1) National Industrial Conference Board, Inc.; (2) New York State Banking Department; (3) New York State Labor Department; (4) Bureau of Labor Statistics, United States Department of Labor; (5) United States Securities and Exchange Commission; (6) Bankers Trust Company of New York; (7) New York State Department of Insurance.
(8) Institute of Life Insurance; (9) United States Savings and Loan League; and (10) Federal Home Loan Bank Board.

Method of Presentation

It is axiomatic that the essential characteristics of savings and loan associations should be understood before these institutions may be considered as investment outlets for noninsured private corporate pension funds. The nature of savings associations will be discussed in Chapter II. It is equally true that the essential features of noninsured private corporate pension plans are significant to an evaluation of the investment of pension funds in savings and loan associations. Certain basic provisions are common to all noninsured pension plans and these features exert an influence on the investment portfolio of the pension fund. After identifying these features in Chapter III, the investment objectives, policies, and portfolios of noninsured private corporate pension funds will be examined in Chapter IV.

In Chapter V, methods of channeling the accumulations of pension funds into savings associations will be described and evaluated from the standpoint of the investment practices of pension funds and the operations of savings and loan associations. A summarization of the study and the conclusions drawn from the study will be presented in Chapter VI.
CHAPTER II

THE NATURE OF SAVINGS AND LOAN ASSOCIATIONS

The basic features of savings and loan associations will be presented in this chapter. These characteristics include the following: (1) purposes of savings associations, (2) source of authority, (3) nature of ownership, (4) local character of operations, (5) nature of investments, (6) sources of funds, (7) legal provisions governing withdrawal of funds, (8) federal income taxation, (9) membership in the Federal Home Loan Bank System, (10) membership in the Federal Savings and Loan Insurance Corporation, and (11) legislation and supervision.

**Purposes of Savings and Loan Associations**

Various modifications have been introduced in the operations of savings and loan associations in more than a century of development. The objectives of promoting savings and financing homes which were emphasized in the early savings associations continue to be the two principal objectives of these institutions in the present economy.
Savings Objective

The degree of success which savings and loan associations have achieved in promoting the savings objective can be seen by examining Tables, 4, 5, and 6. As indicated in Table 4, the total amount of savings held by seven selected media increased nearly six times from the end of 1940 to the end of 1959. The amount of savings held by each of these intermediaries increased during this period, with the exception that the postal savings deposits was $300 million less in 1959 than in 1940. During this period the amount of time deposits in commercial banks increased approximately four times, from $15.4 billion to $62.7 billion; the amount of savings accounts in mutual savings banks increased more than three times, from $10.6 billion to $35.0 billion; and the reserves of life insurance companies increased nearly four times, from $24.7 billion to $91.0 billion.

In terms of the dollar amount of savings in each of the seven media, the three intermediaries showing the most rapid rate of growth between 1940 and 1959 were savings and loan associations, United States Savings bonds and credit unions. The amount of savings accounts in savings associations increased approximately thirteen times, from $4.3 billion to $54.7 billion; the current redemption value of United States Savings bonds held by individuals increased nearly
<table>
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<th>Year</th>
<th>Commercial Banks</th>
<th>Mutual Savings Banks</th>
<th>Savings and Loans</th>
<th>U.S. Savings Bonds</th>
<th>Postal Savings</th>
<th>Credit Unions</th>
<th>Reserves of Life Ins. Companies</th>
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<td>4.4</td>
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a Time deposits of individuals, partnerships, and corporations.

b Regular and special savings accounts.

c Savings accounts, deposits, and investment certificates, excluding shares pledged against mortgage loans and investments of U.S. Government.

d Current redemption value of bonds held by individuals.

e Outstanding principal and accrued interest on certificates of deposit.
TABLE 4 (cont'd)

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<th>Year</th>
<th>Mutual Savings Banks^</th>
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<th>U.S. Savings and Loans®</th>
<th>Postal Savings Bonds^d</th>
<th>Credit Union Life Ins.®</th>
<th>Reserves of Unions® Companies® Total^h</th>
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<tr>
<td></td>
<td>Shares and members' deposits.</td>
<td>Sum of estimated reserves plus dividends left to accumulate, less premium notes and policy loans.</td>
<td>Total will not total because of rounding.</td>
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</tbody>
</table>

seventeen times, from $2.8 billion to $45.9 billion; and the amount of shares in credit unions increased twenty-two times, from $200 million to $4.4 billion.

The relative share of total savings in each of the seven media in selected years from 1940 to 1959 may be seen in Table 5. Savings associations, credit unions, and United States Savings bonds have each increased their relative share of the total savings in all seven media. Commercial banks, mutual savings banks, postal savings, and life insurance companies each held a smaller relative share of the total savings in all seven media in 1959 than each held in 1940.

The rate of growth in the amount of savings held by savings and loan associations in comparison to their main competitors during the 1950's may be more clearly seen by examining Table 6. Credit unions and savings associations have grown at a faster rate than the other five savings intermediaries during the period from 1950 to 1959. While the total amount of savings in all seven media increased $118.3 billion, or approximately 67.1 per cent during this period, the amount of savings in savings and loan associations increased by $40.7 billion, or approximately 290.7 per cent during the same period. The shares and deposits in credit unions increased from $.9 billion to $4.4 billion, or an increase of 388.9 per cent during this
<table>
<thead>
<tr>
<th>Year</th>
<th>Commercial Banks</th>
<th>Mutual Savings Banks</th>
<th>Savings and Loans</th>
<th>U.S. Savings Bonds</th>
<th>Postal Savings</th>
<th>Credit Unions</th>
<th>Reserves of Life Ins. Companies</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>26.4%</td>
<td>17.8%</td>
<td>7.2%</td>
<td>4.7%</td>
<td>2.2%</td>
<td>.3%</td>
<td>41.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1945</td>
<td>21.9</td>
<td>11.2</td>
<td>5.4</td>
<td>31.5</td>
<td>2.2</td>
<td>.3</td>
<td>27.5</td>
<td>100.0</td>
</tr>
<tr>
<td>1949</td>
<td>20.6</td>
<td>11.3</td>
<td>7.3</td>
<td>28.9</td>
<td>1.9</td>
<td>.4</td>
<td>29.4</td>
<td>100.0</td>
</tr>
<tr>
<td>1950</td>
<td>20.0</td>
<td>11.3</td>
<td>7.9</td>
<td>28.1</td>
<td>1.7</td>
<td>.5</td>
<td>30.4</td>
<td>100.0</td>
</tr>
<tr>
<td>1951</td>
<td>19.9</td>
<td>11.4</td>
<td>8.8</td>
<td>26.7</td>
<td>1.5</td>
<td>.6</td>
<td>31.1</td>
<td>100.0</td>
</tr>
<tr>
<td>1952</td>
<td>20.1</td>
<td>11.6</td>
<td>9.8</td>
<td>25.2</td>
<td>1.4</td>
<td>.7</td>
<td>31.3</td>
<td>100.0</td>
</tr>
<tr>
<td>1953</td>
<td>20.2</td>
<td>11.7</td>
<td>11.0</td>
<td>23.8</td>
<td>1.2</td>
<td>.8</td>
<td>31.3</td>
<td>100.0</td>
</tr>
<tr>
<td>1954</td>
<td>20.2</td>
<td>11.9</td>
<td>12.3</td>
<td>22.5</td>
<td>1.0</td>
<td>.9</td>
<td>31.2</td>
<td>100.0</td>
</tr>
<tr>
<td>1955</td>
<td>19.7</td>
<td>12.0</td>
<td>13.7</td>
<td>21.4</td>
<td>.9</td>
<td>1.0</td>
<td>31.4</td>
<td>100.0</td>
</tr>
<tr>
<td>1956</td>
<td>19.5</td>
<td>12.1</td>
<td>14.9</td>
<td>20.2</td>
<td>.7</td>
<td>1.2</td>
<td>31.4</td>
<td>100.0</td>
</tr>
<tr>
<td>1957</td>
<td>20.5</td>
<td>12.1</td>
<td>16.0</td>
<td>18.4</td>
<td>.5</td>
<td>1.3</td>
<td>31.3</td>
<td>100.0</td>
</tr>
<tr>
<td>1958</td>
<td>21.3</td>
<td>12.1</td>
<td>17.1</td>
<td>17.0</td>
<td>.4</td>
<td>1.4</td>
<td>30.8</td>
<td>100.0</td>
</tr>
<tr>
<td>1959</td>
<td>21.3</td>
<td>11.9</td>
<td>18.6</td>
<td>15.6</td>
<td>.3</td>
<td>1.5</td>
<td>30.9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Table 4.
period. This high percentage gain for credit unions is somewhat misleading due to the fact that the amount of savings held by these institutions was relatively small at the end of 1950 so that a small increase in the amount of savings held would result in a large percentage gain.

TABLE 6

AMOUNT AND PERCENTAGE CHANGE IN SAVINGS HELD BY SELECTED MEDIA AT YEAR END 1959 COMPARED TO YEAR END 1950 (AMOUNTS IN BILLIONS OF DOLLARS)

<table>
<thead>
<tr>
<th>Media</th>
<th>Amount 1959</th>
<th>Amount 1950</th>
<th>Amount of Change</th>
<th>Per Cent of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>$ 62.7</td>
<td>$ 35.2</td>
<td>$ 27.5</td>
<td>78.1%</td>
</tr>
<tr>
<td>Mutual savings banks</td>
<td>35.0</td>
<td>20.0</td>
<td>15.0</td>
<td>75.0</td>
</tr>
<tr>
<td>Savings and loans</td>
<td>54.7</td>
<td>14.0</td>
<td>40.7</td>
<td>290.7</td>
</tr>
<tr>
<td>United States Savings bonds</td>
<td>45.9</td>
<td>49.6</td>
<td>- 3.7</td>
<td>- 8.1</td>
</tr>
<tr>
<td>Postal savings</td>
<td>1.0</td>
<td>3.0</td>
<td>- 2.0</td>
<td>-200.0</td>
</tr>
<tr>
<td>Credit unions</td>
<td>4.4</td>
<td>.9</td>
<td>3.5</td>
<td>388.9</td>
</tr>
<tr>
<td>Reserves of life insurance companies</td>
<td>91.0</td>
<td>53.6</td>
<td>37.4</td>
<td>69.8</td>
</tr>
<tr>
<td>Total</td>
<td>$294.7</td>
<td>$176.4</td>
<td>$118.3</td>
<td>67.1%</td>
</tr>
</tbody>
</table>

Source: Table 4.

The amount of savings in commercial banks, mutual savings banks, and the reserves of life insurance companies has
increased significantly between 1950 and 1959. The relative gain in the amount of savings held by these institutions during this period is, however, substantially smaller than the percentage increase in the amount of savings in savings and loan associations. The amount invested in United States Savings bonds declined approximately 8 per cent, from $49.6 billion in 1950 to slightly under $46 billion in 1959. Postal savings deposits dropped sharply from $3 billion to $1 billion during this period, a decline of 200 per cent.

**Home Financing**

Savings and loan associations lead all other types of lenders in home mortgage financing. This fact is evident upon examination of the data presented in Tables 7 and 8. As indicated in Table 7, the total dollar amount of non-farm home mortgage recordings of $20,000 or less by all residential real estate lenders increased from slightly over $4 billion in 1940 to approximately $32.2 billion in 1959. This volume of recordings by all lenders in 1959 was approximately eight times greater than the dollar amount recorded in 1940 and twice the volume recorded by all lenders in 1950.

As shown in Table 7, the total dollar volume of home mortgage recordings of savings associations in 1959 was $13.1 billion, or approximately ten times the volume of
TABLE 7
AMOUNT OF NONFARM HOME MORTGAGE RECORDINGS OF $20,000 OR LESS BY
TYPE OF LENDER, SELECTED YEARS, 1940 TO 1959
(MILLIONS OF DOLLARS)

<table>
<thead>
<tr>
<th>Year</th>
<th>Savings and Loans</th>
<th>Commercial Banks</th>
<th>Insurance Companies</th>
<th>Mutual Savings Banks</th>
<th>Individuals</th>
<th>All Other Lenders</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>$ 1,283</td>
<td>$1,006</td>
<td>$ 334</td>
<td>$ 170</td>
<td>$ 640</td>
<td>$ 598</td>
<td>$ 4,031</td>
</tr>
<tr>
<td>1945</td>
<td>2,017</td>
<td>1,097</td>
<td>250</td>
<td>217</td>
<td>1,402</td>
<td>666</td>
<td>5,650</td>
</tr>
<tr>
<td>1950</td>
<td>5,060</td>
<td>3,365</td>
<td>1,618</td>
<td>1,064</td>
<td>2,299</td>
<td>2,773</td>
<td>16,179</td>
</tr>
<tr>
<td>1951</td>
<td>5,295</td>
<td>3,370</td>
<td>1,615</td>
<td>1,013</td>
<td>2,540</td>
<td>2,572</td>
<td>16,405</td>
</tr>
<tr>
<td>1952</td>
<td>6,452</td>
<td>3,600</td>
<td>1,420</td>
<td>1,137</td>
<td>2,758</td>
<td>2,651</td>
<td>18,018</td>
</tr>
<tr>
<td>1953</td>
<td>7,365</td>
<td>3,680</td>
<td>1,480</td>
<td>1,327</td>
<td>2,840</td>
<td>3,055</td>
<td>19,747</td>
</tr>
<tr>
<td>1954</td>
<td>8,312</td>
<td>4,239</td>
<td>1,768</td>
<td>1,501</td>
<td>2,882</td>
<td>4,272</td>
<td>22,974</td>
</tr>
<tr>
<td>1955</td>
<td>10,452</td>
<td>5,617</td>
<td>1,932</td>
<td>1,857</td>
<td>3,361</td>
<td>5,265</td>
<td>28,484</td>
</tr>
<tr>
<td>1956</td>
<td>9,532</td>
<td>5,458</td>
<td>1,799</td>
<td>1,824</td>
<td>3,558</td>
<td>4,917</td>
<td>27,088</td>
</tr>
<tr>
<td>1957</td>
<td>9,217</td>
<td>4,264</td>
<td>1,472</td>
<td>1,430</td>
<td>3,554</td>
<td>4,307</td>
<td>24,244</td>
</tr>
<tr>
<td>1958</td>
<td>10,516</td>
<td>5,204</td>
<td>1,460</td>
<td>1,640</td>
<td>3,435</td>
<td>5,133</td>
<td>27,388</td>
</tr>
<tr>
<td>1959</td>
<td>13,094</td>
<td>5,832</td>
<td>1,523</td>
<td>1,780</td>
<td>3,946</td>
<td>6,060</td>
<td>32,235</td>
</tr>
</tbody>
</table>

$1.3 billion recorded by these institutions in 1940 and 2.6 times the amount of their recordings in 1950. Between the years 1940 and 1959, savings associations have not only increased their dollar volume of home mortgage financing but they also have improved their competitive position among all residential real estate lenders. This fact is more clearly illustrated by the data presented in Table 8.

Analysis of Table 8 reveals that savings and loan associations have recorded a larger share of the total dollar amount of home mortgage recordings than any other type of mortgage lender in each selected year from 1940 to 1959. They also have increased their relative share from 31.8 per cent of the total volume in 1940 to 40.6 per cent in 1959. Savings associations have, therefore, improved their relative position as a home mortgage lender to the extent that in 1959 they were recording approximately twice as many nonfarm home mortgages as their nearest competitor.

It may be argued that judging the relative position of savings associations as home mortgage lenders on the basis of nonfarm home mortgage recordings may overstate their relative importance. It is true that mortgage recording statistics do not give a complete picture of the role being played by the various types of lenders engaged in home mortgage financing. First, the data include only mortgage loans not exceeding $20,000, and therefore tend to
TABLE 8

PERCENTAGE DISTRIBUTION OF NONFARM HOME MORTGAGE RECORDINGS OF $20,000 OR LESS BY TYPE OF LENDER, SELECTED YEARS, 1940 TO 1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Savings and Loans</th>
<th>Commercial Banks</th>
<th>Insurance Companies</th>
<th>Mutual Savings Banks</th>
<th>Individuals</th>
<th>All Other Lenders</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>31.8%</td>
<td>25.0%</td>
<td>8.3%</td>
<td>4.2%</td>
<td>15.9%</td>
<td>14.8%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1945</td>
<td>35.8</td>
<td>19.4</td>
<td>4.4</td>
<td>3.8</td>
<td>24.8</td>
<td>11.8</td>
<td>100.0</td>
</tr>
<tr>
<td>1950</td>
<td>31.3</td>
<td>20.8</td>
<td>10.0</td>
<td>6.6</td>
<td>14.2</td>
<td>17.1</td>
<td>100.0</td>
</tr>
<tr>
<td>1951</td>
<td>32.3</td>
<td>20.5</td>
<td>9.8</td>
<td>6.2</td>
<td>15.5</td>
<td>15.7</td>
<td>100.0</td>
</tr>
<tr>
<td>1952</td>
<td>35.8</td>
<td>20.0</td>
<td>7.9</td>
<td>6.3</td>
<td>15.3</td>
<td>14.7</td>
<td>100.0</td>
</tr>
<tr>
<td>1953</td>
<td>37.4</td>
<td>18.6</td>
<td>7.5</td>
<td>6.7</td>
<td>14.4</td>
<td>15.5</td>
<td>100.0</td>
</tr>
<tr>
<td>1954</td>
<td>36.2</td>
<td>18.5</td>
<td>7.7</td>
<td>6.5</td>
<td>12.5</td>
<td>18.6</td>
<td>100.0</td>
</tr>
<tr>
<td>1955</td>
<td>36.7</td>
<td>19.7</td>
<td>6.8</td>
<td>6.5</td>
<td>11.8</td>
<td>18.5</td>
<td>100.0</td>
</tr>
<tr>
<td>1956</td>
<td>35.2</td>
<td>20.2</td>
<td>6.6</td>
<td>6.7</td>
<td>13.1</td>
<td>18.2</td>
<td>100.0</td>
</tr>
<tr>
<td>1957</td>
<td>38.0</td>
<td>17.6</td>
<td>6.1</td>
<td>5.9</td>
<td>14.6</td>
<td>17.8</td>
<td>100.0</td>
</tr>
<tr>
<td>1958</td>
<td>38.4</td>
<td>19.0</td>
<td>5.3</td>
<td>6.0</td>
<td>12.5</td>
<td>18.8</td>
<td>100.0</td>
</tr>
<tr>
<td>1959</td>
<td>40.6</td>
<td>18.1</td>
<td>4.7</td>
<td>5.5</td>
<td>12.2</td>
<td>18.8</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Table 7.
understate the total volume of home financing. Second, they include to a certain extent loans on properties other than residential. It is, however, believed that such loans do not bulk large in the data and that the inclusion of such loans tends to balance the omission of loans over $20,000. Third, mortgage recording data comprise only mortgage originations, whereas certain lenders also purchase in considerable volume the mortgages originated and recorded by other lenders.

The fact that home mortgage recording statistics do not overstate the relative importance of savings and loan associations as permanent suppliers of home mortgage credit is revealed in the data presented in Table 9. The total mortgage indebtedness outstanding on one-to-four family nonfarm dwellings exceeded $131 billion at the end of 1959. Approximately $49.7 billion of this amount or nearly 38 per cent was in the portfolio of savings associations. At the end of 1959, life insurance companies held $23.6 billion or 18 per cent of the total outstanding home mortgage debt; commercial banks held $19.2 billion or nearly 15 per cent of all home mortgages; mutual savings banks held $16.9 billion or approximately 13 per cent of the total; and $21.7 billion or 16.5 per cent of nonfarm home mortgage debt was held by all other lenders, including the Federal National Mortgage Association. At the end of 1959, savings and loan
<table>
<thead>
<tr>
<th>Year</th>
<th>Savings and Loans</th>
<th>Life Insurance Companies</th>
<th>Commercial Banks</th>
<th>Mutual Savings Banks</th>
<th>FNMA</th>
<th>Individuals and Others&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>$3,919</td>
<td>$1,803</td>
<td>$2,363</td>
<td>$2,162</td>
<td>$178</td>
<td>$6,966</td>
<td>$17,391</td>
</tr>
<tr>
<td>1945</td>
<td>5,156</td>
<td>2,306</td>
<td>2,875</td>
<td>1,894</td>
<td>7</td>
<td>6,353</td>
<td>18,591</td>
</tr>
<tr>
<td>1950</td>
<td>13,116</td>
<td>8,478</td>
<td>9,481</td>
<td>4,312</td>
<td>1,328</td>
<td>8,455</td>
<td>45,170</td>
</tr>
<tr>
<td>1951</td>
<td>14,844</td>
<td>10,610</td>
<td>10,275</td>
<td>5,531</td>
<td>1,818</td>
<td>8,333</td>
<td>51,711</td>
</tr>
<tr>
<td>1952</td>
<td>17,645</td>
<td>11,757</td>
<td>11,250</td>
<td>6,194</td>
<td>2,210</td>
<td>9,444</td>
<td>58,500</td>
</tr>
<tr>
<td>1953</td>
<td>20,999</td>
<td>13,195</td>
<td>12,025</td>
<td>7,373</td>
<td>2,358</td>
<td>10,144</td>
<td>66,094</td>
</tr>
<tr>
<td>1954</td>
<td>25,004</td>
<td>15,153</td>
<td>13,300</td>
<td>9,002</td>
<td>2,328</td>
<td>10,890</td>
<td>75,677</td>
</tr>
<tr>
<td>1955</td>
<td>30,001</td>
<td>17,661</td>
<td>15,075</td>
<td>11,100</td>
<td>2,444</td>
<td>11,969</td>
<td>88,250</td>
</tr>
<tr>
<td>1956</td>
<td>34,004</td>
<td>20,130</td>
<td>16,245</td>
<td>12,990</td>
<td>2,866</td>
<td>12,802</td>
<td>99,037</td>
</tr>
<tr>
<td>1957</td>
<td>37,996</td>
<td>21,441</td>
<td>16,385</td>
<td>14,110</td>
<td>3,777</td>
<td>13,908</td>
<td>107,617</td>
</tr>
<tr>
<td>1958</td>
<td>42,890</td>
<td>22,374</td>
<td>17,628</td>
<td>15,640</td>
<td>3,580</td>
<td>15,574</td>
<td>117,686</td>
</tr>
<tr>
<td>1959</td>
<td>49,727</td>
<td>23,622</td>
<td>19,240</td>
<td>16,868</td>
<td>4,938</td>
<td>16,749</td>
<td>131,144</td>
</tr>
</tbody>
</table>

<sup>a</sup>This series includes mortgages held by individuals, trust departments of commercial banks, pension funds, philanthropic and educational institutions, fraternal organizations, casualty and fire insurance companies, real estate and mortgage companies, other organizations, and mortgages held by FHA and VA.

associations held more than twice the dollar amount of outstanding loans on nonfarm family dwellings than was held by any other type of lender.

Other Functions of Savings Associations

In addition to their main objectives of providing home mortgage credit and a medium for the accumulation of savings, many savings and loan associations offer other services to their customers or to the public. Many of them sell money orders, issue traveler's checks, issue official checks payable to a third party, cash checks for customers, serve as collection representatives for local utility companies, rent safe deposit facilities, serve as fiscal agents for the United States Government in the sale and redemption of Series E Savings bonds, and in general offer counsel or advice on home construction and family financial matters.

Source of Authority

A group of people who wish to form a savings and loan association must apply to the proper authorities for a charter. When applying for a federal charter, the application is sent to the Federal Home Loan Bank Board through the Federal Home Loan Bank in the region in which the association will be located. If the organizers desire a
state charter, the application is sent to the appropriate state supervisory authority.

Federal laws and regulations prohibit the granting of charters to new federal associations unless (1) members of the applicant group are of good character and responsibility, (2) there is need for such an institution in the community to be served, (3) there is reasonable probability of its success, and (4) the new association can be established without undue injury to properly conducted existing local thrift and home-financing institutions.\(^1\) In general, it appears that in granting charters the state supervisory authorities are guided by approximately the same principles. Some states also provide that certain terms, such as "savings and loan" or "building and loan" must be included as part of the name of the association. In the case of savings associations desiring federal charters, the words "Federal Savings and Loan Association" must be included as part of full association title.\(^2\)

The issuance of a charter permits the savings association to begin operations. An association which begins operations under a state charter may later convert into a


\(^2\)\textit{Ibid.}, Sec. 543.1.
federal association upon such terms and conditions as the Federal Home Loan Bank Board may prescribe.  

Under this dual system of charter authorization, there were 6,230 savings and loan associations in this country at the end of 1959. Of these associations, 4,389, or 70 per cent, had state charters while 1,841 associations, representing 30 per cent of all associations, had federal charters.

Characteristics of State Charters

Until 1933, the only authorities which granted charters to savings and loan associations were the supervisory bodies of the respective states. Practically all states have enacted savings and loan association codes to deal with this particular type of financial institution. These codes are a collection of all the laws pertaining specifically to the formation, administration, supervision, and possible liquidation or merging of associations. They also indicate the powers, outline the duties and responsibilities, and specify many details of the operation of savings associations. The nature of the charter under which a state-chartered association operates depends, of course, upon the law of the state in which it was formed. The typical state

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3 Ibid., Sec. 543.8 and Sec. 543.9.

4 United States Savings and Loan League, Fact Book 1960 (Chicago: United States Savings and Loan League, 1960), Table 47, p. 70.
charter, however, usually includes the name of the association, the purpose of its formation, its place of business, the names and residences of its members, and the number, names and residences of the directors and their tenure of office.5

**Characteristics of Federal Charters**

The formation of federal savings and loan associations was authorized by the Home Owners' Loan Act of 1933. Section 5(a) of this act states:

In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as "Federal Savings and Loan Associations" and to issue charters therefore, giving primary consideration to the best practices of local mutual thrift and home financing institutions in the United States.6

The rules and regulations relating to the issuance of federal charters have been revised several times by the Federal Home Loan Bank Board. Under the original regulations promulgated in 1933, the charter form issued to all

---


federally chartered associations was referred to as Charter E. In 1936, the rules and regulations were revised and a new charter form, referred to as Charter K, was authorized. A third revision of the regulations was made in 1949 and resulted in another new charter form, Charter N. The latest revision was undertaken in 1953 and embodied in a new charter form, called Charter K (revised). The regulations promulgated by the Federal Home Loan Bank Board in 1953 gave approval to associations to adopt Charter K (revised) if they were operating under any one of the other three charter forms. New federally chartered associations may be organized under either Charter N or Charter K (revised).

The several forms of federal charters under which savings associations may be operating contain provisions dealing with the association title, location of the home office, purposes and powers of the association, nature and rights of association members, composition and duties of the board of directors, withdrawal provisions, loans and investments, borrowing restrictions, and provisions related to reserves, surplus, and the distribution of earnings.\(^7\)

\(^7\)Federal Home Loan Bank Board, *op. cit.* , Sec. 544.1.
The particular provisions under which an association is operating must be determined by reference to its particular charter form.

**Nature of Corporate Ownership**

Savings and loan associations are formed as corporations but they may operate either as mutual organizations or as permanent stock companies. Stock companies are owned by the holders of the outstanding permanent capital stock and only these stockholders have the right to vote in association affairs. In a savings association of the mutual type, there is no permanent capital stock outstanding. The members of the mutual association are the owners with the right to vote for directors as their representatives in the conduct of the general affairs of the association. The regulations embodied in both state and federal laws define a member as any person owning a savings account or any person borrowing from an association. According to federal regulations and the majority of state savings association codes, a savings member is entitled to one vote for each $100 balance, or fraction thereof, in his savings account. A borrowing member is entitled to one vote in addition to any number of votes he may be entitled

---

to cast as a savings account holder. The maximum number of votes to which any one member is entitled is generally limited to 50 votes. 9

Federal regulations require that all federally chartered associations be of the mutual type. Most state associations are mutual organizations and those state institutions which operate as stock companies are located in the states which authorize savings and loan associations to incorporate either as mutual associations or as permanent stock companies.

The number of stock companies, their total assets, and the states which permit the formation of stock savings associations can be seen in Table 10. The 466 stock companies represented approximately 7 per cent of the 6,230 savings and loan associations in business at the end of 1959. At the end of 1959, stock associations held approximately $8.2 billion of assets, representing nearly 13 per cent of the total assets of all savings and loan associations. The predominance of mutual associations is indicated by the fact that 1,841 federally chartered associations and 3,923 state associations, or approximately 93 per cent of all associations, are mutually owned. At the end of 1959 mutual savings associations held approximately $55.3 billion

9Loc. cit.
of assets, or more than 87 per cent of the total assets of all savings and loan associations.

### TABLE 10

**TOTAL ASSETS AND NUMBER OF PERMANENT STOCK SAVING ASSOCIATIONS BY STATES AT YEAR END 1959**

<table>
<thead>
<tr>
<th>State</th>
<th>Number</th>
<th>Assetsa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arizona</td>
<td>6</td>
<td>$90,068</td>
</tr>
<tr>
<td>California</td>
<td>158</td>
<td>4,927,714</td>
</tr>
<tr>
<td>Colorado</td>
<td>21</td>
<td>272,489</td>
</tr>
<tr>
<td>Idaho</td>
<td>1</td>
<td>11,796</td>
</tr>
<tr>
<td>Illinois</td>
<td>18</td>
<td>52,915</td>
</tr>
<tr>
<td>Indiana</td>
<td>2</td>
<td>10,130</td>
</tr>
<tr>
<td>Kansas</td>
<td>39</td>
<td>171,065</td>
</tr>
<tr>
<td>Nevada</td>
<td>2</td>
<td>16,848</td>
</tr>
<tr>
<td>Ohio</td>
<td>93</td>
<td>1,607,967</td>
</tr>
<tr>
<td>Oregon</td>
<td>1</td>
<td>1,554</td>
</tr>
<tr>
<td>Texas</td>
<td>111</td>
<td>887,857</td>
</tr>
<tr>
<td>Utah</td>
<td>6</td>
<td>129,625</td>
</tr>
<tr>
<td>Virginia</td>
<td>3</td>
<td>10,300</td>
</tr>
<tr>
<td>Washington</td>
<td>4</td>
<td>14,235</td>
</tr>
<tr>
<td>Guam</td>
<td>1</td>
<td>1,215</td>
</tr>
</tbody>
</table>

**Total** 466 $8,205,744

---

*a In millions of dollars.


**Local Character of Operations**

Except for one brief period in the history and development of savings and loan associations, savings and loan authorities suggest that these institutions are "inherently..."
local in character." As local or community institutions, the bulk of their funds comes from savings members who live within the locality of the association, most of their loans are granted only on property which is located within a specified distance from the institution, and the board of directors of these associations is comprised primarily of local community members. The phrase "operating as local institutions" does, however, not mean that all savings and loan associations are prohibited from establishing branch offices, promoting savings from people who live outside the geographic hinterland of the association, or lending a certain amount of funds on property located outside a certain radius of the association.

**Nature of Investments**

The amount and distribution of the principal assets of all savings and loan associations are presented in Table 11. Approximately $53.1 billion or nearly 84 per cent of the total assets of all savings and loan associations was in the form of mortgage loans at the end of 1959. This ratio has remained relatively constant during the past decade, ranging from 81 to 84 per cent.\(^{11}\)

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\(^{11}\) United States Savings and Loan League, *op. cit.*, p. 78.
TABLE 11
AMOUNT AND PERCENTAGE DISTRIBUTION OF ASSETS HELD BY ALL SAVINGS AND LOAN ASSOCIATIONS IN THE UNITED STATES BY TYPE OF ASSET AT YEAR END 1959

<table>
<thead>
<tr>
<th>Asset</th>
<th>Amount(^a)</th>
<th>Per Cent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash on hand and in banks</td>
<td>$2,189</td>
<td>3.5%</td>
</tr>
<tr>
<td>U.S. Government obligations</td>
<td>4,471</td>
<td>7.0</td>
</tr>
<tr>
<td>Mortgage loans</td>
<td>53,087</td>
<td>83.6</td>
</tr>
<tr>
<td>Federal Home Loan Bank stock</td>
<td>856</td>
<td>1.4</td>
</tr>
<tr>
<td>Other assets</td>
<td>2,869</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$63,472</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

\(^a\)Amount of assets in millions of dollars.


**Mortgage Loans**

While mortgage loans constitute the most important investment of savings associations, these loans are not identical in all respects. They may differ in several ways such as the purpose for which the loan was granted, the presence or absence of insurance or guaranty provisions, the size of the loan, the interest rate, the term or maturity of the loan, and the manner of repayment.
Purpose of Loans

The typical mortgage loan made by savings associations is employed for the financing of single-family, owner-occupied dwellings. There are, however, several purposes for which this mortgage lending is done. These purposes can be grouped into three major categories including (1) loans for new home construction, (2) loans to purchase existing homes, and (3) loans for all other purposes.

As may be observed in Table 12, approximately $5.3 billion, or slightly more than 34 per cent of the total amount of mortgage loans granted by savings associations in 1959 was used to finance new home construction. Loans made for the purpose of enabling borrowers to acquire homes already built have always accounted for the major portion of the loan closings of these institutions. In fact, the amount of loans granted by savings associations for this purpose has exceeded the volume of loans made for any other purpose in every year of record. Approximately $6.8 billion, or nearly 44 per cent of the mortgage lending of savings associations in 1959 was made to finance the purchase of existing homes.

Loans for "all other purposes" are comprised mainly of loans made for the purpose of modernizing and reconditioning residential properties, refinancing existing mortgage obligations, and other miscellaneous objectives. Such
<table>
<thead>
<tr>
<th>Year</th>
<th>Home Construction</th>
<th>Home Purchase</th>
<th>All Other Purposes</th>
<th>Total Loans</th>
<th>Home Construction</th>
<th>Home Purchase</th>
<th>All Other Purposes</th>
<th>Total Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>$399</td>
<td>$426</td>
<td>$375</td>
<td>$1,200</td>
<td>33.3%</td>
<td>35.5%</td>
<td>31.3%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1941</td>
<td>1,437</td>
<td>581</td>
<td>361</td>
<td>1,379</td>
<td>31.7%</td>
<td>42.1%</td>
<td>26.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1942</td>
<td>190</td>
<td>576</td>
<td>286</td>
<td>1,051</td>
<td>18.1%</td>
<td>54.6%</td>
<td>27.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1943</td>
<td>106</td>
<td>802</td>
<td>275</td>
<td>1,184</td>
<td>9.0%</td>
<td>67.7%</td>
<td>23.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1944</td>
<td>95</td>
<td>1,064</td>
<td>295</td>
<td>1,454</td>
<td>6.5%</td>
<td>73.2%</td>
<td>20.3%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1945</td>
<td>180</td>
<td>1,358</td>
<td>375</td>
<td>1,913</td>
<td>9.4%</td>
<td>71.0%</td>
<td>19.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1946</td>
<td>615</td>
<td>2,357</td>
<td>612</td>
<td>3,584</td>
<td>17.2%</td>
<td>65.8%</td>
<td>17.1%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1947</td>
<td>894</td>
<td>2,128</td>
<td>789</td>
<td>3,911</td>
<td>23.5%</td>
<td>55.8%</td>
<td>20.7%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1948</td>
<td>1,046</td>
<td>1,710</td>
<td>851</td>
<td>3,607</td>
<td>29.0%</td>
<td>47.4%</td>
<td>21.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1949</td>
<td>1,083</td>
<td>1,559</td>
<td>994</td>
<td>3,636</td>
<td>29.8%</td>
<td>42.9%</td>
<td>27.3%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1950</td>
<td>1,767</td>
<td>2,246</td>
<td>1,224</td>
<td>5,237</td>
<td>33.7%</td>
<td>42.9%</td>
<td>23.4%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1951</td>
<td>1,657</td>
<td>2,357</td>
<td>1,236</td>
<td>5,250</td>
<td>31.6%</td>
<td>44.9%</td>
<td>23.5%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1952</td>
<td>2,105</td>
<td>2,955</td>
<td>1,557</td>
<td>6,617</td>
<td>31.8%</td>
<td>44.7%</td>
<td>23.5%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1953</td>
<td>2,475</td>
<td>3,488</td>
<td>1,804</td>
<td>7,767</td>
<td>31.9%</td>
<td>44.9%</td>
<td>23.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1954</td>
<td>3,076</td>
<td>3,816</td>
<td>2,047</td>
<td>8,969</td>
<td>34.3%</td>
<td>42.9%</td>
<td>22.8%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1955</td>
<td>4,041</td>
<td>5,211</td>
<td>2,150</td>
<td>11,412</td>
<td>35.3%</td>
<td>45.8%</td>
<td>18.8%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1956</td>
<td>3,772</td>
<td>4,727</td>
<td>2,046</td>
<td>10,545</td>
<td>35.8%</td>
<td>44.8%</td>
<td>19.4%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1957</td>
<td>3,562</td>
<td>4,708</td>
<td>2,132</td>
<td>10,402</td>
<td>34.2%</td>
<td>45.3%</td>
<td>20.5%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1958</td>
<td>4,097</td>
<td>5,251</td>
<td>2,998</td>
<td>12,316</td>
<td>33.2%</td>
<td>42.5%</td>
<td>21.3%</td>
<td>100.0%</td>
</tr>
<tr>
<td>1959</td>
<td>5,296</td>
<td>6,766</td>
<td>3,401</td>
<td>15,463</td>
<td>34.2%</td>
<td>43.8%</td>
<td>22.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

loans constituted 22 per cent of the mortgage loans made by savings and loan associations in 1959. Complete data are not available as to the total volume of funds extended by these institutions for the improvement and modernization of properties, but it is estimated that currently this amounts to an annual volume of approximately $600 million.\textsuperscript{12}

Presence or Absence of Insurance or Guaranty Provisions

The mortgage loans made by savings and loan associations differ not only as to the purpose for which the loan is granted, but also according to whether or not they are (1) conventional loans, (2) loans insured by the Federal Housing Administration, or (3) loans guaranteed by the Veterans Administration.

The relative importance of each type of loan can be seen upon examination of the data presented in Table 13. The conventional type of mortgage loan is by a wide margin the predominant loan of savings associations in financing home ownership. In 1959, conventional loans amounted to $14 billion and comprised 90.6 per cent of the total loan closings of all savings associations. The VA loans made by savings associations in 1959 amounted to $621 million or 4 per cent of the total dollar volume of mortgage lending. With the exception of 1958, this represented the lowest

\textsuperscript{12}\textit{Ibid.}, p. 52.
TABLE 13
AMOUNT AND PERCENTAGE DISTRIBUTION OF MORTGAGE LOANS MADE BY
SAVINGS AND LOAN ASSOCIATIONS ACCORDING TO THE PRESENCE
OR ABSENCE OF INSURANCE OR GUARANTY PROVISIONS,
ANNUALLY, 1945 TO 1959
(AMOUNTS IN MILLIONS OF DOLLARS)

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
<th>Per Cent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Conventional</td>
<td>VA</td>
</tr>
<tr>
<td>1945</td>
<td>$1,685</td>
<td>$175</td>
</tr>
<tr>
<td>1946</td>
<td>2,294</td>
<td>1,250</td>
</tr>
<tr>
<td>1947</td>
<td>2,843</td>
<td>870</td>
</tr>
<tr>
<td>1948</td>
<td>2,819</td>
<td>571</td>
</tr>
<tr>
<td>1949</td>
<td>3,062</td>
<td>336</td>
</tr>
<tr>
<td>1950</td>
<td>4,232</td>
<td>741</td>
</tr>
<tr>
<td>1951</td>
<td>4,373</td>
<td>703</td>
</tr>
<tr>
<td>1952</td>
<td>5,753</td>
<td>691</td>
</tr>
<tr>
<td>1953</td>
<td>6,681</td>
<td>853</td>
</tr>
<tr>
<td>1954</td>
<td>7,883</td>
<td>877</td>
</tr>
<tr>
<td>1955</td>
<td>9,163</td>
<td>1,591</td>
</tr>
<tr>
<td>1956</td>
<td>9,128</td>
<td>1,166</td>
</tr>
<tr>
<td>1957</td>
<td>9,371</td>
<td>786</td>
</tr>
<tr>
<td>1958</td>
<td>11,349</td>
<td>445</td>
</tr>
<tr>
<td>1959</td>
<td>14,004</td>
<td>621</td>
</tr>
</tbody>
</table>

proportion in any year since the VA loan program was estab-
lished in 1944. FHA loans originated by savings associa-
tions, however, amounted to $838 million in 1959, or 5.4 per
cent of total loan closings. This was the highest propor-
tion FHA loans had reached since 1949, but this type of loan
represented a relatively small proportion of the total
loans made by these associations in comparison with conven-
tional loans.

The primary explanation for the predominance of the
conventional loan in the mortgage portfolio of savings
associations is relatively simple. The interest rate on
both VA loans and FHA loans is controlled so that the lend-
ing institution granting these loans cannot charge the
borrower more than a specified maximum interest rate. As
interest rates have risen, savings associations have
increased the interest rate on conventional loans and have,
therefore, created substantially greater earnings for the
associations. A savings association which makes, for
example, a conventional loan at 6.5 per cent rather than a
VA loan of the same amount at the maximum rate at 5.25 per
cent produces nearly 24 per cent more gross income for the
association on the conventional loan than on the VA loan.
The additional earnings created by the conventional loan can
then be appropriated to a reserve account to cover any
losses the association may suffer.
Size of the Loan

On conventional home loans, federal savings and loan associations may lend up to 80 per cent of the appraised value of the property. State-chartered associations are usually limited to from 66-2/3 to 80 per cent of the property value on such loans. All savings and loan associations may make FHA loans or VA loans up to the maximum percentage of value acceptable to the insuring or guaranteeing agency.

The average size of mortgage loans originated by all types of lenders has increased from $5,336 in 1950 to $8,523 in 1959. The average size of such loans made by savings associations during 1959 was $9,502, or approximately 75 per cent larger than the average mortgage loan granted by these institutions in 1950.\(^\text{13}\)

Interest Rate on Loans

The rate of interest charged by savings and loan associations on conventional loans naturally varies with different time periods, customers, geographic regions and many other considerations. At the present time these rates range from 5 to 7 per cent. The maximum rate of interest which may be charged on FHA loans is 5-1/4 per cent per annum. In addition to this the borrower must pay an

\(^{13}\)United States Savings and Loan League, op. cit., pp. 39-40.
insurance premium on the loan of 1/2 of 1 per cent per annum. The maximum rate which may be charged on VA loans is 5-1/4 per cent per annum.

Term or Maturity of Loans

The length of maturity of the loans made by savings and loan associations depends largely upon the purpose for which the loan is granted, the amount of the loan, and whether or not it is a conventional loan or one guaranteed by the Veterans Administration or insured by the Federal Housing Administration. At the present time, savings associations are permitted to make conventional loans for the acquisition of homes on terms up to 25 years. The maximum maturity on FHA and VA loans is established by administrative regulations or legislative enactments and is currently 30 years on ordinary home loans.

Manner of Repayment

In the past, many home loans ran for a specified number of years, at the end of which period the entire principal amount became due. During the life of this type of loan, called a "straight loan," the interest was paid periodically on the original amount of the loan. All the loans granted by federal savings and loan associations and the loans made in recent years by most state savings associations are, however, "direct-reduction" loans. Under this plan the
borrower pays a fixed amount at regular intervals, usually monthly. Part of this fixed payment is used to pay the interest due and the balance is immediately credited against the principal amount of the loan. Since interest is computed on the balance outstanding at the end of each month, a larger portion of the fixed monthly payment is applied to reduce the principal as time passes.

Other Assets of Savings Associations

While the bulk of the funds of savings and loan associations is invested in home mortgage loans, other assets are quantitatively important to these institutions. As shown in Table II presented earlier in this chapter, these assets include (1) cash on hand and on deposit in commercial banks and the Federal Home Loan Bank; (2) U.S. government securities; (3) Federal Home Loan Bank stock; and (4) other assets such as office building, furniture and equipment, and Federal Home Loan Bank obligations. With the exception of Federal Home Loan Bank stock, the brief names of these asset accounts are self-explanatory. Federal Home Loan Bank stock represents ownership by savings associations in the regional Federal Home Loan Bank. In general, all savings and loan associations which are members of the Federal Home Loan Bank System are required to hold
this stock in an amount equivalent to at least 2 per cent of their outstanding home mortgage loans.

Sources of Funds

Savings and loan associations have two principal sources from which they obtain the bulk of the funds used for mortgage lending and all other purposes. These sources are "net savings receipts," which is merely the difference between gross savings receipts and the amount of withdrawal payments, and mortgage loan repayments, including prepayments. Another important though quantitatively far less significant source of funds is the net income which is retained in the business. In 1959 mortgage loan repayments, net savings receipts, and retained earnings supplied these institutions with $8 billion, $6.7 billion, and $565 million, respectively. The total volume supplied by these three sources was, nevertheless, inadequate by the amount of $173 million to support the $15.5 billion of mortgage loans made by savings associations. In order to grant this volume of mortgage loans and to supply the funds required for their other investments and other purposes, savings associations obtained additional funds from other sources. These include advances from the regional Federal Home Loan Bank and other borrowed money, the sale of capital stock, the sale of security holdings, or the reduction of cash holdings.
Mortgage Loan Repayments

As mentioned previously, most of the mortgage loans granted by savings and loan associations are amortized loans which require the borrower to make monthly payments on the principal. The aggregate of the mortgage loan repayments received annually by these institutions amounts to a very substantial sum. The amount and relative importance of this source of funds to all savings associations during 1959 is indicated in Table 14. In that year, principal repayments on mortgage loans supplied funds totaling approximately $8 billion or 47.5 per cent of the total supply of funds available to these institutions.

Net Savings Receipts

As may be observed in Table 14, a second major source of funds to savings associations is "net savings receipts." The saver who places savings in a savings and loan association may do so by opening or making additions to one or more of three different types of accounts depending upon the particular association chosen for the purpose. These include (1) the savings share account, (2) the deposit account, and (3) investment certificates.

Savings Share Accounts

The savings share account is by far the most common type of account, although it is commonly referred to as
### TABLE 14

**AMOUNT AND PERCENTAGE DISTRIBUTION OF PRINCIPAL SOURCES OF FUNDS OF SAVINGS AND LOAN ASSOCIATIONS FOR THE YEAR 1959**

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount a</th>
<th>Per Cent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage loan repayments(^b)</td>
<td>$8,003</td>
<td>47.5</td>
</tr>
<tr>
<td>Net savings receipts(^c)</td>
<td>6,722</td>
<td>39.9</td>
</tr>
<tr>
<td>Advances from FHLD(^d)</td>
<td>836</td>
<td>5.0</td>
</tr>
<tr>
<td>Net income after dividends</td>
<td>565</td>
<td>3.4</td>
</tr>
<tr>
<td>Reduction of cash on hand and in banks</td>
<td>396</td>
<td>2.4</td>
</tr>
<tr>
<td>Sale of participation loans(^e)</td>
<td>205</td>
<td>1.2</td>
</tr>
<tr>
<td>Additional borrowed money</td>
<td>104</td>
<td>0.6</td>
</tr>
<tr>
<td>Sale of capital stock</td>
<td>5</td>
<td>0.03</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$16,836</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

\(^a\)Amount in millions of dollars.

\(^b\)Derived by adding the amount of mortgage loans made during the year 1959 to the outstanding balance at the beginning of the year and subtracting the outstanding balance at the end of the year.

\(^c\)Gross savings receipts minus withdrawals. Gross savings receipts include savings accounts, deposit accounts, investment certificates, and dividends credited to savings accounts, but do not include shares pledged against mortgage loans.

\(^d\)Total advances made by the Federal Home Loan Banks during the year 1959 minus total repayments made during the year.

\(^e\)Derived by subtracting the cumulative volume at the beginning of the year from the comparable figure at the end of the year.

the "share account," "savings account," or "withdrawable share account." Savings and loan associations offer savers a number of different classes of savings share accounts which may be classified according to their various characteristics. They may be categorized according to (1) the nature or type of ownership, (2) the manner of saving, and (3) the method of paying dividends.

Nature of ownership. Not only do savings associations accept individual accounts in which one person is the owner of the funds but they also accept many other different types of accounts. Among these are included joint tenancy accounts, tenancy in common accounts, trust accounts, partnership accounts, voluntary association accounts, and the accounts of corporations.

Manner of savings. Savings and loan associations have developed different types of savings share accounts based on the various savings habits of individuals and organizations. The four principal types of accounts classified according to the manner in which the owner of the account saves are (1) regular accounts, (2) systematic accounts, (3) investment accounts, and (4) prepaid accounts.

The regular account is the most popular form of savings share account in these institutions. This account, sometimes referred to as an "optional" account, can usually be opened with as little as one dollar and additions to the
account can be made in any amount at any time. The ownership of the account ordinarily is evidenced by a passbook. Additions to and withdrawals from the account are recorded in the passbook. Dividends are credited directly to the account as of the date the dividend is declared payable by the board of directors, usually semiannually.

Systematic accounts are established for those savers who prefer to save a fixed amount at regular intervals over a certain period of time, usually until a predetermined goal is reached. The parents of a child, for example, may agree to save $30.00 per month for ten years in order to provide a college fund for the child. As a reward for saving a fixed amount regularly for a given period of time, a "bonus" or higher dividend is paid by some associations on this type of account, sometimes referred to as a "bonus account." Bonus arrangements vary but typically the bonus may amount to as much as 1 per cent over and above the regular rate of earnings paid by an association. A passbook customarily is issued for systematic accounts and dividends are credited directly to the account. This type of account is terminated if the saver fails to make regular payments, decides to discontinue the systematic feature of the account, or wishes to make withdrawals.

In the investment account, which is also known as a "full-paid account," a lump sum, usually in $100 units, is placed with the association. In contrast to the regular and systematic accounts, the ownership of each unit of savings in an investment account generally is evidenced by a certificate rather than a passbook. All additions to and withdrawals from this account are in multiples of $100. Dividends, when declared, are paid to the certificate holder by check.

Similar to the investment account, a prepaid account requires the saver to place a lump sum with the association. The lump sum can, however, be any amount and need not be in units of $100. Dividends are credited to the account, which is evidenced by a passbook, until the account balance reaches a predetermined maturity value. The prepaid account is somewhat similar in one respect to Series E Savings bonds. The saver pays a certain portion of the maturity value of the account when it is opened, and by permitting dividends to accumulate, the account ultimately matures. At maturity the account is either withdrawn or transferred to one of the other types of accounts.

Method of paying dividends. As noted in the immediately preceding discussion, the ownership of investment accounts is generally evidenced by certificates and dividends are mailed at the end of the dividend period to
the saver in the form of a check. The owners of regular, systematic, and prepaid savings share accounts are generally issued passbooks and dividends automatically are credited directly to their accounts. Federal associations operating under Charter N or Charter K (revised) have, however, the option of issuing either a passbook or a certificate for all types of savings share accounts. The saver who places funds in one of these associations can advise the association as to whether he prefers to receive dividends by check or have them credited to a passbook account. If there has been no special request from the saver, the association exercises its judgment whether to issue a certificate and pay the dividend by check or credit the dividend to the balance in the passbook account.

Investment Certificates

In addition to offering savings share account facilities, some savings and loan associations accept the funds of savers under a contract creating a creditor obligation. In California and some of the other western states, for example, permanent stock associations can issue to savers "investment certificates." These investment certificates represent a debt of the association. The holder of an investment certificate is issued either a passbook or a certificate in the same manner as the owner of a savings share account. In the event of liquidation, the holders
of investment certificates in an uninsured savings association must be paid in full before anything can be paid to the holders of savings share accounts or permanent stock. The Federal Savings and Loan Insurance Corporation (FSLIC) does not, however, distinguish between investment certificates and savings share accounts so far as its obligation to a member institution's savers is concerned.

Deposit Accounts

Federal associations and most state-chartered savings associations are prohibited by law from labeling the accounts of savers as "deposits." State associations formed in some states, notably Ohio, are allowed to accept "deposit accounts," as well as savings share accounts. These deposit accounts are more similar to time deposits in a commercial bank than are the savings share accounts of a savings and loan association. The return paid on the deposit account is referred to as "interest" rather than as "dividends" since the saver is a creditor and the association is a debtor with respect to the money. In the event an uninsured savings association fails, the holders of the deposit accounts have a prior claim ahead of savings share accounts and permanent stock. The FSLIC does, however, not distinguish between deposit accounts and savings share accounts for purposes of insurance coverage.
Federal Home Loan Bank Advances

Savings and loan associations which are members of the Federal Home Loan Bank System may borrow from their regional bank on both a long-term and short-term basis. The former require collateral, principally the security of home mortgages, and may run for a period up to ten years subject to restrictions described in the laws and administrative regulations. At the discretion of the regional bank, unsecured advances may also be made to members for terms of one year or less. Savings associations which are not members of the System may borrow from the regional bank on a secured basis with FHA loans as the only acceptable security.

Legal Provisions Governing Withdrawal of Funds

In practice, savings and loan associations pay withdrawals on request, but they have an absolute right to demand a written notice from account holders who wish to withdraw all or a portion of their account balances. The length of notice is 30 days for federal associations and varies from 30 to 90 days in state associations, but 30 days is typical.


16 Ibid., Sec. 10b.
If a federal savings association cannot meet its withdrawal requests in full on demand at the end of a stated notice period, the procedure that it must follow is governed by the provisions in its charter or by the law and regulations under which it operates. Typically, these provide that the association must utilize a portion of current receipts for the purpose of meeting withdrawals. Withdrawals are honored in the order in which they have been filed with the association except for a withdrawal request for more than $1,000. In this instance, the account holder is paid an initial $1,000 and his application is renumbered and placed at the end of the waiting list. This process is repeated until all requests are fully met or until the association is declared in default and closed by the supervisory authorities.

Savings and loan associations in most states may legally utilize this rotation procedure. In practice, federal and state associations do not use this procedure but honor withdrawals immediately on demand.

According to the Rules and Regulations for the Federal Savings and Loan System, a federal association that has a Charter K (revised) may follow this procedure but the board of directors has the right to pay an amount not exceeding $200 to any account holder in any calendar month. Federal Home Loan Bank Board, op. cit., Part 544, Sec. 544.1, subsection (b).
Federal Income Taxation

Dividends or interest paid out by savings associations or credited to the accounts of savers are reported by savers as interest income for federal income taxation and are fully taxed in the year in which they are paid or credited. Savings and loan associations are also subject to federal corporate income tax laws. They are, however, allowed more liberal treatment under provisions of the Internal Revenue Code than are given many other corporations. Unlike many corporations which cannot deduct the dividends paid to the owners of the corporation in determining the amount of taxable income, savings associations may deduct "amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends on their deposits or withdrawable accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw."  

A second provision of the Internal Revenue Code allows savings and loan associations to deduct any amount it adds to reserves for future losses until the amount of such reserves, when added to its surplus, undivided profits, and other reserves, equals "twelve per cent of the total

deposits or withdrawable accounts of its depositors at the close of the year."\textsuperscript{19}

The effect of these two provisions is that a savings and loan association can avoid the payment of federal corporate income taxes by paying a liberal return to savers and by adding to its reserve account until such time as the aggregate of its surplus, undivided profits and reserves are 12 per cent of its withdrawable accounts.

\textbf{Membership in Federal Home Loan Bank System}

The Federal Home Loan Bank System was created by the Federal Home Loan Bank Act of 1932 to provide a system of reserve credit to eligible member institutions. The major components of the System include the (1) Federal Home Loan Bank Board, (2) eleven regional Federal Home Loan Banks, and (3) the member institutions. The principal duties of the Board, which consists of three members appointed by the President with the consent of the Senate, are to establish policies and regulations for the operation of the system, to serve as trustees of the Federal Savings and Loan Insurance Corporation, and to supervise and examine the member institutions and regional banks. The basic function of these regional banks is to make funds

\textsuperscript{19}Ibid., Sec. 593.
available to member institutions when they have unusual withdrawal requests or when the demand for mortgage loans exceeds the local supply.

The three types of institutions eligible for membership in the Federal Home Loan Bank System are savings and loan associations, mutual savings banks, and insurance companies. At the end of 1959, all except twenty-five of the 4,624 institutions holding membership in the system were savings and loan associations. All federally chartered savings and loan associations automatically become members when they are issued a charter. State-chartered associations may become members upon application and approval of the Federal Home Loan Bank Board.

At the end of 1959, 1,841 federal associations and 2,758 of the 4,389 state savings and loan associations were members of the system. The 4,599 member associations represented approximately 74 per cent of the total 6,230 savings associations in the country. The combined assets of the member associations, however, amounted to approximately $62 billion which represents 97 per cent of the total assets of all savings and loan associations.

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20 Federal Home Loan Bank Act, op. cit., Sec. 4(a).
21 United States Savings and Loan League, op. cit., p. 94.
22 Ibid., p. 95.
Membership in Federal Savings and Loan Insurance Corporation

The Federal Savings and Loan Insurance Corporation (FSLIC) was created by Title IV of the National Housing Act of 1934 for the purpose of insuring accounts in all savings and loan associations which apply and qualify. Membership in the FSLIC is mandatory for all federally chartered savings and loan associations. State-chartered associations which qualify are eligible to become members depending upon whether or not they are in good financial condition and are willing to abide by all the rules and regulations issued by the FSLIC.

On December 31, 1959, 1,841 federal associations and 2,138 state associations held membership in the FSLIC. While these 3,979 institutions represented less than 64 per cent of the total 6,230 savings and loan associations, they held approximately $59.5 billion of assets or nearly 94 per cent of the total assets of all savings associations.

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24 Ibid., Sec. 403(b)
25 United States Savings and Loan League, op. cit., p. 103.
26 Loc. cit.
The Rules and Regulations for Insurance of Accounts defines an insured account in a savings and loan association as "A withdrawable or repurchasable share, investment certificate, deposit, or savings account held by an insured member in an institution insured by the Corporation, up to but not exceeding $10,000 to any one insured member."²⁷

In the event of default by an insured institution payment on each insured account is made according to the provisions of Section 405 of Title IV of the National Housing Act, as amended by legislation approved on September 21, 1950. This statute states:

In the event of a default by any insured institution, payment on each insured account in such insured institution which is surrendered and transferred to the Corporation shall be made by the Corporation as soon as possible either (1) by cash or (2) by making available to each insured member a transferred account in a new insured institution in the same community or in another insured institution in an amount equal to the insured account of such insured member.²⁸

While this law provides that an insured account shall be paid as soon as possible after an insured institution is in default, it should be noted that the term default does not mean inability to pay out cash on demand to savers but


²⁸The National Housing Act, as amended, 81st Congress, approved September 21, 1950; 48 Stat. 1256, 12 U.S.C. 1728(b), Sec. 405(b).
rather the official determination of that status by the proper authority. This point is expressed in the statutes as follows:

The term "default" means an adjudication or other official determination of a court of competent jurisdiction or other public authority pursuant to which a conservator, receiver, or other legal custodian is appointed for an insured institution for the purpose of liquidation.²⁹

An insured savings and loan association may, therefore, invoke notice requirements before paying withdrawals or inaugurate a withdrawal rotation plan, as was discussed previously under the subject of withdrawal provisions, without being deemed to be in default, inasmuch as these two procedures are provided for in the savings contract.

Regulation and Supervision

Practically every phase of the operations of a savings and loan association is covered by legislation or regulation whether it is a federal association or a state-chartered institution. This legislation or regulation begins with the granting of charters to savings associations and extends through regulations governing loans and investments, sources of funds, maintenance of reserves and surplus, distribution of earnings, withdrawals by savers, and numerous other phases of their operations.

²⁹Ibid., Sec. 401(d).
These institutions are also closely supervised to determine the extent of compliance with laws and regulations, financial condition, integrity and accuracy of records, and the safety and efficiency of methods and procedures employed in the conduct of operations. State associations function primarily under state legislation and the supervision of an official authorized to exercise supervisory powers on behalf of the state government. Savings associations with federal charters are under the supervision of the Federal Home Loan Bank Board and operate under federal legislation and regulation.

Examination and audit of federal savings and loan associations are conducted by examiners under the direction of the Federal Home Loan Bank Board. State associations are examined by state supervisory authorities and the examination reports are reviewed by the Board to check compliance with FHLB regulations with which member institutions must comply and to check adherence to FSLIC regulations with which insured associations must comply. State associations which are members of the FSLIC have the option of being audited periodically by an examining staff under the direction of the FHLB Board or by auditors who are selected by the association in a manner satisfactory
to the FSLIC. The examiners of the FHLB Board do, however, conduct a periodic examination of all insured associations irrespective of the auditing procedure chosen by the association.
CHAPTER III
NATURE OF NONINSURED PRIVATE CORPORATE PENSION PLANS

Certain provisions are common to most noninsured private corporate pension plans. These provisions have a significant effect upon the investment of the pension fund which may be established according to the provisions of the plan. It is the purpose of this chapter to summarize the essential features of noninsured pension plans rather than to make a complete inventory of the infinite variety of their contractual provisions. Despite the many facets of a pension plan, these features can be summarized under the general headings of participation requirements, eligibility requirements, vesting provisions, benefit structure, source of contributions, method of financing and pension plan administration.

Participation Requirements

Participation requirements refer to the qualifications which a new employee must fulfill in order to be
covered by the plan.\(^1\) The earliest date at which an employee may participate in a plan marks the time from which he (1) starts accruing pension benefits, (2) starts accumulating credited service to be applied in vesting, early retirement, and other provisions, and (3) starts making contributions if the plan is contributory.

The employee group may be stratified in several ways without jeopardizing approval of the resulting plan or plans under the provisions of the Internal Revenue Code. Participation in a pension plan is, therefore, frequently limited to those employees who meet certain requirements. The most common bases used for this purpose normally fall into the following four classes: (1) length of service, (2) age, (3) mode of compensation, and (4) level of compensation.

**Length of Service**

Many pension plans require that an employee complete a minimum period of service before achieving membership in the program. The obvious purpose of this requirement is to eliminate the unnecessary administrative expense and

attendant records connected with covering recently hired employees who are subject to a high rate of job turnover.

An analysis of the New York State Banking Department survey of 643 pension plans in that state reveals that 41 per cent of the plans surveyed had no service requirement, 40 per cent of the plans required a minimum period of service from one to five years, and only 19 per cent of the plans in this survey required more than five years service.\(^2\) Substantially similar results were obtained by the National Industrial Conference Board in a survey of 124 pension plans covering approximately 1.2 million employees in 1955.\(^3\)

The more recent tendency in pension plan provisions is to liberalize service requirements. This was disclosed by the New York State Labor Department study which surveyed 290 larger pension plans in that state and which included 1.7 million employees. Approximately two-thirds of the plans in this study covered an employee as soon as he was hired, approximately one-sixth of the plans required employment for a period of one year or less, and only one-sixth of the plans required more than one year of

\(^2\)George A. Mooney, *Pension and Other Employee Welfare Plans*, New York State Banking Department, 1955, Table 53, p. 53. This table summarizes the service requirements of pension plans covering 2.6 million employees.

service for coverage in the plan. A similar trend toward more liberal service requirements for plan membership is illustrated by the 1960 Study of Industrial Retirement Plans of Bankers Trust Company. A comparison of the latest figures for the 318 pension plans in this study with comparable figures during the periods 1950-1952 and 1953-1955 indicates a definite tendency toward the reduction or elimination of service requirements in pension plan provisions.

**Age**

An employee may be excluded from membership in a pension plan because he is either too young or too old. A minimum-age limitation is included in a pension plan for much the same reason that a service requirement is made, to exclude high turnover employees. When the plan is contributory, a minimum-age requirement has the additional function of excluding those employees who may not have a great interest in receiving benefit payments far in the future.

The underlying reason for the adoption of a maximum-age requirement is that the cost of providing a pension

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5 Bankers Trust Company, 1960 Study of Industrial Retirement Plans (New York: Bankers Trust Company, 1960), Table 2, p. 8. Approximately 6 million employees were covered by the plans of this study.
for employees who are hired at an advanced age is prohibitive since they will be employed for a short period of time in which to underwrite the cost of eventual retirement. At the same time, an employer may feel little responsibility for the retirement needs of an employee who rendered services for only a short period before retirement.

An analysis of the several studies referred to above reveals that in each study more than 60 per cent of the plans did not have a minimum-age requirement as a qualification for membership in the plan. The plans which were covered in these studies and which specified minimum-age requirements for employees most commonly established the entrance condition as the attainment of ages 25 or 30.

Contrary to the noticeable absence of minimum-age requirements in most pension plans, the New York State Labor Department study, for example, indicates that the majority of pension plans specify a maximum-age limitation. According to the results of this study, approximately 60 per cent of the plans surveyed set a maximum age

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6 Ibid., Table 3, p. 8; National Industrial Conference Board, Inc., op. cit., Table 7, p. 13; State of New York Department of Labor, op. cit., p. 9; George A. Mooney, op. cit., Table 53, p. 53.

7 Loc. cit.
for employee participation in the plan, usually at ages 50, 55, or 60.\textsuperscript{8}

\textbf{Mode of Compensation}

Some pension plans cover salaried employees only while others cover hourly paid employees only. Both salaried and hourly employees are covered in some plans. In the early 1940's, many of the companies that had pension programs limited the coverage of these programs to salaried employees. In subsequent years the trend, however, has been away from such limited programs and toward covering both salaried and hourly paid employees. The Bankers Trust Company study, for example, discloses that only 63 per cent of the companies included in its 1943-45 study had programs covering both groups of employees. This firm's 1953-1955 study and 1956-1959 study both showed that this figure had increased to 90 per cent.\textsuperscript{9} The extension of coverage has been accomplished in large part by providing a different plan for the group that was previously excluded from membership.

\textsuperscript{8}State of New York Department of Labor, \textit{op. cit.}, pp. 9-10.

\textsuperscript{9}Bankers Trust Company, \textit{op. cit.}, p. 7.
Level of Compensation

In some plans employees are not eligible for membership in the plan unless their annual compensation exceeds a minimum amount. One basis for this exclusion is the treatment of earnings under Federal Old-Age and Survivors Disability Insurance (OASDI). In an effort toward achieving an equilibrium between earnings and retirement income, some employers have established plans covering only those employees with earnings above the limit on OASDI coverage. As might be expected, revisions in the OASDI wage base and benefit formula have precipitated amendments to many plans integrated with OASDI. A second rationale for this minimum-salary requirement is to limit participation in those plans designed for the specific benefit of a certain stratum of executives.

Eligibility Requirements

The fact that an employee is eligible to participate in a pension plan does not assure him of an eventual pension benefit. The actual receipt of retirement benefits is governed by the specific provisions of the pension plan which prescribe the requirements and conditions of normal retirement, deferred retirement, and termination of employment before normal retirement.
Normal Retirement

All pension plans contain provisions which prescribe the conditions under which employees are permitted to retire with full pension benefits. This is a contractual right and can be exercised without the consent of the employer. The requirements necessary to obtain this status are the attainment of a specified age, referred to as the normal retirement age, or a definite age supplemented by a minimum period of service. The normal retirement age is the earliest age at which an eligible employee may choose to retire and receive the full benefits to which his length of service and/or earnings entitle him.

The vast majority of corporate pension plans provide for normal retirement at age 65. This is undoubtedly a reflection of the Social Security program, under which age 65, for males, is the earliest age at which the full amount of old-age payments are available. A small percentage of plans do, however, specify an age lower than 65 for female employees, age 60 being the most common variant.

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10 Ibid., Tables 6, 7, pp. 11-12; National Industrial Conference Board, Inc., op. cit., Table 18, p. 27; George A. Mooney, op. cit., Tables 82, 83, pp. 82-83; State of New York Department of Labor, op. cit., p. 10.

11 George A. Mooney, op. cit., Table 83, p. 83.
In addition to age requirements, most pension plans also require that an employee must have worked for the company a minimum number of years before he is eligible for normal retirement benefits. This minimum-service requirement varies from 5 to 25 years, with 10 and 15 the most common requirements. While a service requirement is frequently used in conjunction with an age requirement, it is rarely used by itself.

**Deferred Retirement**

If the participants in a pension plan are permitted, with or without the consent of the employer, to defer their retirement beyond the age designated as the normal retirement age, the age at which they must retire is known as the compulsory retirement age. It is the age at which the worker loses the privilege of deciding whether he should retire or continue in his job. If the employees do not have the option of continuing their employment beyond the normal retirement age, the normal retirement age is, in effect the compulsory retirement age. A worker may, however, be allowed to continue employment beyond the compulsory retirement age on a year-to-year basis if the

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employee requests and the employer consents and in some cases subject to the employee passing physical examinations or meeting standards of job performance. The maximum age at which the worker must cease his employment under the provisions of some pension plans, even though the company may give its approval for the employee to remain at work, is known as the mandatory or automatic retirement age.\footnote{14}

Analysis of the New York State Banking Department study shows that 263 of the 643 plans included in the survey had no provision for compulsory retirement; 373 plans contained a compulsory retirement age; and 7 plans did not furnish information on this feature.\footnote{15} Of the 373 plans containing provisions for compulsory retirement, the compulsory retirement age was the same as the normal retirement age in 273 plans and higher in 100 plans. Of the latter, 48 plans had a compulsory retirement age of 68 and 44 plans had a compulsory retirement age of 70. In 294 of the 373 plans containing a compulsory retirement age, the company reserved to itself the right to permit the employee to continue beyond that date.

Substantially similar results were disclosed in the New York State Labor Department study of 290 pension plans.\footnote{16}

\footnote{14}Ibid., p. 4; National Industrial Conference Board, Inc., \textit{op. cit.}, p. 27.

\footnote{15}George A. Mooney, \textit{op. cit.}, Table 84, p. 84.

\footnote{16}State of New York Dept. of Labor, \textit{op. cit.}, pp. 11,12.
In more than two-thirds of the plans in this survey which contained provisions concerning compulsory retirement, an employee is required to retire as soon as he reaches normal retirement age, which is age 65 among most of the plans. In most of the remaining plans, the compulsory retirement age is either three or five years later than the normal retirement age. Practically all plans which had a compulsory retirement age specified that only company executives were authorized to permit employees to work beyond that age. In 14 plans a later mandatory retirement age had also been set, beyond which company officials could not grant an extension.

Termination of Employment Before Normal Retirement

While a pension plan is established for the purpose of providing pension benefits to employees who remain with the company until normal retirement age, it must be recognized that a relatively large percentage of the persons who enter the service of a particular employer do not remain with that employer until the attainment of this age. It is necessary, therefore, for the pension plan to outline the rights and eligibility requirements of those workers who qualify for membership in the plan but sever their connection with the company, for one reason or another, before reaching normal retirement. These
requirements can be discussed under the principal headings of early retirement, death before retirement, and disability retirement.

Early Retirement

Most pension plans contain provisions which provide that an employee may retire prior to the specified normal retirement age and receive an immediate but usually actuarially reduced benefit. In some plans a worker may, however, obtain a larger retirement pension by electing to defer the receipt of benefits until normal retirement age is attained and in a few plans, a somewhat higher pension benefit is paid to one who retires at the time selected by the company. In contrast to normal retirement, under which the right to retire is at the option of the worker, pension plans are about equally divided as to whether or not early retirement is contingent upon the consent of the employer.

Ordinarily, employees must meet certain requirements before they are eligible for early retirement. Approximately half of corporate pension plans surveyed have both

17 Bankers Trust Company, op. cit., Tables 10, 11, pp. 13, 14; George A. Mooney, op. cit., Table 90, p. 90; National Industrial Conference Board, Inc., op. cit., Tables 19, 20, pp. 27, 28.

an age and length of service requirement; about one-third specify an age requirement only; approximately one-tenth of pension plans require the worker to fulfill only a certain period of service; and a limited number of plans either have other requirements or no age or service requirements. 19

The most common provision in those plans with a combined age and service requirement is age 55 and 20 years' service. The service requirements specified most frequently are 10, 15, and 20 years while most plans with age requirements specify that the employee must attain age 55 or 60 to be eligible for an early retirement pension. 20

Death Before Retirement

Relatively few pension plans provide for the payment of benefits to a beneficiary in the event of an employee's death before retirement. Most of the plans which do contain such provisions are contributory plans. 21 The benefit

19 Ibid., Table 8, p. 15; Bankers Trust Company, op. cit., Tables 11, 12, pp. 14, 15; National Industrial Conference Board, Inc., op. cit., Table 20, p. 27; George A. Mooney, op. cit., Table 91, p. 91.

20 Loc. cit.

21 Walter W. Kolodrubetz, "Characteristics of Pension Plans," Monthly Labor Review, August, 1958, p. 852; National Industrial Conference Board, Inc., op. cit., p. 30. See also George A. Mooney, op. cit., Table 120, p. 120. Less than 20 per cent of the 643 plans in the latter study contained provisions for death benefits.
is usually paid in lump sum to the deceased employee's estate or designated beneficiary and is usually equal to at least the value of the deceased worker's contribution. In a few plans, the employer's contributions are also included in determining the benefit. Most of the pension plans which have death benefit provisions impose no age or service requirements as necessary qualifications for death benefits.\(^{22}\)

Disability Retirement

The purpose of a disability retirement provision is to permit an employee who becomes totally and permanently disabled before normal retirement age to retire with an immediate benefit. The definition of the term "permanent and total disability" varies considerably among pension plans. In some plans, for example, it may mean only inability of the employee to perform his customary job; in others it may mean inability to perform any job at all.

Among the plans that provide disability pensions, the amount of the benefit which the employee receives may be the actuarial equivalent of his normal retirement pension; it may be his normal retirement pension without actuarial adjustment; or it may be his normal retirement pension.

\(^{22}\)George A. Mooney, op. cit., Table 122, p. 122.
pension plus an additional benefit payable until he becomes eligible for Social Security payments.\textsuperscript{23}

The extent of disability retirement provisions in pension plans is reflected in a number of studies. The National Industrial Conference Board found that 146 companies, representing nearly 45 per cent of the 327 companies included in its investigation, had disability provisions in their pension plans while 52 per cent of the 643 plans in the New York State Banking Department survey contained provisions on disability benefits.\textsuperscript{24} The study of 290 plans made by the New York State Labor Department revealed that two-thirds of all the plans had disability provisions.\textsuperscript{25} The increasing prevalence of such provisions is also demonstrated by the fact that 65 per cent of the pension plans in the Bankers Trust Company study in 1960 provided disability benefits to employees compared to 54 per cent of the plans in this firm's 1953-1955 study.\textsuperscript{26}

\textsuperscript{23}Bankers Trust Company, \textit{op. cit.}, p. 15.

\textsuperscript{24}National Industrial Conference Board, Inc., \textit{op. cit.}, Table 21, p. 28; George A. Mooney, \textit{op. cit.}, Table 117, p. 117.

\textsuperscript{25}State of New York Department of Labor, \textit{op. cit.}, p. 12.

\textsuperscript{26}Bankers Trust Company, \textit{op. cit.}, p. 15.
In terms of age, service, or combined age and service requirements imposed on employees, the qualifications for disability retirement benefits in many pension plans tend to be less restrictive than those under early retirement provisions. In the New York State Banking Department study, for example, it was disclosed that 25 per cent of the pension plans in the survey imposed no service or age requirements on employees to qualify for disability benefits while only 5 per cent of the plans imposed no service or age requirements under early retirement benefit provisions. An analysis of several pension studies reveals that approximately 40 per cent of the pension plans investigated require that a disabled employee must satisfy a minimum-service requirement to be eligible for disability benefits. Among these plans, the length of service ranges from one to 25 years, with 10 and 15 years appearing as the most common periods. An equally large group of plans set an age requirement in addition to a service requirement. Among these plans, the age requirement was

27 George A. Mooney, op. cit., Tables 91, 119, pp. 91, 119.

28 Ibid., Table 119, p. 119; Bankers Trust Company, op. cit., pp. 15-17; National Industrial Conference Board, Inc., op. cit., Table 21, p. 28; State of New York Department of Labor, op. cit., pp. 12, 13.
set most frequently at either 50 or 55, with 15 years of previous service.  

Although some pension plans do not specifically provide for disability benefits, there are other benefits that may give the disabled worker some financial aid during his incapacity. As indicated earlier, early retirement provisions permit an employee, who fulfills the necessary requirements, to retire with a reduced benefit earlier than the normal retirement age. Other plans provide benefits to the disabled worker by utilizing vesting provisions which will now be discussed.

**Vesting Provisions**

The term "vesting" may be defined as "a guaranty to the worker of a right or equity in a pension plan based on all or part of the employer's contributions made in his behalf should his employment be terminated before he becomes eligible for retirement benefits."  

Vesting refers only to the right of the employee to retain the benefits which have accrued from the employer's contributions; it never refers to the right of the worker to the return of any contributions he personally may have made.

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These contributions remain his property and the right to them is unquestioned.\footnote{If a worker leaves the employer before normal retirement his contributions, virtually without exception, are either (1) refunded to him, usually with interest, at the time he is terminated, or (2) allowed to remain in the plan to combine with employer contributions to finance pension payments when he reaches normal retirement age.}

**Types of Vesting**

While the majority of pension plans provide for some type of vesting, there are, perhaps, two main reasons which explain why some companies have no vesting provisions in their pension plans.\footnote{Over 87 per cent of the pension plans analyzed by Bankers Trust Company in its 1960 study contained some type of vesting. Bankers Trust Company, *op. cit.*, p. 18. Similar results were disclosed by the State of New York Department of Labor, *op. cit.*, p. 15.} One, the cost of the pension will be lower because company contributions can be discounted for the expected turnover of employees who leave the company prior to the normal retirement age. Two, the possibility of losing retirement benefits may tie employees closer to the company and prevent the loss of experienced employees.

In direct contrast to this nonvested type of pension plan are the company plans at the other extreme that provide "immediate, full vesting." These plans vest all employer contributions in the worker from the time he joins the firm. If an employee leaves the company before

retirement age, he has a vested right to all his benefits which have accrued during his years of service with the company, without having his right deferred until completion of any age, service, or combination of age and service requirements. Among the pension plans which contain vesting provisions, immediate, full vesting is uncommon. 33

The predominant type of vesting is referred to as "deferred, full vesting." Under this type of vesting provision, the worker retains a right to all accrued benefits after he attains a certain age and/or completes a specified period of service. 34 Another type of vesting provision found in some pension plans is called "deferred, graded vesting." In deferred, graded vesting, the employee has a right to a certain percentage of accrued benefits after he has fulfilled specified requirements. 35 This percentage increases as additional requirements are fulfilled, until the worker is entitled to the full benefit. A deferred, graded vesting provision might, for example, provide that an employee would be entitled to

33 The New York State Banking Department study disclosed that only 14 of the 643 plans in its survey provided for immediate, full vesting. George A. Mooney, op. cit., Table 78, p. 78.


35 Loc. cit.
50 per cent of his accumulated benefits after a service period of 10 years; an additional 10 per cent would be provided to him for each additional year of service thereafter, until full vesting was attained after 15 years of service.

**Eligibility Requirements Under Vesting Provisions**

Analysis of several pension surveys reveals that the eligibility requirements vary widely among the pension plans which provide for deferred, full vesting. Vesting rights are virtually always conditioned upon a minimum length of service or a combination of both service and a minimum age requirement. Seldom will age alone entitle an employee to full vesting privileges. The service requirements range from 5 to 30 years with the most common requirements set at 10, 15, or 20 years. In terms of combination of age and service, the most common

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36 Only three plans out of 148 plans with vesting provisions which were analyzed by the New York State Labor Department provided for vesting on the basis of age alone. State of New York Department of Labor, *op. cit.*, Table 8, p. 15. The New York State Banking Department study disclosed that only 11 plans of the 279 plans with vesting provisions specified only a minimum age requirement. George A. Mooney, *op. cit.*, Table 78, p. 78.
requirements imposed are ages 40, 45, 50, or 55 and 10 or 15 years of service.\footnote{37}

In comparison to the eligibility requirements for full vesting, there is a much greater emphasis placed on service requirements only in graded vesting provisions than on the combination of both service and age which is common in full vesting provisions. The most common type of graded vesting provides for 25 or 50 per cent initial vesting after a specified minimum period of service, usually 10 or fewer years, with an additional 5 or 10 per cent vested for each additional year of service. In many plans, the worker is fully vested only after 20 or more years of service.\footnote{38}

In addition to age and/or service requirements, the nature of the termination or separation from employment may be a conditioning factor in determining eligibility for vesting. Most plans permit vesting regardless of circumstances that might terminate the worker's employment. Specifically, the employee would be entitled to keep the rights he has earned through his service whether the termination resulted from withdrawal, discharge, death, 

\footnote{37 Bankers Trust Company, \textit{op. cit.}, pp. 17-19; National Industrial Conference Board, Inc., \textit{op. cit.}, Table 24, p. 33; George A. Mooney, \textit{op. cit.}, Table 79, p. 79; State of New York Labor Department, \textit{op. cit.}, Table 8, p. 15.}

\footnote{38 George A. Mooney, \textit{op. cit.}, Table 80, p. 80.}
or disability. Some plans do, however, limit vesting according to the reason for separation. An example of such a provision would be the plans which permit the employee to exercise his rights only in the case of voluntary withdrawal.

**Benefits of Vesting**

A worker who has fulfilled the vesting requirements under most pension plans is assured of a retirement benefit which is based on his accrued benefits and which starts at normal retirement age. In some plans he has the option of receiving an immediate cash payment, a deferred retirement benefit which starts at normal retirement age, or a reduced pension benefit at an age earlier than the normal retirement age.

**Benefit Structure**

The actual amount of pension income to be received by the employee who has fulfilled all the necessary requirements at normal retirement age is determined by the benefit formula provided in the plan. Additional variables affecting the size of pension benefits to which a worker is entitled are the inclusion in pension plans of provisions related to OASDI benefits, minimum benefits, and maximum benefits.
Benefit Formulas

There are many types of benefit formulas written in noninsured pension plans but they can be broadly classified into two main categories: (1) those in which benefits are expressed as a rate of compensation, and (2) those in which benefits are stated as a flat sum of money.

Benefits Related to Compensation

The provisions in those pension plans which express pension benefits as a percentage of compensation are carefully worded so as not to leave any doubt as to the amount of employee earnings which is actually used in determining retirement benefits. Such items as overtime pay, sick pay, bonuses, and commissions are specifically excluded or included. Whether the benefits are based on the earnings of the employee during his entire period of credited service or on earnings during a selected period, are also carefully defined in the pension formula.

The majority of pension plans that relate pension benefits to compensation base the benefit payments on earnings for the total period of the employee's employment, or on "career earnings," as the concept is called. 39

39 Bankers Trust Company, op. cit., Table 17, p. 20. Approximately 56 per cent of the 241 plans in this study which provide benefits that vary with employee compensation use career average formulas. See also National Industrial Conference Board, Inc., op. cit., p. 23 and George A. Mooney, op. cit., p. 97.
The annual pension benefit that each retired employee receives under this type of benefit formula is usually expressed as a percentage of his average annual compensation multiplied by the number of years of his credited service. The percentage used in such formulas usually ranges from 1 to 2-1/2 per cent, with 1-1/2 per cent predominating.\(^40\)

An increasing number of pension plans contain formulas in which retirement benefits are based on compensation earned over a specified period of employment rather than the total period of employment. Examples of such formulas are those which base the benefits on an employee's average salary for the last 5 or 10 years immediately preceding his retirement or on his average salary for the 5 or 10 years during which his earnings were highest. Whichever base is defined in the plan, a specified percentage of the calculated earnings is multiplied by the employee's years of credited service to determine his actual pension benefit. Under normal circumstances, this type of formula will produce an earnings base higher than that of the career average, since most employees reach the peak of their income in the years immediately prior to retirement. This is, however, offset in many such formulas by crediting a lower

\(^{40}\)George A. Mooney, \textit{op. cit.}, Table 98, pp. 98, 98(a).
percentage of earnings toward retirement benefits. The percentage used in such formulas ranges generally from 1/2 to 2-1/2 per cent, with 1 per cent predominating.41

Another type of benefit formula used in a few pension plans is one which provides that a retired worker is awarded a pension that is equivalent to a stipulated percentage, such as 30 per cent, of his average compensation over a period of time, irrespective of his number of years of service. All participants who are eligible for normal retirement benefits receive the same percentage rate of their compensation.

Flat-Sum Benefits

Benefit formulas which do not base benefits on earnings are of two general types. One type provides that a uniform amount, such as $100 per month, is provided to all workers who retire upon completion of a specified period of service, such as 25 or 30 years. Benefits are related to neither earnings nor service except that an employee must accumulate a minimum period of credited service to receive any benefits. A variation of this formula provides that benefits are scaled down proportionately for employees with lesser service records. A second

41Ibid., Table 99, pp. 99, 99(a). See also National Industrial Conference Board, Inc., op. cit., pp. 21, 22.
type of flat-sum formula is one which provides a flat benefit, such as $25 or $30 per year, multiplied by the number of years of credited service. Some plans using this formula specify a maximum number of years of credited service which may be used in computing the pension benefit.

Relation of Pension Benefits to OASDI

The amount of pension benefits to be received by a retired worker under a private pension plan may also depend on the relationship of the plan to OASDI. In some plans, pensions are computed under benefit formulas which are independent of OASDI and retired employees are entitled to receive the full amount accrued under the particular benefit formula of the company in addition to the federal old-age benefits.

Many private pension plans, however, contain provisions which take into account the payments to be received by retired workers under the OASDI program. Several approaches may be used to accomplish this objective. The simplest method is to deduct all the OASDI benefits to which the worker is entitled from those that would otherwise be payable under the private plan. Some plans provide that only half the OASDI benefit shall be deducted in recognition of the fact that an employer's contributions
under the Social Security Act are matched by those of the employee.

A second method of integrating a private pension plan with the OASDI program is to exclude that portion of earnings on which OASDI is based. Amendments to the Social Security Act have raised this amount from $3,000 to $3,600 in 1951 to $4,200 in 1955 to $4,800 in 1959. Since 1959, this has meant that no benefits are payable on the first $4,800 of an employee's earnings if this method is used. Many pension plans established before 1959 have, however, retained the exclusion at $3,000, $3,600, or $4,200 level. Other plans have been amended to correspond to the higher amount.

A third method of integration used in some plans is that the benefit formula is designed to take into account the differences that workers at different wage levels may expect to receive. This is accomplished in the formula by applying a smaller percentage, such as 1 per cent, to the first $3,000, $3,600, $4,200, or $4,800 of annual earnings and a larger percentage, such as 2 per cent, to the earnings above such amounts, for each year of credited service. Benefit formulas of this type have not always been revised with changes in the maximum taxable wage base under the Social Security Act.\textsuperscript{42}

\textsuperscript{42}Bankers Trust Company, \textit{op. cit.}, p. 22.
Minimum Benefit Provisions

Many pension plans contain provisions which provide for minimum pension benefits to all retired workers upon completion of a specified period of service at normal retirement age. Under flat-sum benefit formulas the benefit is, of course, the equivalent of a minimum pension. The minimum benefit provisions in the pension plans which express benefits as a percentage of compensation almost defy classification. The minimum benefits in the plans range from $100 to $1,800 per year.\textsuperscript{43} In some instances, the minimum includes the Social Security benefits; in others, it is exclusive of that benefit. The provision found most frequently promises a minimum benefit of $1,200 per year, including OASDI benefits, after 25 years of service, with benefits reduced proportionately for shorter periods of service.\textsuperscript{44}

Maximum Benefit Provisions

The flat benefit of the flat-sum formula plans operates both as an upper limit to benefits as well as a lower limit. The provisions of many plans which relate benefits to compensation also limit the maximum pension which a retired worker may receive. This maximum may be

\textsuperscript{43}George A. Mooney, \textit{op. cit.}, Table 108, p. 108.

\textsuperscript{44}\textit{Loc. cit.}
stated in the provisions in one of three basic forms: (1) a limitation which restricts the benefit to a fixed dollar amount per year, (2) a limitation on the annual earnings which may be considered in computing benefits, and (3) a limitation on the number of years of credited service which may be considered in computing benefits. The most common fixed dollar benefit limitation in pension plans ranges between $10,000 to $15,000 per year, the most common limitation on annual earnings which may be considered in computing benefits is usually between $10,000 and $15,000; and the most common limitation on the number of years which may be used in determining benefits is between 30 and 35.45

Source of Contributions

The cost of providing the pension benefits according to the terms of a pension plan may be borne entirely by the employer or jointly by the employer and the participants. Contributory plans require that part of the cost of the program be borne by employee contributions with the employer and pension fund earnings assuming the cost of the remaining portion. Under a noncontributory plan the employee is not required to make contributions to the cost of the program. Under a few noncontributory plans,

45George A. Mooney, op. cit., Table 109, p. 109
however, employees are given the opportunity to elect voluntarily to make contributions in order to increase their pension benefits. Under some of these last-mentioned plans, optional contributions are restricted to employees earning more than a specified annual salary.

**Prevalence of Noncontributory Plans**

The predominance of noncontributory pension plans is pronounced. Of the 327 companies surveyed by the National Industrial Conference Board, 42.5 per cent of the companies had plans which were entirely noncontributory for all employees covered and another 16 per cent of the firms had basic noncontributory plans in which employees could elect to make contributions to increase their benefits.  

Similar results were revealed in the New York State Banking Department study of 643 pension plans in that state. More than two-thirds of the plans in this study did not require employees to make contributions as a condition of membership.  

The New York State Labor Department study of the larger pension plans in that state also discloses that approximately three-fourths of the 290 plans in the study were noncontributory, slightly more than one-fifth

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46 National Industrial Conference Board, Inc., *op. cit.*, Table 9, p. 15.

47 George A. Mooney, *op. cit.*, Table 65, p. 65.
of the plans required employees to contribute to the pension fund, and in the few remaining plans, pensions were granted to employees who did not contribute but added benefits accrued to those workers who did contribute.\textsuperscript{48} Analysis of the 241 plans surveyed by the Bankers Trust Company in its 1960 study also discloses that approximately three-fourths of the plans in this study were noncontributory plans.\textsuperscript{49}

**Amount of Contributions**

Based on statistics developed by the Securities and Exchange Commission, the amount of contributions made by employers and employees under all contributory and noncontributory plans in recent years may be seen by examining Table 15. In 1959 total contributions from both employers and employees to all noninsured private corporate pension funds amounted to $3.0 billion. Contributions from employers amounted to $2.6 billion in 1959, representing 88.1 per cent of total contributions, while employee contributions amount to $354 million in that year, or 11.9 per cent of total contributions. Thus, employees under all private pension plans bear, at least directly, a relatively small share of the cost of their benefits.

\textsuperscript{48} State of New York Department of Labor, *op. cit.*, p. 5.

\textsuperscript{49} Bankers Trust Company, *op. cit.*, pp. 9-10.
TABLE 15
AMOUNT AND PERCENTAGE DISTRIBUTION OF EMPLOYER AND EMPLOYEE CONTRIBUTIONS TO NONINSURED PRIVATE CORPORATE PENSION FUNDS, ANNUALLY, 1955 TO 1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Employer Contributions</th>
<th>Employee Contributions</th>
<th>Total</th>
<th>Employer Contributions</th>
<th>Employee Contributions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1959</td>
<td>$2,629</td>
<td>$354</td>
<td>$2,983</td>
<td>88.1</td>
<td>11.9</td>
<td>100.0%</td>
</tr>
<tr>
<td>1958</td>
<td>2,275</td>
<td>331</td>
<td>2,606</td>
<td>87.3</td>
<td>12.7</td>
<td>100.0%</td>
</tr>
<tr>
<td>1957</td>
<td>2,303</td>
<td>316</td>
<td>2,619</td>
<td>87.9</td>
<td>12.1</td>
<td>100.0%</td>
</tr>
<tr>
<td>1956</td>
<td>2,053</td>
<td>267</td>
<td>2,320</td>
<td>88.5</td>
<td>11.5</td>
<td>100.0%</td>
</tr>
<tr>
<td>1955</td>
<td>1,803</td>
<td>222</td>
<td>2,025</td>
<td>89.0</td>
<td>11.0</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Amount in millions of dollars.


Even among contributory plans, the employer bears a preponderant portion of the cost. In the New York State Banking Department study, for example, the total contributions from both employees and employers under all contributory plans in the study amounted to approximately $174 million. Employee contributions represented only slightly more than one-fourth of this amount.50

When employees are required to contribute toward the cost of a pension plan, their contributions are usually

50 George A. Mooney, op. cit., Table 65, p. 65.
stated as a percentage of their earnings. The employee contribution rate usually ranges between 3 and 5 per cent of each year's compensation. The employer contributes such additional amounts as are needed to provide the benefits guaranteed under the plan.  

Methods of Financing

A pension plan which provides for the accumulation of a pension fund from which the future payment of pension benefits may be made is known as a funded plan. Plans which do not require the accumulation of a pension fund are described as unfunded plans. Various techniques are used to accumulate the fund required in a funded plan or to budget the money required to pay for the benefits provided in an unfunded pension plan. These techniques are usually referred to as "methods of funding." These methods fall into three general groups: cash disbursement, terminal funding, and advance funding. Terminal funding and advance funding methods are used under funded pension plans while the cash disbursement method is used under unfunded plans. It would, therefore, appear more logical


52 Method of funding is to be distinguished from medium of funding which, as noted in Chapter I, refers to the type of organization through which benefits are provided.
to refer to all three methods as "methods of financing" rather than methods of funding since there is no fund set aside in the cash disbursement method.

**Cash Disbursement Method**

Probably the oldest method of financing a pension plan is the one referred to as the pay-as-you-go approach. Under this method, retirement benefits are treated as payroll costs and are paid directly to the superannuated workers by the employer. There is no fund accumulated in advance for the payment of pension benefits. Such benefits, if reasonable in amount, are deductible from the employer's gross income as a necessary business expense and are taxable to the pensioner as ordinary income.

Under pay-as-you-go plans, no provisions are made to meet the accruing benefits of those employees who are working. The cost of providing retirement benefits under this method is, therefore, normally low when a pension plan is first established and the number of retired employees is relatively small. As the employee group matures and the number of pensioners increases, the costs of retirement benefits constitute a significant percentage of total payroll costs.

In order to anticipate the heavy demands on cash that this method ultimately entails, some companies use what is
known as the "balance sheet" or "book-reserve" method of financing. This involves an appropriation of a portion of the surplus account as a reserve for pension fund. It does not place any assets beyond the control of the employer, it does guarantee that sufficient cash will be available to pay pension benefits, and it does not give the employer an immediate tax deduction as an ordinary and necessary business expense. To be tax deductible, the sums would have to be placed in a fund beyond the control of the employer such as by transfer to a trustee under a trust agreement. The benefits are, however, deductible in the tax year in which they are paid.

**Terminal Funding**

Some plans follow a procedure known as "terminal funding." Under this method, no provision is made to accumulate a fund from which benefits may be paid to active employees upon their retirement. The money required to provide benefits to retired employees normally comes out of the current income of the employer since by definition the employer makes no advance provision for the accumulation of the sums needed, other than through the possible creation of a balance sheet reserve. As each employee reaches retirement a principal sum, actuarially estimated to be sufficient to provide the benefits promised,
is transferred to a trustee. If otherwise eligible, such sums are deductible for federal income tax purposes at such time as they are transferred to the trustee.

Advance Funding

The method of financing used in most pension plans is referred to as "advance funding." This term is applied to any arrangement under which predetermined amounts intended for the payment of retirement benefits are set aside irrevocably in advance of the date of actual employee retirement. Virtually all pension plans which use the advance funding method each year set aside sufficient funds to meet the pension obligations created during that year, plus a portion of the past service pension liability, in order to have all obligations fully funded at the earliest practicable date. An employer cannot, however, liquidate more than 10 per cent of the past service liability as a deduction for federal income tax purposes in any one tax year.

Prevalence of Advance Funding Method

The provisions in most all pension plans require advance funding. In the study of 327 companies by the National Industrial Conference Board, for example, nearly 94 per cent of the companies had pension plans which
required advanced funding. The New York State Labor Department study also revealed that approximately 95 per cent of the 290 plans in its survey required this method of financing while the study made by Bankers Trust Company indicated that, among the plans which related benefits to employee compensation, 98 per cent of the plans required advanced funding.

Factors Affecting Pension Costs

The mechanics of advance funding require that funds be set aside for the payment of pension benefits in advance of their due date. The amount of contributions an employer must place in the pension fund to provide the benefits according to the provisions of the pension plan is based upon actuarial assumptions and computations. At this point, the difference between the terms "outlay" and "ultimate cost" should be noted. The annual "outlay" is the amount of contribution determined by an actuary to be sufficient to provide for the anticipated benefits on the basis of his valuation assumptions. The "ultimate cost" is the sum total of all benefits actually paid, plus expenses of administering the plan and fund, minus the net


earnings on fund investments. Outlay is, therefore, an estimate of ultimate cost and when properly computed, it affords a level method of payment to meet future costs. It is the function of the actuary to consider and evaluate each factor that has a bearing on the ultimate cost and therefore, the outlay. In this process consideration must be given to such factors as (1) mortality of employees, (2) personnel turnover, (3) expenses of operation, (4) age of retirement, (5) investment yield, (6) changes in rate of compensation, and (7) employee contributions.

Mortality of Employees

The rate of mortality among employees, along with the rate of withdrawal, determines the number of employees who will become entitled to pension benefits, the cost of such benefits; and how long the benefits will be paid. Mortality among retired employees is computed according to an annuity table while mortality before retirement may be estimated according to an insurance, annuity, or other table. Contributions under virtually all plans are discounted for anticipated mortality. In the interest of conservatism, a longer life is usually assumed than that which is actually expected.
Personnel Turnover

Employee turnover also reduces the number of persons to whom retirement benefits must be paid. The number of employees who will terminate their employment is generally computed from a turnover table, which may reflect the experience of the employer or may represent the turnover rates applicable to a broader segment of industry. Future contributions are frequently discounted for past employee turnover experience.

Expenses of Operation

The expenses of administering the plan and the fund may be an integral part of the amount of contributions made to the pension fund and withheld by the trustee from the amounts contributed; they may be treated entirely separate from the contributions and charged to the employer on a pay-as-you go basis; or they may be met out of the trust fund assets. Included among these expenses are legal fees, actuarial fees, trustee fees, and other administrative costs. While these expenses may or may not be treated as part of the required employer contributions they must, however, be included in actuarial assumptions of the ultimate cost of the plan.
Age of Retirement

For purposes of actuarial computation, it is usually assumed that retirement will occur at the normal retirement age. Retirement at an age earlier than the normal retirement age, when permitted, generally does not increase the cost of the plan since the employee usually receives only the actuarial equivalent of the pension benefit which he would have received had he retired at the normal retirement age. In the plans which permit the deferment of retirement to a later age, either on employee option or employer invitation, the most conservative actuarial assumption is to continue to use the normal retirement age in determining the amount of employer contributions. Under such plans, the annual contributions of the employer may, however, be reduced by the amount of benefits which would normally have been paid to employees who defer retirement.

Investment Yield

Contributions to a pension fund are invested and produce an income until they are paid out as benefits. For purposes of funding it is, therefore, necessary to make an assumption as to the long-term rate of income the fund may be expected to produce. For purposes of safety, a spread is usually maintained between the rate actuarially
assumed and the foreseeable actual rate. The adoption of a prudent rate assumption does not mean any loss to the employer or to the fund. If the actual rate earned is greater than the assumed rate, either the employer's subsequent contributions can be reduced or the added income can be used to increase benefits to employees.

Changes in Rate of Compensation

For purposes of funding, changes in the rate of employee compensation need be considered only in those plans in which benefits are directly related to compensation. Among such plans, it is normal practice to anticipate the effect of increases in compensation through the use of an assumed or projected salary scale which reflects the rate of earnings for each age to retirement. Such a salary scale assumption prevents the cost estimates from being considerably understated and eliminates the necessity of increased employer contributions in the future when the earnings level of employees has increased.


56 Ibid., p. 42.
Employee Contributions

It is obvious that, with a given scale of benefits in a pension plan, employee contributions to a pension fund reduce both the outlay or contributions and the ultimate cost of a pension plan to the employer. It is, however, necessary to make the reservation concerning the scale of benefits since in some plans, employee contributions are reflected in higher benefits for the participants rather than in a reduction of the employer's outlay.

Administration of Pension Plans

The operation of a pension plan involves many administrative details as well as considerations concerning over-all policy formulation. The administration of a pension plan can, however, be broadly divided into two major areas of responsibility: (1) administration of the plan and (2) administration of funding.

Administration of the Plan

The scope of the activity within this area of responsibility involves (1) developing, amending, and enforcing rules and regulations for the operation of the plan; (2) interpreting the contractual provisions of the plan; (3) maintaining employee records; (4) providing such forms as
may be needed in the plan; (5) processing applications; and (6) explaining the plan and options to employees.

Administration of Funding

The administration of funding involves those activities which are related to the financial management of the fund which is created under the provisions of the pension plan. This area of responsibility includes (1) selecting the medium of funding, (2) adopting the method of funding, (3) selecting the actuary and other advisory assistance, (4) determining the amount of contributions, (5) investing the funds, and (6) distributing pension payments to retired workers.

Over-All Policy Formulation

Under the majority of pension plans, the over-all policies regarding the administration of both the plan and the fund are formulated by the employer or by a body created especially for this purpose. This body, usually referred to as the "pension committee," is also known as the "retirement committee," the "pension board of trustees," or the "employee benefit committee."^57

The pension committee usually consists solely of representatives appointed by the board of directors of

the company and is made up primarily of a variety of company executives. Serving most frequently on the committee are the personnel director, a vice-president, the treasurer, the secretary, the president, and the comptroller. Some plans provide for employee or union representation on the pension committee. These representatives are usually appointed by the employer, except in a few plans in which they are selected by the employee participants in the plan.

Day-By-Day Administration

While the over-all administration of the plan and the policy formulation in regard to the financial management of the fund usually are vested in the employer or the pension committee, many of the functions connected with these responsibilities are delegated to others. The trustee, for example, is usually empowered to decide on specific investments for the fund, subject to any general investment policy established by the employer or pension committee. The trustee may also be assigned the tasks of keeping the employee records, making the benefit payments, giving advice on either the contractual provisions of the plan or the fund, and performing other functions which have been delegated by the responsible authority.

In some plans, certain activities connected with the day-by-day administration of the plan, such as maintaining records, processing applications, explaining the plan and options to employees, and similar activities, are assigned to a department or division within the employer's company. Among the departments most frequently assigned such tasks are the personnel department, finance department, and the employee benefit or insurance department.
In order to select the particular investment outlets which are appropriate to his specific objectives, an investor must appraise a particular investment against some criteria. The following are the criteria commonly listed for this purpose: safety of principal, adequacy of income, certainty of income, liquidity, capital appreciation, maintenance of purchasing power, demand of attention, denomination, tax position, marketability, collateral value, convenience, maturity, and legality. The attainment of some of these objectives obviously conflicts with or limits the achievement of some of the others.

**Factors Affecting Pension Fund Investment Policy**

Like other types of investors, a pension fund trustee must choose investments which are appropriate to the objectives of the pension fund which he is administering. The trustee must, therefore, either use the criteria mentioned above or develop other criteria. A number of these criteria overshadow others because of several factors which exert a significant influence on pension fund
investment policy. It is the purpose here to identify these factors and to analyze the effect that each one has on the investment practices of pension funds.

Nature of Pension Fund Obligations

The primary purpose of a pension fund is to provide eligible participants with retirement benefits. As a matter of fact, in order for a pension fund to qualify for tax-exempt status under the Internal Revenue Code, the contributions by the employer to a pension fund must be unconditionally divorced from the employer and irrevocably dedicated to the objective of providing retirement benefits. The obligation of the employer to provide these benefits is fixed according to the provisions of the pension plan itself. The object in establishing a pension fund is to transfer the liability from the employer to the pension fund. The pension fund which the employer establishes may, therefore, be considered as a group of investments which are set aside as a pledge or collateral for the fulfillment of its promise to meet its liabilities.¹

At the outset and from time to time thereafter, reasonably accurate actuarial computations can be made of

the dollar amount of assets which the pension fund must possess in order to meet its obligations. Pension fund trustees do not guarantee that the principal of the fund will be sufficient to meet these liabilities. The relatively fixed nature of these liabilities, however, suggests that the amount and quality of a fund's assets should enable the employer to meet its retirement income commitments to its employees; it suggests that the asset values of fund investments should at least parallel the fixed liability of the fund.

The nature of a pension fund's obligation lie at the historical foundation of pension fund investment policy. It explains, at least to some extent, why relatively stable-value investments, such as bonds, have constituted a significant segment of pension portfolios. It also explains, in large part, why pension fund trustees place great emphasis on investments of high quality.

Statistical evidence confirms the proposition that the portfolios of pension funds are of a high grade of investment quality.\(^2\) The New York State Banking Department

study disclosed that over 99.2 per cent of all the securities, including stocks, held in pension funds by banks in New York were of investment grade. Investment grade was defined as meaning that they were of a quality satisfactory for investment by a banking institution under standards regarded as conservative by the Banking Department itself. Most of the securities noted as substandard were only a single rating below investment grade. This study also disclosed that pension fund trustees not only purchase high-grade common stocks but that they concentrate their common stock investments within a rather short list of high-grade stocks. Nearly 92.5 per cent of all the common stocks held by pension funds in New York banks was on a list of 206 common stocks and approximately 50 per cent of all common stock holdings was concentrated in 30 stocks. These findings also were supported by the Senate Committee on Banking and Currency.

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George A. Mooney, Pension and Other Employee Welfare Plans, New York State Banking Department, Table 3, p. 3.

Ibid., Table 4, p. 4(c).

Distinction Between Principal and Income

Another important influence on pension fund investment policy is that there is no need for the pension fund trustee to distinguish between principal and income in recording capital appreciation and investment cash receipts as is required for life tenant or remainderman interests.\(^6\) The entire pension fund is committed to provide pension benefits for eligible employees who have the same rights in both principal and income. In view of this objective, it makes no difference to the eligible pensioner, who is entitled to a certain level of benefits, whether the pension fund which will provide him with these benefits is accumulated from the inflow of cash contributions from the employer, from income earned on fund investments, or from capital appreciation of investments in the fund portfolio. Eligible employees have the same rights in both principal and income.

The fact that there is no need for the pension trustee to distinguish between principal and income exerts a strong

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influence on pension fund investment policy. It gives the trustee considerable flexibility in the distribution of the various types of assets in the fund portfolio. It encourages increased holdings of common stock in pension fund portfolios not only because common stocks potentially yield a higher rate of return than do fixed-income investments but also because common stocks provide a greater opportunity for capital appreciation than is generally obtainable with fixed-dollar investments. The total return, therefore, generally is greater on common stocks than on fixed-income investments.

Threat of Continued Inflation

It can be argued that, because its liabilities are relatively fixed, a pension fund should be invested entirely in fixed-dollar investments. This point of view, understandable as it may be in terms of rationality, overlooks the fact that the long-term record of the United States economy shows a decline in the purchasing power of the dollar, with corresponding rises in living costs and salary scales.

Many pension fund trustees suggest that the long-term inflationary trend and the future inflationary outlook of our economy have changed the basic objective of a pension fund. They suggest that the obligation of a pension fund
is to pay not only a predictable number of dollars at a predictable date, regardless of whatever the dollars may be worth in purchasing power. It is their contention that the ultimate goal of a pension fund is to provide a satisfactory level of retirement benefits as measured by purchasing power. One prominent trust officer stated this viewpoint in the following way:

The purpose of pension reserves is not, realistically speaking, to provide funds with which to pay pensions according to a definite-benefit formula but to provide funds with which to pay pensions that are adequate in terms of living costs and salary and wage scales.

The inflationary outlook, and the resulting desire of pension fund trustees to protect the assets of a pension

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8 C. Wadsworth Farnum, "Investments for Pension and Profit-Sharing Trusts," An Address at the Mid-Winter Trust Conference of the American Bankers Association, New York City, February 9, 1959 (mimeographed), p. 5. For a summary of the ideas presented in this address, see C. Wadsworth
fund against inflation in order to protect the purchasing power of the pension benefits paid to employees, is a powerful influence on pension fund investment policy. An investment portfolio which, at least to some extent, offers a hedge against inflation has obvious attractions. In large measure, this explains why trustees have invested extensively in common stock instead of a portfolio invested solely in fixed-income investments. The effect of the threat of continued inflation on pension fund investment policy was summed up well by Howard F. Wortham, who stated:

There are times when interest rates rise and prices fall, thus making it possible to purchase high grade bond issues at substantial discounts. These periods afford trustees, who are alert enough to catch the swings, an opportunity to make money out of their bond accounts and thus in part help compensate for the inflationary tendencies of our economy. However, the greatest potentials for enhancement of capital and income are inherent in common stocks because they are the only class of investments where the return to the investor can increase over the years. It is recognized that there is no absolute protection against inflation but for a pension fund, common stocks present the best and most practical medium for that purpose.9


Pressure for Increased Benefits or Reduced Costs

Rises in the cost of living also have resulted in more employee pressure for liberalization of pension benefits. Even without further inflation that many trustees expect, the tendency in pension plans is to base pension benefits on the salary earned by the employee during his final years of service. This means bigger pensions in the future. There is little doubt that demands for more liberal normal retirement provisions, vesting provisions, early retirement provisions, and disability retirement provisions will be forthcoming. Viewed realistically, it appears likely that pension fund trustees are correct in assuming that pension benefits will be revised upward from time to time. ¹⁰

Liberalized pension benefits obviously increases the future liabilities of a pension fund. These liabilities can be financed either by (1) increasing employer contributions, (2) increasing employee contributions, (3) increasing the productivity of a pension fund's investments, or (4) by a combination of any two or all three of these

alternative courses of action. It is doubtful that employee contributions can be increased significantly. Most pension plans are noncontributory. Then too, it would be difficult to increase employee contributions under contributory plans because of employee and/or union pressure against such practice. In any event, regardless of whether or not employees contribute, a substantial part if not all of the cost of financing the plan is borne by the employer through its contributions. It is, therefore, logical that larger employer contributions to the pension fund and/or pension fund investment productivity must meet the liabilities of expanded retirement benefits.

The productivity of a pension fund, as used here, refers to either investment income or capital appreciation, since there is no need to distinguish between the principal and income in-pension fund investment policy. If the increased benefits are financed by larger employer contributions rather than increased investment productivity of the pension fund, the cost of financing the plan to the employer obviously is increased. Alternatively, if increased productivity of pension fund assets can be used to raise benefit levels, the contributions and the resulting cost of the plan to the employer can remain constant or be reduced. On the basis of actuarial analysis, it is frequently stated that an increase of 1/4 of 1 per cent in the
rate of annual yield of a pension fund over a 25-year period will result in a decrease of 5 to 6 per cent in the annual financing cost or in a similar increase in pension benefits. Consequently a yield differential of 1 percentage point could mean a reduction in cost or an increase in benefits as high as 20 to 25 per cent over a 25-year period.

The investment productivity of a pension fund is, therefore, of paramount importance to the employer because of its role in determining the cost of the pension plan. The pension fund's productivity is significant to employees because their ability to obtain liberalized benefits may depend largely upon the earnings and capital appreciation of the pension fund. As cost-conscious employers and benefit-conscious employees have become increasingly aware of this productivity factor, they have scrutinized more closely the performance of their pension fund. Investment productivity of the pension fund is, therefore, also vital to the professional pension fund trustee in view of the high degree of competition for pension fund business and

the fact that the trustee is evaluated by comparison with his competitors.\textsuperscript{12}

The increasing pressure for greater productivity of pension fund assets has affected the formulation and execution of the investment policy of pension funds in several ways. As a general rule it is typical for pension fund trustees to keep fully invested at all times. Under most circumstances, pension funds held for future investment will tend to earn less than will funds invested immediately. Since a fund's productivity can be increased either by increasing the rate of return on invested funds and/or by capital appreciation of the assets in the fund, pension fund trustees have devoted an increasing percentage of pension fund portfolios to those investments which offer greater total return possibilities, whether through yield or appreciation. Fixed-income investments offer little opportunity for capital appreciation as compared to that offered by common stocks. This presents a rather compelling argument in favor of including common stocks in the investment portfolio of pension funds.

Pension fund trustees also are interested in securing the highest possible income on invested funds consistent

with reasonable safety. Reliable studies reveal that, over a period of time, the yield on high grade equities has been considerably higher than could have been obtained on fixed-income investments. The better yield on common stocks has been an important factor in their acceptance as suitable investments for pension funds.

The importance of obtaining the highest rate of return on pension fund portfolios also significantly affects the selection of the fixed-income segment of these portfolios. Since a relatively small variation in the investment yield on this part of the portfolio can make a considerable difference in the productivity of the fund, pension fund trustees are shifting emphasis away from minimizing credit risks to a policy of improving yields on fixed-income investments.

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investments. The shifts from Government obligations to high-grade corporate bonds and the greater participation in private placements by pension fund trustees are obvious steps in the direction to bolster the yield on fixed-income investments in pension fund portfolios.

Expected Life of Pension Funds

As indicated in Chapter I, the establishment and rapid growth of corporate pension plans has occurred in the past decade. Most pension plans and the resulting pension funds are, therefore, relatively new. At the inception of a pension plan, the average age of the plan's participants is usually substantially below retirement age so that the accumulation of funds to provide pension benefits and the distribution of such funds will extend far into the future. In fact, although workers come and go, there is no prospect that the accumulated pension fund will ever be liquidated, particularly since pension plans, once established, are normally expected to be a permanent part of an employer's personnel policy.

The long-term nature of a pension fund influences the investment policies of pension fund trustees in several respects. The duration of the fund reduces the need for

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liquidity, making it possible for them to invest in long-term maturities which tend to yield a higher return than short-term investments. One well-known pension fund trustee suggests, "The emphasis is much less on the results for a single year and much more on experience during the life of the fund."\textsuperscript{16}

The length of time over which pension fund trustees may hold investments, and their concern for the long-term rather than immediate future, makes it feasible for them to hold common stocks, which offer long-term price appreciation possibilities, with little fear of the cyclical swings of the common stock price level. One authority, commenting on the duration of a pension fund, stated:

\begin{quote}
It permits the trustee to invest for long-range results, not for the intermediate price swings resulting from unpredictable changes in interest rates, shifts in tax and monetary policies, wars and depressions, inflation, the health of a head of State, and the constant shifting of company and industry prospects.\textsuperscript{17}
\end{quote}

The duration of a pension fund also offers the trustee the opportunity to employ dollar averaging in stock purchases. This makes it possible for him to avoid the effects

\textsuperscript{16}Murray, \textit{op. cit.}, p. 254.

of unfortunate timing in stock acquisitions. In addition, the expected life of pension funds gives trustees a long time in which to redistribute pension fund portfolios if they so desire.

**Magnitude of Net Cash Inflow**

Another unique characteristic of pension funds, which is closely related to their long-term nature is that, for the foreseeable future, the inflow of money to a pension fund will exceed outgo by a substantial margin. The inflow of money to the fund is comprised of annual contributions to the fund together with earnings on the fund investments. The inflow each year to the fund will far exceed the outgo, or benefit payments, for many years after the inception of the fund.

The amount of cash inflow to a pension fund confers considerable flexibility upon the trustee in investment of the pension fund. He can divert the inflow with great freedom in the direction of the investment outlet most attractive at the time and can, therefore, redistribute the portfolio with relative ease. As a result of the magnitude of inflow, there is almost no threat for an indefinite period that it will be necessary for the pension fund trustee to invade the principal of the fund to meet pension benefit payments. This obviously reduces the
degree of liquidity required in pension fund portfolios. This being the case, the trustee can invest a sizable portion of the fund in common stocks, by employment of dollar averaging if he so desires, in the expectation that he will not be under compulsion to liquidate on depressed markets to meet pension liabilities. This reduces an important part of the speculative element of stock ownership. In this regard, one authority stated:

A well managed pension trust should never be in the position of being compelled to liquidate its equity holdings on unfavorable markets. The trust should meet its liabilities from current contributions, fund earnings, and maturing bond issues -- not from sale of equities. Therefore, market fluctuations of equity prices are not a matter of controlling importance.18

The magnitude of cash inflow to a pension fund requires, however, that the trustee give attention to the denomination of selected investments. The trustee is faced with the situation of investing considerable amounts of money at one time and those investment outlets which make it possible for him to dispose of only small sums are not particularly desirable. This consideration is well illustrated in the remarks of a pension fund administrator who in an interview stated,

We do not like to invest in small blocks as this produces a tremendously long list of

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18 Haines, "Investment of Retirement Funds," op. cit., p. 6.
different investments which in turn produce difficulties from both an operational and administrative viewpoint.\textsuperscript{19}

The magnitude of cash inflow also requires that the pension fund trustee give attention to the maturity of those investments in the fund portfolio which have maturity dates. It is desirable that the maturity dates of such investments be staggered or spread so that the problem of investing large amounts of funds at one time is not further accentuated.\textsuperscript{20}

**Regularity of Inflow of Funds**

Not only are the sums flowing into pension funds of great magnitude, but another important and closely related characteristic of pension funds is that this inflow of money is placed at the disposal of the trustee periodically over a long period of time. Cash contributions to the pension fund from the employer and employees, if the plan is contributory, are based on actuarial assumptions and are made continuously at regular intervals. In speaking of this characteristic of pension funds, one trustee stated:

Instead of receiving our entire trust deposits at one time as we do in the


\textsuperscript{20}Wortham, "The Investment Specialist in an Era of Specialists," \textit{op. cit.}, p. 9.
case of a testamentary trust or most living trusts, we receive a continuous flow of new funds for investment.21

The continuous inflow of money which they regularly have available for investment gives a rather dynamic character to the investment decisions of pension fund trustees. This flow of funds offers them the opportunity for the natural spacing of maturities if the new funds are placed in investments with maturity dates. It means that investments which provide regularity or continuity of income are not a necessary part of the portfolio since benefit payments can be made from the regular cash increments to the fund. The continuous inflow of funds means that, under ordinary circumstances, funds are available for current disbursements without invasion of the principal of the investment portfolio. The combination of safety from forced liquidation of principal and the steady inflow of cash enables the trustee to scatter investment of the fund periodically rather than making a single, large investment at one time only. It offers him the opportunity, therefore, of applying dollar averaging in common stock purchases to a substantial degree without the great danger of having to sell this stock at depressed prices.

market levels to meet unexpected demands for cash. In this connection, Paul I. Wren, a well known pension fund trustee, stated:

The unusually attractive feature of regular additions to principal ... puts cash in the hands of the trustee at various levels of the stock market, permitting the accumulation of stocks over a period of time, thus averaging the cost.22

Predictability of Cash Needs

Except for the funds used by the trustee to make investments, pension benefits are the only significant outflow of cash from a pension fund. The possible demand for cash on a pension fund to meet this obligation is determined by the provision of the pension plan which relate to such features as normal retirement benefits, early retirement benefits, disability benefits, death benefits, and vesting provisions. The number of participants eligible to receive these benefits and the amount of their claims during any period are actuarially predictable. Disbursements from a pension fund to provide benefit payments can, therefore, be predicted long in advance with only a limited margin of error. Moreover, the regular inflows of cash from employer, and employee if the pension plan is contributory, are fairly reliable and predictable. The

actuarial assumptions which are employed in the determina-
tion of pension claims and the resulting disbursements,
are easily adjusted by the actuary in periodic review.
There is no possibility of huge claims on a catastrophic
scale. In discussing this characteristic of pension funds,
Paul L. Howell states, "Retirement plans are not subject
to catastrophic hazards; retirement and payments can be
forecast years in advance."23

As a result of the predictability of their needs for
cash and the absence of catastrophic hazards, there is
little need for the pension fund trustee to take a
"defensive" investment position with primary emphasis on
safety of principal and the resulting lowering of over-all
portfolio yield. Since there is little danger of having
to liquidate investments at depressed price levels to meet
unexpected demands for cash, the trustee need not purchase
securities which have early maturity dates. He can invest
more heavily in less liquid assets without exposing him-
self to a great risk of principal loss. The conversion
of investments into cash can be scheduled considerably in
advance of needs for the funds and timed to avoid princi-
al loss.

23 Howell, op. cit., p. 93. See also Haines, "Invest-
ment of Retirement Funds," op. cit., p. 6, and Andrews,
"Interests at Stake in the Investment of Pension Funds," op. cit., p. 753.
In order to protect themselves against any possible years of deficit cash flow and against times when there may be particularly high demands for benefit payments, under circumstances possibly unfavorable to liquidation, some pension fund trustees do, however, advocate that the maturity of investments in the portfolio which have maturity dates be spaced over a period of years. In this way, if unusual payments must be made they can be met through the liquidation of obligations which mature in a relatively short time and which fluctuate in price very little.

Influence of Accounting Practices

Another factor which has an important bearing on the investment policy of pension funds is the accounting requirements which are applicable to pension trusts. In general, they are at complete liberty with regard to the method used for the valuation of assets in these funds. The usual practice is to value fixed-income investments

at amortized cost and all other investments at original cost.\textsuperscript{25} Realized capital gains and losses are, therefore, taken into account in valuing the fund's assets but unrealized gains and losses are not. Federal income tax regulations do not, however, allow tax-exempt pension funds to accumulate any loss reserves for possible future investment losses out of the income of the fund or out of realized capital gains.

The inability to accumulate a loss reserve to provide a cushion against adverse investment experience affects the investment policy of pension funds in several respects. The absence of such a reserve makes conventional real estate mortgage loans and lower quality corporate bonds considerably less attractive for pension fund investment purposes. It may be argued that an essential procedure in managing pension fund portfolios which include these assets is to establish a reserve for losses to cover investment experience between good and bad years.\textsuperscript{26} While the forthright accumulation of a loss reserve by tax-exempt pension funds is not permitted under present federal income tax regulations, it is possible for a pension fund to have

\textsuperscript{25} Gradison, op. cit., p. 86, and Murray, "Investment Aspects of the Accumulation of Pension Funds," op. cit., p. 253.

\textsuperscript{26} Murray, "Investment Aspects of the Accumulation of Pension Funds," op. cit., pp. 253-254.
built-in "reserves" created through the use of conservative actuarial interest assumptions and the existence of unrealized appreciation in the value of pension fund assets. Investments which provide greater capital appreciation, therefore, offer considerable attraction to the pension fund trustee. One trustee stated, "The pension trustee derives a great feeling of comfort from the cushion of unrealized capital gains."27 Another pension fund authority said, "There is need for . . . a systematic accumulation of a reserve for the amortization of inevitable losses. In the case of pension funds unrealized appreciation can be utilized to provide such a cushion."28 The buoyant market for common stocks in recent years, which has created a significant difference between the value of the stocks on the books of the fund and market value, has, therefore, provided pension fund trustees with an opportunity to build an investment experience reserve. This adds to the attractiveness of common stocks for pension fund investments.


Exemption from Federal Income Taxation

As discussed in Chapter I, a qualified pension trust is not subject to federal income taxes either on investment income or on realized capital gains. The implications of this tax-exempt status on the investment decisions of the pension fund trustee are twofold. One, the trustee does not need to distinguish between principal appreciation of investments and investment income as would other types of investors. Two, tax-exempt obligations, which ordinarily sell on a lower yield basis than United States Government bonds or corporate bonds of comparable investment quality, hold no particular attraction for the pension fund trustee. He can make his investment decisions without reference to capital-gains taxation or without the problem of providing a reasonable after-tax income.

Size of Pension Fund

The size of a pension fund also exerts an important influence on its investment policy. Small pension funds are inherently more susceptible to volatile turnover experience and mortality experience than are the large

pension trusts which enjoy the protection of large numbers. This means that small pension funds are subject to less regular and less predictable needs for cash and therefore, have greater requirements for safety of principal and liquidity preference than do large pension funds. This partly explains why small pension funds have a higher proportion of cash and Government securities than do the large funds.  

Small funds are handicapped by other investment limitations. The small amount of funds which they possess makes diversification of investment difficult. The unavoidably high expense of administering small sums in a widely diversified portfolio of higher yielding corporate stocks and bonds would be disproportionate to any possible gain in return. This is another reason why small pension funds resort to easily acquired and low yielding Government securities. Because of the small volume of funds they command, small pension funds also are limited to the degree which they can participate in the more attractive private placements.

30 U.S. Securities and Exchange Commission, Survey of Corporate Pension Funds, 1951-1954, October 1, 1956, Table 4, p. 28.

In order to overcome many of the investment and other problems inherent in small pension funds, a large number of trust companies and trust departments of commercial banks in many different cities have each developed a "pooled pension fund." A pooled pension fund is simply one large pension trust formed to hold the combined assets of any number of pension funds, regardless of size, which qualify as tax-exempt trusts under the applicable sections of the Internal Revenue Code. The assets of each of the participating pension funds are placed in a commingled pension fund which is invested as one collective investment fund.

A pooled pension fund provides each participating pension trust with the opportunity of greater investment diversification and a correspondingly higher degree of safety of principal than each could obtain separately.

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A more diversified portfolio coupled with the substantial economies, which result from administering one large fund rather than small separate funds, offers each participating pension trust greater potential yield than if each were invested separately. The pooling of mortality experience, which is practiced under some commingled funds, also lessens the need for highly liquid investments which are required in small pension funds.\footnote{Myers, op. cit., p. 1098.} As one well-known pension fund trustee stated:

The savings which can be effected in investing small and medium-size trusts through the use of commingled funds and the better investment results available to the customer are obvious.\footnote{William F. Lackman, "Streamlining Administration and Operation," \textit{Trusts and Estates}, March, 1956, p. 231.}

\textbf{Nature of Trust Agreement}

Another factor which exerts considerable influence on the investment practices of a pension fund is the nature of the trust agreement which is made a part of the pension plan and under which the pension fund trustee must abide. Under the investment provisions of some trust agreements, the trustee has complete discretion as to the
choice of investments for the particular fund. Such an
agreement may read as follows:

The trustee is expressly authorized and
empowered to invest, acquire by exchange,
sell, and reinvest the fund in its dis­
cretion in such stock (of any classifi­
cation), bonds or other property, without
regard to the proportion such property of
a similar character so held may bear to
the entire amount held, as it discretion
may determine, and whether or not the same
may be authorized by law for the investment
of trust funds.  

Under such provisions, a trustee is allowed tremendous
latitude in his selection of investments for a pension
fund. Naturally the trustee can, if he so desires, adopt
a self-imposed limit on any type of investment. Old
Colony Trust Company of Boston, for example, has a self-
imposed limit on pension fund investments in common stock.
This firm's policy "has been to invest about 30 per cent
of a pension trust fund, where the trust instrument
allows full discretion, in common stocks of proved merit
and future potentialities."  

Many pension fund trustees
prefer not to invest in the client's own common stock for
its client's pension fund. This does not, however, pre-
clude investment in one client's stock for another

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36 Old Colony Trust Company of Boston, Mass., Should Common Stocks Be Used In a Pension Fund?, 1957, p. 9.
client's pension fund. There are two principal reasons for this policy. One, each time such investments are made, they must be reported to the Commissioner of Internal Revenue and permission must be obtained. Two, such investments could give employees of the client or the general public the idea that a company's pension fund is a captive source of funds for the company's operations.

In addition to these self-imposed restrictions, the trustee's full investment authority may be limited by the terms of the trust agreement or by subsequent agreements with the company. The following are included among the more common restrictions:

1. The purchase of the company's own securities or those of any of its subsidiaries or affiliates is prohibited.

2. The total purchases of the securities of any one issuer is limited to a certain percentage of the total value of the fund, except for securities of the United States Government.

3. The purchase of common stock is limited to a certain percentage of the total value of the pension fund.

4. The acquisition of investments is restricted to those investments which qualify for fiduciaries or as "legals" under the laws of the state in which the fund is domiciled.
Many combinations and variations of these common restrictions are found in pension trust agreements. None of them have the effect of relieving the pension trustee of the responsibility of making sound investments of its own choosing. They merely reduce the latitude of freedom which the trustee may exercise in selecting investments for the pension fund.

Under the terms of other trust agreements, the trustee has the basic responsibility of investing the pension funds but the employer maintains some control over the trustee's actions through the exercise of a veto power. To do so, such conditions as the following may be incorporated in the investment provisions of the trust agreement:

The trustee shall notify the company in advance of any investment or reinvestment of the securities which it proposes to purchase and shall not make any investment or reinvestment in any securities as to which the company shall within five (5) days after the receipt of such notice notify the trustee in writing of its disapproval as an investment for the fund at that particular time.37

Such veto or approval powers often are exercised in a very informal manner. When a trustee is considering an acquisition or liquidation of an investment, it may call a member of the pension committee or other appropriate representative

37Ibid., p. 13.
of the company to discuss the matter. Approval usually is granted at that time. In some instances the employer's pension representatives will, however, consider the proposal and make counter proposals.

Employers that wish to exercise more than a veto power in the trustee's investment responsibilities may insert in the trust agreement such clauses as the following:

Except to the extent hereinafter provided and having regard for the cash requirements of the plan, as stated to it from time to time by the pension committee, the trustee shall invest and reinvest the principal and income of the fund without distinction between principal and income and keep the fund invested in such securities (excluding those of the company), common stocks, preferred stocks, bonds or other property, whether real or personal, as the pension committee may from time to time direct without being limited in any respect by any statutes, court decisions, rules of court, or otherwise, now or hereafter in force, purporting to limit, restrict or define investments for trustee. The trustee, in its discretion, may retain a portion of the fund in cash or cash balances, temporarily awaiting investment without liability for interest thereon so much of the fund as the pension committee may deem advisable for the purpose of meeting contemplated payments under the plan, and shall be under no obligation to invest the same as herein provided.38

Under such provisions, the pension or investment committee of the employer meets periodically with the trustee to

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discuss investment policy for the fund, or transmits its thinking to the pension fund trustee from time to time. In some cases the trustee is bound by these suggestions while according to the terms of some trust agreements he is only guided by them.

In a few pension funds, the trust agreement gives the employer full control over investment policy of the fund. Under such provisions the trustee acts principally as the custodian of funds. He acquires or liquidates investments in the fund according to the instructions of the employer. When an employer assumes full control over the investment of pension funds, it may rely on people on its staff, it may engage outside investment consultants, or it may use the facilities of a brokerage firm or an investment banking firm.

Evidence that the trust agreement of many pension funds places full investment control of the fund in the hands of pension fund trustees is indicated by the testimony given during the Senate hearings in 1955. These hearings revealed that 65 large banks had investment control over nearly three-fourths of the 5,269 pension and other employee benefit trust accounts which they administered. Further evidence of the large measure of

investment power entrusted to pension fund trustees is provided by the New York State Banking Department study. This study revealed that in nearly 70 per cent of the 1,024 pension funds surveyed, the pension fund trustee had full investment authority, in approximately 20 per cent of the funds the trustee had general investment authority subject to the veto or direction of the employer or the employer's pension plan administrator, and in only 10 per cent of the funds did the employer retain full control over pension fund investments.40

This study also disclosed that firms with larger pension funds tend to give more responsibility to the pension trustees than do employers with smaller pension funds. All but seven of the 40 funds in the study which had assets of $25 million or more placed investment powers completely at the discretion of the pension fund trustees. Similarly, in nearly three-fourths of the pension funds with assets of $10 million to $25 million, the trustee had full investment authority. He had such authority in approximately 60 per cent of the funds with assets of less than $1 million.41 There were no general investment restrictions in the trust indentures of more than 60

40George A. Mooney, op. cit., Table 30, p. 30.

41Loc. cit.
per cent of the 1,024 pension funds in the New York State Banking Department study. The trust agreement of the remainder of the funds restricted investments in some way. The most common type of restriction specifically limited investments to those which were legal for insurance companies or fiduciaries in New York State. Further evidence that pension trust agreements give wide investment latitude to pension fund trustees was revealed in the New York State Insurance Department study of nonbank trusteed pension funds in New York State. Of 164 pension funds in this study, the trustee enjoyed complete investment freedom, or nearly so, in most instances.

The investment provisions of a trust agreement, under which a pension fund trustee must abide, obviously affects the investment policies of a pension fund. The scope of permitted investments may be extremely broad or very narrow. The trust agreement of most pension funds, however, gives pension trustees tremendous latitude in the management of investments. Most trustees are not forced to select from among those investments which appear on a legal list or are legal for fiduciaries.

\[42\] Ibid., Table 27, p. 27.

\[43\] Martin S. House, Private Employee Benefit Plans--A Public Trust, New York State Insurance Department, 1956, Table II, p. 118.
the contrary, they may, at their discretion, select those investment outlets which seem appropriate at the particular time. It should, however, be noted that in the standard type of trust agreement, the right is reserved to the employer to change the trustee at any time. In the final analysis, whether or not a veto power is part of the investment provisions of the indenture, the employer has the last word on those investments selected for its pension fund. The attitude of the employer is, therefore, important in the investment policies which a pension trustee establishes for the client's pension fund.

Legislative Investment Restrictions

In sharp contrast to the numerous legal restrictions which specify or describe the kinds of investments in which many other types of financial intermediaries are authorized to invest, there are virtually no formal legislative investment restrictions upon pension funds. The only formal legal encumberances upon pension fund investments are contained in the Internal Revenue Code. While the Code contains no specific limitations on pension fund investments, the tax-exempt status of the fund may be forfeited if the investments made by the trustee constitute

prohibited transactions within the meaning of Section 503 of the Code. In general these transactions would include any negotiations that would serve to divert a substantial amount of securities or property in the trust to the creator of the trust. An allied restriction of the Code requires that full disclosure must be made by pension fund trustees of those pension funds which are invested in securities of the employer and permission for such investments must be obtained in order for the trust to retain its tax-exempt status. The obvious intent of these restrictions is to prevent pension funds from becoming captive sources of funds to employers; these restrictions are not intended to serve as a regulatory law regarding pension fund investment.

While the portfolio policy of pension funds is not directly guided or restricted by formal legal restrictions, a pension fund trustee is bound by the terms of the trust agreement of the particular fund. As noted above, the trust indenture may give the trustee unlimited discretion in the choice of investments or it may impose virtually any restriction on portfolio policy. It may, for example, limit the selection from among those investments that are legal for fiduciaries under the laws of the state in which the fund is domiciled. Trustees who
administer pension funds which contain such provisions are, therefore, subject to fiduciary law.

Uniform practice does not exist in the 50 states in the laws pertaining to activities of fiduciaries. The older type of state regulation sets out a specific enumeration of the kinds of investments that may be made by a trustee and these investments are referred to as the "legal list" of the state. Investments which qualify as "legal" under the laws of one state may not be recognized as "legal" in another. Only a few states, however, restrict trustees' investments to a legal list of investments. Most states have adopted the so-called "prudent-man rule" for the investment of funds. This rule states in effect that the principles governing the investment of trust funds are the same as those which would be observed by a prudent man in the investment of his own funds.

The prudent-man rule first received legal recognition in the case of Harvard College vs. Amory in 1830 and the Massachusetts courts have upheld the prudent-man rule since that year. In other states, such as New York, the practice had been to limit trustees, unless expressly freed from the restriction by the terms of the trust agreement, to investments on a "legal list." By 1950 the prudent-man rule, also called the "Massachusetts rule," had been adopted through legislation or court decision in
37 states, the District of Columbia, and Hawaii. The most notable departure from the legal list states occurred in 1950 when the New York legislature enacted into law a modified form of the prudent-man rule. The New York law permits fiduciaries, restricted to legal investments by trust indentures, to invest in "bonds, debentures, notes, equipment trust obligations or other evidences of indebtedness and shares of common and preferred stocks" but further limits investment in common stocks to 35 per cent of the total value of the trust fund and prescribes that these stocks must be "registered on a national securities exchange." The 35 per cent must include any other investments which are held in the portfolio but which are not included on the legal list. The remainder of the portfolio must be in the fixed-income securities to be found on the legal list.

The absence of legislative investment restrictions gives the trustee considerable freedom in the choice of investments for a pension fund. This liberty partly explains the relatively high proportion of common stock in pension fund portfolios, although it is essentially a


46 New York Personal Property Law, Sec. 21(m).
permissive rather than a positive influence. The liberalization of fiduciary law, particularly in New York, also has exerted a significant influence on pension fund investment policy. By giving pension trustees, who were restricted by trust instruments to those investments that qualify as legal for fiduciaries, the right to invest up to 35 per cent of the trust in common stock or any other investment they considered prudent, common stock was made a more "respectable" investment for pension funds. Even though the liberalization of fiduciary law did not have legal bearing on those pension trustees expressly exempt from fiduciary law by the trust agreement, it did, by declaration of public sanction and legal recognition, give additional courage to these trustees to proceed with common-stock investments without undue fear of future surcharge.

**Type of Trustee Appointed**

The type of trusteeships appointed to administer a pension fund is another factor which influences pension fund investment policy. The selection of pension fund trustees usually is made by the employer. In approximately 97 per cent of 1,024 pension funds trusteeed by New York banks, the trustee had been appointed by the
employer alone. Of the 371 bank-trusteed funds, which were included in the study by the New York State Insurance Department, 256 were administered by the employer alone or by pension boards, committees or trustees appointed by the employer. In the remaining 115 funds in this study, the employer shared the authority with a union in the appointment of trustees in 103 funds and in only 12 funds was the employer's influence absent in the selection of trustees.

A corporate trustee, usually a bank or trust company, or a group of individuals may be appointed to administer a corporation's pension fund. There are a number of substantial pension funds, such as Bethlehem Steel, General Electric, U.S. Steel, which are independently administered. As one pension consultant noted, however, "There can be little doubt that even after taking such plans into account, it is the trust companies which manage the vast bulk of the assets of (noninsured) pension funds." Statistical evidence supports the conclusion that a marked concentration of pension funds is placed with corporate trustees. The New York State Banking Department revealed

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47 George A. Mooney, op. cit., Table 31, p. 31.
48 Martin S. House, op. cit., Table 5, p. 93.
that at the end of 1953, 51 banks in New York held nearly $5 billion of pension fund assets. 50 This represented more than 50 per cent of the total assets in all noninsured private corporate pension funds in the United States. Of the total $5 billion, more than 98 per cent was held by 13 banks.

More recent information reveals that, as of September 30, 1959, 79 banks in New York held pension fund assets of nearly $12 billion and 11 New York City banks held approximately 96 per cent of this amount. 51 The important position of New York banks in pension fund administration is illustrated by the fact that as of September, 1959, they held nearly 60 per cent of the total assets in all noninsured pension funds in the United States. The importance of the position held by bank trustees as pension fund trustees is heightened when the funds administered by bank trustees domiciled in states other than New York, such as Old Colony Trust Company of Boston, Massachusetts, are added to the aggregate of pension funds held by New York banks.

When an employer appoints individuals as trustees for its pension fund or the fund is administered by officers

50 George A. Mooney, op. cit., Table 31, p. 31.

51 New York State Banking Department, "Pension and Other Welfare Funds Held by Banks in New York State, September 30, 1959," Single page table.
of the employer, the employer can exercise its influence directly on the trusteeship. The board of trustees or administrators appointed by the employer is invariably weighted heavily with officers of the corporation and they inevitably reflect directly the feelings of top management in regard to the conduct of investments for the fund. Then too, the terms of nonbank pension fund trust agreements are, as noted earlier, usually written liberally so that the latitude for fund investment is quite wide. The ability to influence trustees and to write liberal trust agreements strengthens the employer's influence on the investment of a pension fund. The result, according to one pension authority, is that "One encounters greater extremes of conservatism and passivity in some funds, and vigorous, determined exploration of investments in others."  

When a bank trustee is appointed to administer a pension fund, a great insulation of formal and informal institutional forces separates the employer and investment of the pension fund. The employer's influence on the investment policies of funds entrusted to a bank is, therefore, less direct than where trusteeship is performed by officers of the corporation or by a board of individual

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trustees appointed by the corporation. This does not mean that the employer is powerless over investments made by a bank-trusteed fund but only that its wishes are effected through the medium of the bank which adds the constraints of its professional livelihood. The employer can restrict the investments which are authorized by the trustee according to the terms of the trust agreement. The employer also ultimately retains the sanction of investment policy through its ability to appoint or discontinue a trustee. Bank trustees are fully aware of the employer's power and give it due consideration in their relationship with the employer. Despite the authority of the employer, in the final analysis they negotiate for their own views on proper investments for the employer's pension fund and, for that reason, are relied upon by the employer. While a pension trustee may be evaluated by comparison with his competitors, the canons of investment practice generally accepted by fiduciaries and the influence of fiduciary history and law act more forcefully on bank-trusteed pension funds than on funds governed almost entirely by the employer.

The result of these institutional forces on the corporate trustee is that there is a greater uniformity of investments in the pension funds they administer than where trusteeship is performed by officers of the employer.
or by a board of individual trustees. Bank trust officers tend to experiment less with newer forms of investment than in the case of individual trustees. The differences between the investment policies of the two types of pension fund trustees are apparent when the investment portfolios of the two types are compared. As may be observed in Table 16, nonbank-trusteed funds tend to hold a greater proportion of cash and U.S. Government securities than do bank-trusteed funds. They also tend to hold a greater proportion of common stock, real estate and mortgages, and "other" assets than do corporate trusteed funds. The latter, however, hold a greater proportion of corporate debt than do nonbank-trusteed funds. While there is little difference in the proportion of the preferred stock component in the portfolios of the two types of trusteed funds, the proportionately larger holdings of real estate and mortgages and "other" assets in nonbank trusteed funds than in bank-trusteed funds reflects the tendency for the former type of trustee to invest in what may be considered the more unusual forms of investments.

53 The data presented in this table represent the most recent published information which reports separately the portfolio composition of corporate-trusteed and nonbank-trusteed pension funds. Unfortunately, the data for the two types of trusteeships do not refer to the same point of time. Since the difference in time period is only one year, it is believed that the data are useful in noting general tendencies, which is the purpose here.
TABLE 16
AMOUNT AND PERCENTAGE COMPOSITION OF PENSION FUND ASSETS IN 1,024 PENSION FUNDS HELD BY NEW YORK BANK TRUSTEES AT THE END OF 1953 AND IN 211 NONBANK TRUSTEED PENSION FUNDS IN NEW YORK STATE AT THE END OF 1954 (DOLLAR AMOUNTS IN MILLIONS OF DOLLARS)

<table>
<thead>
<tr>
<th>Asset</th>
<th>Bank-Trusted Funds</th>
<th>Nonbank-Trusted Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Per Cent</td>
</tr>
<tr>
<td>Cash</td>
<td>$ 93</td>
<td>1.9%</td>
</tr>
<tr>
<td>U.S. Government Securities</td>
<td>917</td>
<td>18.7%</td>
</tr>
<tr>
<td>State and Local Bonds(^a)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate and Other Bonds</td>
<td>3,065</td>
<td>62.6%</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td>138</td>
<td>2.8%</td>
</tr>
<tr>
<td>Common Stock</td>
<td>613</td>
<td>12.5%</td>
</tr>
<tr>
<td>Real Estate and Mortgages</td>
<td>30</td>
<td>0.6%</td>
</tr>
<tr>
<td>Other Assets</td>
<td>35</td>
<td>0.7%</td>
</tr>
<tr>
<td>Total(^b)</td>
<td>$4,894</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

\(^a\)The amount of state and local bonds is not available separately in the bank-trusted funds, but presumably is included in "corporate and other bonds".

\(^b\)Detail may add to total because of rounding.

Source: George A. Mooney, Pension and Other Employer Welfare Plans, New York State Banking Department, 1951, Table 31, p. 31, and Martin S. House, Private Employee Benefit Plans--A Public Trust, New York State Insurance Department, 1956, Table 12, p. 119.
Attitude of Trustee

The attitude of the pension fund trustee exerts a significant influence on pension fund investment policy. This attitude may be affected by each one of the other factors discussed above; it also may be affected by additional influences. One such influence is that pension trustees usually have a background in and knowledge of corporate securities. They are accustomed to forming judgments as to the relative merits of different corporate issues and "they are attracted to familiar and accepted investment media . . .".\(^{54}\)

In recent years there has been, however, a notable change in the attitude of pension fund trustees as to the proportion of the different types of securities which should be held in the investment portfolio of pension funds.\(^{55}\) One prominent pension fund trustee stated:

Whereas at one time pension funds were regarded as havens of fixed-income investments, they are now in many quarters thought of as pools of


capital ideally suited to the accumulation of large proportions of common stock.  

An indication of the changed attitude of pension trustees is also reflected in the following comment, "Ten years ago there was hardly a large corporate trustee in the country which used common stocks as a general practice in pension funds. Today the use of common stocks has become widely accepted." The changed climate of investment thinking was also expressed by another notable pension fund authority who stated:

The purchase of common stocks with so sizable a percentage of a Pension Plan's funds, has become a widely accepted investment practice only within very recent years. It was not until the 1940's that either trustees or donor-corporations, generally, began to think seriously of equities as a medium for Pension funds, and the idea did not gain any wide favor until the very last part of the decade. Since 1949, however, there has been a very decided trend toward increasing equity investment.

While pension fund trustees have become more receptive to common stock investments, they do not recommend placing all the assets of a pension fund in this medium. On the contrary, they usually advocate a balanced fund of

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56 Farnum, op. cit., p. 1.
57 Old Colony Trust Company of Boston, Massachusetts, Why Should Pension Plans Be Flexible?, 1952, p. 5.
58 Weedon, op. cit., p. 94.
diversified fixed-income and variable-income investments. The proportion of the fund in each type of investment naturally varies among different trustees and may differ among the several pension funds which one trustee may administer.

Pension Fund Portfolios

The annual surveys of noninsured corporate pension funds by the United States Securities and Exchange Commission (SEC) have provided valuable information concerning the present investment portfolios of these funds and the broad investment policies which they have followed. The distribution of assets held in pension funds at the end of each year from 1951 through 1959 are shown in Tables 17 and 18, which are derived from the data contained in the SEC surveys. At the end of 1959 nearly $12.8 billion, or more than half of all noninsured pension fund assets, were invested in corporate bonds. Cash and deposits amounted to $407 million and constituted 1.6 per cent of the combined portfolio of all funds. The holdings of United States Government securities amounted to $2.1 billion and represented 8.5 per cent of total pension fund assets.

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Deposits</td>
<td>$291</td>
<td>$265</td>
<td>$313</td>
<td>$296</td>
<td>$343</td>
<td>$332</td>
<td>$368</td>
<td>$383</td>
<td>$407</td>
</tr>
<tr>
<td>U.S. Government Securities</td>
<td>2,170</td>
<td>2,162</td>
<td>2,297</td>
<td>2,284</td>
<td>2,536</td>
<td>2,293</td>
<td>2,032</td>
<td>1,985</td>
<td>2,148</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>3,125</td>
<td>4,142</td>
<td>5,181</td>
<td>6,359</td>
<td>7,225</td>
<td>8,704</td>
<td>10,392</td>
<td>11,731</td>
<td>12,797</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td>272</td>
<td>331</td>
<td>397</td>
<td>454</td>
<td>510</td>
<td>570</td>
<td>611</td>
<td>655</td>
<td>657</td>
</tr>
<tr>
<td>Common Stock</td>
<td>812</td>
<td>1,206</td>
<td>1,649</td>
<td>2,286</td>
<td>2,958</td>
<td>3,774</td>
<td>4,770</td>
<td>6,042</td>
<td>7,714</td>
</tr>
<tr>
<td>Mortgages&lt;sup&gt;a&lt;/sup&gt;</td>
<td></td>
<td></td>
<td>146</td>
<td>230</td>
<td>313</td>
<td>405</td>
<td>576</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Assets</td>
<td>206</td>
<td>277</td>
<td>384</td>
<td>473</td>
<td>511</td>
<td>736</td>
<td>833</td>
<td>892</td>
<td>1,008</td>
</tr>
<tr>
<td>Total</td>
<td>$6,876</td>
<td>$8,382</td>
<td>$10,222</td>
<td>$12,153</td>
<td>$14,230</td>
<td>$16,639</td>
<td>$19,319</td>
<td>$22,094</td>
<td>$25,307</td>
</tr>
</tbody>
</table>

<sup>a</sup>Included with other assets during the years 1951 through 1954.

TABLE 18

PERCENTAGE DISTRIBUTION OF NONINSURED CORPORATE PENSION FUND ASSETS
AT BOOK VALUE BY TYPE OF ASSET AT THE END OF YEAR, 1951-1959

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Deposits</td>
<td>4.2%</td>
<td>3.2%</td>
<td>3.0%</td>
<td>2.4%</td>
<td>2.4%</td>
<td>2.0%</td>
<td>1.9%</td>
<td>1.7%</td>
<td>1.6%</td>
</tr>
<tr>
<td>U. S. Government Securities</td>
<td>31.6</td>
<td>25.8</td>
<td>22.5</td>
<td>18.8</td>
<td>17.8</td>
<td>13.8</td>
<td>10.5</td>
<td>9.0</td>
<td>8.5</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>45.4</td>
<td>49.4</td>
<td>50.7</td>
<td>52.3</td>
<td>50.8</td>
<td>52.3</td>
<td>53.8</td>
<td>53.1</td>
<td>50.6</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td>3.9</td>
<td>3.9</td>
<td>3.9</td>
<td>3.7</td>
<td>3.6</td>
<td>3.4</td>
<td>3.2</td>
<td>3.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Common Stock</td>
<td>11.8</td>
<td>11.4</td>
<td>16.1</td>
<td>18.8</td>
<td>20.8</td>
<td>22.7</td>
<td>24.7</td>
<td>27.3</td>
<td>30.5</td>
</tr>
<tr>
<td>Mortgages&lt;sup&gt;a&lt;/sup&gt;</td>
<td>1.0</td>
<td>1.4</td>
<td>1.6</td>
<td>1.8</td>
<td>2.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Assets</td>
<td>3.0</td>
<td>3.3</td>
<td>3.8</td>
<td>3.9</td>
<td>3.6</td>
<td>4.4</td>
<td>4.3</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

<sup>a</sup>Included with other assets during the years 1951 through 1954.

Source: Table 17.
The pension fund assets in the form of mortgages amounted to $576 million which was 2. per cent of the combined portfolio all pension funds. Approximately $600 million or 2.6 per cent of pension fund assets were invested in preferred stocks. Nearly $8 billion of all pension fund assets were invested in common stocks and this amount represented more than 30 per cent of pension fund holdings. If the assets of pension funds are valued at market rather than at book value, a greater proportion of the total assets of pension funds is invested in common stocks. As may be observed in Table 19, common stocks constituted 43.4 per cent of the market value of the total assets in pension funds at the end of 1959.

TABLE 19

DISTRIBUTION OF NONINSURED CORPORATE PENSION FUND ASSETS AT MARKET VALUE BY TYPE OF ASSET AT THE END OF 1959

<table>
<thead>
<tr>
<th>Type of Asset</th>
<th>Amount (Millions of Dollars)</th>
<th>Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Government Securities</td>
<td>$1,998</td>
<td>7.1</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>11,368</td>
<td>40.3</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td>592</td>
<td>2.1</td>
</tr>
<tr>
<td>Common Stock</td>
<td>12,251</td>
<td>43.4</td>
</tr>
<tr>
<td>All Other Assetsa</td>
<td>1,986</td>
<td>7.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$28,197</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

aIncludes cash and deposits, mortgages, and all other assets.

The present combined portfolio of pension funds is the product of a rather dramatic redistribution of pension fund assets resulting primarily from two notable developments in the investment portfolios of pension funds. The first is the markedly declining emphasis on Government securities and the second is the markedly increased emphasis on common stocks. As may be observed in Table 17, the dollar holdings of Government securities in pension fund portfolios declined only slightly between 1951 and 1959. The proportion of total pension fund assets in the form of Government securities, however, declined sharply from nearly 32 per cent in 1951 to only 8.5 per cent at the end of 1959, as shown in Table 18. During this same period the percentage of pension fund assets in the form of common stocks increased sharply from less than 12 per cent in 1951 to more than 30 per cent at the end of 1959.

The factors which affect pension fund investment policy provide the explanation for the decline in the relative importance of Government securities, as well as the proportionate decline of cash and deposits, and the increased proportion of common stocks in pension fund portfolios. The low and declining level of Government securities and cash and deposits in the holdings of pension funds is attributable to the minimal liquidity needs of a pension fund due to its (1) high predictability of
cash requirements, (2) magnitude of cash inflow, (3) regularity of cash inflow, and (4) long duration of life. The small proportion of Government securities and cash items also may be attributable in part to the pressure placed on pension fund trustees by employers and employees to increase the investment return on the pension fund investments. Other types of investments generally offer more attractive yields than afforded by Government securities. The quest for greater income obtainable from other fixed-income and variable-income investments has, therefore, provided the incentive to sacrifice some of the safety of Government securities in favor of other investments of high quality. Perhaps the fact that trustees and company officials feel more at home with corporate securities and are better equipped to form a judgment on their merits than they are on Government securities also is partly responsible for the declining importance of the latter in the portfolios of pension funds.

A number of factors afford an explanation for the significant proportion of common stocks in pension fund portfolios. As noted earlier, there is no need for a pension fund trustee to distinguish between the principal and the income of a pension fund. This has encouraged increased holdings of common stocks which offer greater opportunity for capital appreciation than is obtainable
on fixed-income investments, such as Government securities. Unrealized capital appreciation on common stocks also provides pension fund trustees with an opportunity to build a loss reserve which they would otherwise not be able to do under federal income tax regulations. The immunity of a pension fund from pressure to liquidate means that pension fund trustees can invest in common stocks without being placed in the position of being compelled to liquidate these holdings under depressed market conditions. The long duration of a pension fund and the regularity of cash inflow to it offers the pension trustee a natural opportunity of applying dollar averaging in common stock purchases. The absence of restrictions in most pension trust agreements and the absence of legislative investment restrictions gives trustees more liberty in making investments in common stocks than is permitted many other types of financial intermediaries.

Available literature and discussion with pension fund trustees indicate that common stock investment was relatively unimportant until pension trustees recognized the continued threat of inflation. Unlike fixed-income investments, common stocks provide a component of the pension fund portfolio which offers a hedge against a rise in the price level. Informally, pension fund trustees also concede that their memories of unpleasant experience
with common stocks in the 1930's had taken years to subside. Not until the pendulum had swung heavily toward inflation could they stifle this lingering attitude and invest large proportions in common stocks. As noted earlier, the increasing pressure during the 1950's on pension fund trustees to increase pension benefits or reduce the costs to employers has been a stimulant to the increased purchases of common stock by pension trustees. The growth of pooled pension funds has made common stock investments feasible for small pension funds. The liberalization of fiduciary laws also has given additional courage to pension fund trustees to invest in common stock without undue fear of future surcharge.

As may be observed in Table 18, corporate bonds have constituted the largest single component of total pension fund assets each year from 1951 to 1959. The large holdings of corporate bonds in pension fund portfolios is due to several factors including the following: (1) the early precedent in pension fund investment policy established corporate bonds as desirable outlets; (2) the relatively fixed nature of a pension fund's liabilities suggests the need for significant amounts of stable-value investments; (3) the trust agreement in some pension funds restricts the pension fund trustee to those investments on a legal list, which would normally include investment grade
corporate bonds; (4) the yield is generally superior on high grade corporate bonds than on Government securities; (5) the trustees of pension funds usually stress the need for a balance between the various investment components of a pension fund portfolio; and (6) the pension fund trustees usually have greater knowledge and experience with investments in corporate bonds than they do in many other types of fixed-income investments, such as mortgages or the sale and leaseback.
CHAPTER V

PENSION FUND INVESTMENT IN SAVINGS AND LOAN ASSOCIATIONS

Several methods could be used for the purpose of channeling the accumulations of pension funds into savings and loan associations. It is the purpose of this chapter to evaluate each of these alternatives from the standpoint of the investment practices of pension fund trustees and the operations of savings and loan associations.

Savings Accounts

An investor or saver may place his savings in a savings and loan association through one or more of three different types of accounts depending upon the particular association chosen. These include the savings share account, the deposit account, and the investment certificate account.

A number of factors contribute to the safety of an account placed in the typical savings and loan association. These include the conservative management of these institutions, the type of investments made by these institutions, the insurance of accounts, the supervision
and aid of regulatory bodies, and the building of reserves against possible future losses. Savings and loan associations invest primarily in amortized residential real estate mortgage loans. These loans are relatively safe investments because (1) the management of these firms usually is careful to grant loans only to worthy loan applicants, (2) there is a sufficient margin between the amount of the mortgage loan and the current market value of the mortgaged property, (3) the regular monthly repayment of the mortgage loan reduces the loan risk at a more rapid rate than the property depreciates, (4) some of the loans are insured by the Veterans Administration or guaranteed by the Federal Housing Administration, and (5) the substantial demand for residential property makes the property fairly marketable in the event the mortgagor runs into financial difficulties.

Each account holder who has funds in a savings and loan association which is a member of the Federal Savings and Loan Insurance Corporation (FSLIC) is insured up to $10,000. Supervision and examination by regulatory bodies also help to maintain the safety of an account in a savings and loan association. In addition, savings associations are required to apportion a segment of current earnings as a reserve against possible decline in the value of their assets.
An account in the typical savings and loan association meets most savers' need for liquidity. Legally, these institutions can require written notice from account holders who wish to withdraw all or a portion of their account balances. Except at a time of financial panic or severe depression, the typical savings association will return a saver's money upon demand. Savings associations are able to meet investors' withdrawal requests promptly by (1) keeping a portion of their assets in cash and in government securities which are readily salable, (2) obtaining a constant inflow of new savings funds in both new and old accounts, (3) lending chiefly on amortized mortgage loans which assures a steady flow of incoming monthly payments, and (4) borrowing from a Federal Home Loan Bank in time of need.

Since mortgage loans constitute the most important type of investment made by savings and loan associations, the return paid to savers by these institutions is closely related to the rate of interest which they charge on mortgage loans. At the present time the typical rate of return paid to savers by savings and loan associations is from 3 to 4-1/2 per cent. The rate is usually higher than that paid by comparable savings institutions, such as commercial banks and mutual savings banks. Savings and loan associations do not guarantee a saver a fixed rate
of return over a period of years. The rate varies with the general interest rate, prevailing business conditions, section of the country, and rates paid by competitive institutions. Savings associations try to maintain the payment of a steady rate, however, and keep excess earnings as a reserve. When an association anticipates a change in the rate paid to account holders, it usually announces this change several months in advance. A saver who has funds in a savings and loan association is, therefore, fairly certain of getting a regular return for the use of his funds.

In regard to denomination considerations, a saver can usually open an account in a savings and loan association with any amount of money, can make future additions and withdrawals in any amount, and is not required to maintain a minimum balance in his account. An account in one of these institutions also is convenient for most savers. There are very few technical details involved in opening an account. The branch offices and save-by-mail programs which have been established by many associations make it convenient for savers to make additions to and withdrawals from their accounts. Except for checking accounts, many savings and loan associations offer services similar to those of commercial banks. In addition, an account in a savings association requires very little attention on the
part of the saver in managing this type of investment. An account of less than $10,000 in an association which is a member of the FSLIC requires virtually no attention on the part of a saver.

A savings association will return to the saver the funds he has placed with it, plus any earnings which have been credited to his account. Like other types of fixed-income investments which return to the investor the original number of dollars invested, an account in a savings and loan association does not provide the saver with the opportunity for capital appreciation of the principal amount he placed in the account; thus it is no hedge against inflation. The income received by account holders is fully taxable under the federal income tax laws. Such accounts are not attractive to the investor who is seeking an investment which is exempt from federal income taxes.

Considerations to Pension Trustees

An account in a savings and loan association may be an appropriate investment outlet when evaluated in terms of the objectives sought by many investors or savers. Such an account is, however, not a particularly desirable type of investment for noninsured corporate pension funds.
Pension trustees do not need to distinguish between principal appreciation and investment income. Most of the trustees surveyed expect continued inflation and many of them are under pressure to increase the productivity of pension fund portfolios. As a result, the types of investments which potentially offer greater opportunity for capital appreciation generally are more desirable to pension fund trustees.

The expected length of life of pension funds and their magnitude of net cash inflow, regularity of cash inflow, and predictability of cash needs reduce the need for pension trustees to hold liquid assets in pension fund portfolios. The liquidity of funds in an account in a savings and loan association is, therefore, not a significant attraction to pension trustees.

The investment productivity of a pension fund portfolio is of vital concern to pension trustees. As may be observed in Table 20, since 1954 the yield on long-term government bonds has been somewhat above the rate paid to savers by savings and loan associations. In practically every year during the period between 1954 and 1959, the long-term yield on corporate bonds of Aaa rating has been substantially above the yield on accounts in savings associations. In several years during this period, the rate on accounts in these institutions has
TABLE 20
AVERAGE ANNUAL YIELD ON SELECTED TYPES OF INVESTMENTS EACH YEAR, 1954 TO 1959

<table>
<thead>
<tr>
<th>Year</th>
<th>Savings and Loan Accounts</th>
<th>U.S. Government Securities</th>
<th>Corporate Stocks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>3 to 5 Year Issues</td>
<td>Long-Term Bonds</td>
</tr>
<tr>
<td>1954</td>
<td>2.9</td>
<td>1.82</td>
<td>2.70</td>
</tr>
<tr>
<td>1955</td>
<td>2.9</td>
<td>2.50</td>
<td>2.94</td>
</tr>
<tr>
<td>1956</td>
<td>3.0</td>
<td>3.12</td>
<td>3.08</td>
</tr>
<tr>
<td>1957</td>
<td>3.3</td>
<td>3.62</td>
<td>3.47</td>
</tr>
<tr>
<td>1958</td>
<td>3.5</td>
<td>2.90</td>
<td>3.43</td>
</tr>
<tr>
<td>1959</td>
<td>3.7</td>
<td>4.33</td>
<td>4.07</td>
</tr>
</tbody>
</table>

a Bonds maturing or callable in 10 years or more.

b Comprised from Moody's Investors Service.

c Computed on basis of dividend-price ratio by Standard and Poor's Corporation.

been less than the yield on three-to-five year government securities issues. The difference between the yield on accounts in savings and loan associations and the yield on the types of investments normally held in pension fund portfolios, including common stocks, corporate bonds, government securities, and preferred stocks, would not provide pension fund trustees with the incentive of opening accounts in these associations. While it is true that the yield differential on the various types of fixed-income investments may be, at least in part, the result of comparing investments of different maturities, it should again be noted that pension funds have minimal needs for liquidity and for investments of short-term maturities.

Most savings and loan associations pay a return to their account holders twice a year. This regularity of return, is, however, not an essential criterion in the selection of investments by pension fund trustees. In addition to the expected duration of pension funds, the magnitude and regularity of net cash inflows to these funds make regularity of income on pension fund investments of secondary importance.

As noted earlier an insured account, in a savings and loan association which is a member of the FSLIC, is insured up to $10,000. A pension fund trustee may open
one account, with a very large sum in one insured institution and, contrary to popular conception, have complete insurance coverage on the entire amount. This possibility is expressed in the provisions of Section 561.2 of the Rules and Regulations for Insurance of Accounts,¹ and was commented on by William C. Prather, counsel for the United States Savings and Loan League, who stated:

A pension trust or other trust having many beneficiaries may have one account with a very large sum in it, such as $1,000,000, and each beneficiary is protected to $10,000. If no beneficiary has an interest in excess of $10,000, there is complete insurance coverage. This is assuming that the pension or other trust or the association maintains customary records of the interests of each beneficiary.²

An account in an insured savings association would, therefore, afford trustees a high degree of safety. A pension fund trustee would, however, not want to invest large amounts in one insured association even though the institution would agree to accept large sums. This would be contrary to the usual practice of most pension fund trustees, who stress the need for diversification within


the various components of a pension fund portfolio. If a pension fund trustee placed part of the portfolio in insured accounts, he probably would prefer to diversify these accounts by placing funds in several different insured associations. This practice, if followed regularly, would entail a considerable amount of administrative details, expense and inconvenience on the part of the trustee. It is doubtful that pension trustees will expend such effort, particularly in view of the fact that they can invest large amounts in government obligations or high-grade corporate bonds with relatively less inconvenience and with little sacrifice of safety of principal.

Most pension fund trustees are likely to be reluctant toward opening savings accounts in savings and loan associations for several other reasons. The vast majority of pension trustees are employed by the trust departments of commercial banks or trust companies. These institutions have functional departments which are in direct competition with savings and loan associations. It would, therefore, seem highly improbable that the officials of commercial banks and trust companies would, in their capacity as pension trustees, be interested in placing large amounts of funds in savings and loan accounts. Then, too, bank trustees and non-bank pension trustees usually have
experience in forming judgments on the relative merits of securities as investment media. An account in a savings and loan association is neither a traditional investment outlet for pension trustees nor does it offer a startling challenge to make it attractive to them.

Considerations to Savings and Loan Associations

Despite the arguments against their placing funds in the accounts of savings and loan associations, some pension trustees may consider such accounts as appropriate investment media for pension fund portfolios. There are, however, several reasons why many savings associations would not accept such accounts.

Pension fund trustees who invest in accounts in savings and loan associations would probably want to place relatively large amounts in one account or in one institution due to the magnitude of cash inflow to a pension fund and the administrative difficulties involved in opening many accounts in different institutions. The minimal liquidity needs and long duration of pension funds would provide no definite assurance to a savings association that funds placed in an account in the institution would be of a permanent nature. This would, therefore, present a constant threat, real or imagined, that requests
from pension fund trustees to withdraw large sums may be received by an association at any time. Wholesale withdrawals could seriously affect the liquidity position of a savings and loan association by forcing it to liquidate its government obligations or borrow from a Federal Home Loan Bank.

Another consideration to savings and loan associations is that their operations may be affected by the real or psychological pressure, exerted by pension trustees, to maintain or increase the rate paid to account holders. In view of the paramount importance of increasing the productivity of pension fund portfolios, it is natural that pension trustees will be consistently on the alert to place funds in accounts in those savings associations where they will earn the highest rate of return and, if need be, to move those funds from one institution to another to take advantage of a higher rate. The distinctive characteristics of pension funds make it possible for a pension fund trustee to hold pension fund investments for a long-term period if he so desires. This does not, however, prevent trustees from increasing or decreasing various segments of pension fund portfolios in response to yield differentials on investment outlets. Whether a pension fund trustee would threaten to withdraw large sums of money from his account or accounts unless
the association increases its rate, or whether the trustee simply suggests that the association reappraise its rate policy, or whether he says nothing, the mere fact that there exists an instrumentality such as the trustee, who by his determination can quickly drain large sums of money from an association, presents a real potential danger to a savings and loan association.

Such pressure, actual or potential, direct or indirect, exerted on a savings and loan association for a higher rate on its accounts may, for example, tend to encourage it to assume additional risk in its mortgage loan portfolio. It may encourage the association to reduce its liquid assets in favor of higher yielding investments even though a savings association should have a higher liquidity ratio when it has a greater potential withdrawal demand. A savings and loan association could reduce the seriousness of these dangers by refusing to accept large accounts from any one trustee. This probably would, however, curtail the trustee's interest in opening an account in that association.

**Fixed Balance Accounts**

The laws of several states permit state-chartered savings and loan associations to pay a bonus to an account
holder who refrains from making withdrawals from his account for a certain period of time. For several years, leaders in the savings and loan industry have discussed whether or not federally chartered associations should be authorized to establish similar accounts.\(^3\) After considering many proposals, the Federal Home Loan Bank Board recently amended the Rules and Regulations for the Federal Savings and Loan System to permit federally chartered savings and loan associations to offer "fixed balance accounts."\(^4\)

A fixed balance account is a savings share account on which the association pays, in addition to the regular dividend, a bonus of \(\frac{1}{2}\) per cent per annum to the account holder.

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holder who establishes and maintains an account balance of $1,000, or a multiple of $1,000, continuously for a period of not less than 36 months. The holder earns the bonus after the expiration of the 36 months immediately following the date on which the fixed balance account is established but the bonus is not distributed to him until the next regular dividend date which follows the qualifying period. The bonus may be paid in cash or, at the discretion of the holder, it may be credited to another savings share account which he has established at the association. The bonus is not permitted to accumulate in his fixed balance account. Each holder of a fixed balance account is entitled to receive the regular base dividend earned on his account at the same time and at the same rate dividends are declared on all savings share accounts. These base dividends are to be distributed to him or credited to another savings share account which he may have established at the association. In no event are the dividends permitted to accumulate in his fixed balance account.

Considerations to Pension Trustees

Leaders in the savings and loan industry have suggested that the use of the fixed balance account
provides a means for savings and loan associations to attract investment funds not only from individuals but also from pension funds. While such an account may interest some individuals and other types of investors, it is extremely doubtful that a fixed balance account in a savings and loan association would be considered by trustees as an appropriate investment outlet for pension funds for the same reasons that were discussed above in connection with regular accounts. The fact that pension trustees have not placed larger amounts in fixed balance accounts in those state-chartered savings associations which have been permitted to offer such accounts is an indication of the disinterest of pension trustees in fixed balance accounts.

The only attraction that fixed balance accounts offer to pension trustees, which is not already offered by other savings share accounts, is that fixed balance accounts would pay a higher rate of return than is paid on other types of savings share accounts in savings and loan associations. This is not meant to imply that pension fund trustees are not interested in investments

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which pay a high rate of return. It means only that the bonus and the base rate of return paid on these accounts would have to be sufficiently high as to be comparable with other types of alternative investment media which the trustee may consider as desirable for a pension fund portfolio. It is doubtful that a bonus of $\frac{1}{2}$ per cent is sufficiently high to encourage pension trustees to invest large amounts in fixed balance accounts in savings associations.

**Considerations to Savings and Loan Associations**

There are several reasons why some savings and loan associations would consider fixed balance accounts as a desirable means for investors to invest in savings associations. The bonus paid on these accounts might provide sufficient incentive to investors who opened such accounts to minimize withdrawals, at least for some minimum period of time. This would tend to lessen the constant threat to savings and loan associations that requests to withdraw large sums would be received at any one time.

If the higher rate on a fixed balance account attracts investors, it could mean that an association would have to pay the higher rate on only a portion of
its savings accounts rather than raising the rate paid on all accounts. This would be cheaper to an association as the funds would be obtained at a lower average rate.

Another argument supporting the use of the fixed balance account by savings associations to attract investors is that supervisory authorities are sympathetic to such an arrangement. In this regard, Mr. Ira Dixon, member of the Federal Home Loan Bank Board, stated, "Summing up, I think it is correct to say that the Federal Home Loan Bank Board agrees with the principle of a bonus or variable dividend." Mr. Albert J. Robertson, former Chairman of the Federal Home Loan Bank Board, stated, "The Board has been sympathetic in its consideration of some type of incentive or bonus arrangement whereby the systematic saver and the long-term investor would receive larger dividend payments."

There are numerous arguments opposing the use of fixed balance accounts by savings and loan associations.

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7 Albert J. Robertson, "Four Years of Growth and Progress." An address at the 68th Annual Convention of the United States Savings and Loan League, Miami Beach, Florida, November 15, 1960, p. 13. ( Mimeographed).
Such accounts may appear complicated to the majority of their savings customers with the result that savings associations could lose a lot of business which they might otherwise obtain. Then, too, the use of a fixed balance account is a shift in emphasis away from the concept of simplicity of accounts which savings and loan associations have attempted to create in recent years.

If the bonus on a fixed balance account is attractive to investors, it also would be attractive to the present savings customers of savings and loan associations. This could result in the transfer of the type of accounts presently held by savers to fixed balance accounts. The transfer of accounts could result in numerous administrative difficulties in terms of customer education, accounting, and employee training necessary to counsel customers. The transfer of a large number of accounts and the acceptance of fixed balance accounts from new customers would increase the rate that an association pays for the use of funds.

Comparison of the average annual rate paid on savings accounts by savings and loan associations with the average annual yield earned on the assets held by these institutions, reveals that it would be difficult for many savings associations to pay the bonus on a large number of fixed balance accounts. As may be observed in
Table 21, the annual yield earned on the combined assets of all savings and loan associations during the year 1959 was 5.1 per cent while the average annual interest rate charged on mortgage loans, excluding mortgage loan closing costs, was 5.3 per cent. The average annual rate paid on savings accounts by savings associations during 1959 was 3.7 per cent. The spread between the average rate paid on savings accounts and the average annual interest rate charged on mortgage loans was 1.6 percentage points. It usually is suggested that a spread of 2 to 2-1/2 per cent between the rate paid on accounts and the interest rate charged on mortgage loans is necessary in the savings and loan business. It would, therefore, be difficult for many savings and loan associations to pay a high regular dividend rate and a bonus of 1/2 per cent on a large number of fixed balance accounts. Then, too, these institutions already have a large proportion of their assets invested in mortgages and it is doubtful, from an


### TABLE 21

**ANNUAL YIELD ON SELECTED ASSETS HELD BY SAVINGS AND LOAN ASSOCIATIONS, 1953 TO 1959**

<table>
<thead>
<tr>
<th>Year</th>
<th>Interest on Mortgage Loans</th>
<th>Interest and Loan Charges on Mortgage Loans</th>
<th>Income on Combined Earning Assets$^a$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953</td>
<td>4.9%</td>
<td>5.2%</td>
<td>4.5%</td>
</tr>
<tr>
<td>1954</td>
<td>4.9</td>
<td>5.3</td>
<td>4.6</td>
</tr>
<tr>
<td>1955</td>
<td>5.0</td>
<td>5.4</td>
<td>4.7</td>
</tr>
<tr>
<td>1956</td>
<td>5.0</td>
<td>5.4</td>
<td>4.8</td>
</tr>
<tr>
<td>1957</td>
<td>5.1</td>
<td>5.6</td>
<td>5.0</td>
</tr>
<tr>
<td>1958</td>
<td>5.2</td>
<td>5.7</td>
<td>5.0</td>
</tr>
<tr>
<td>1959</td>
<td>5.3</td>
<td>5.9</td>
<td>5.1</td>
</tr>
</tbody>
</table>

$^a$These assets include mortgage loans, other loans, U.S. Government Securities, time deposits in Federal Home Loan Banks, Federal Home Loan Bank stock, and real estate owned other than office buildings.

operational viewpoint, whether they would want to reduce their lower-yielding liquid assets to earn the additional income possible on increased mortgage investment.

Accepting fixed balance accounts from out-of-state investors may not be in the best interests of savings associations for another very good reason. Not only do savings and loan associations operate as inherently local or community institutions but most of them also operate as mutual organizations. The fact that they operate as local institutions and as mutual organizations is the probable explanation why savings and loan associations are allowed more liberal treatment under provisions of the Internal Revenue Code than is given most other types of corporations. It would, therefore, appear logical that any basic diversion or dilution of the character of their operations would invite change in the laws and regulations under which savings associations are taxed for purposes of federal corporate income taxes.

**Permanent Capital Stock**

As noted in Chapter II, all federally chartered savings and loan associations and most state-chartered associations operate as mutual organizations. Of 6,230 savings and loan associations in business as of
December 31, 1959, 5,764 were mutual companies and the remaining 466 operated as stock companies. Only those savings associations which operate as stock companies are permitted to issue permanent capital stock. At the end of 1959 the outstanding capital stock of stock savings and loan associations amounted to approximately $100 million.¹⁰ The 466 stock associations could sell permanent capital stock to pension fund trustees as a means of channeling pension funds to their institutions.

Considerations to Pension Trustees

Most of the 466 stock savings and loan associations would not give pension fund trustees the opportunity to purchase any amount of their permanent capital stock. Even if stock associations agreed to sell stock to pension trustees, the amount of stock offered for sale probably would be so small that it would not be of significant interest to pension trustees, who have the problem of investing large amounts of funds at one time. Then too, some trust agreements prohibit pension trustees from investing in securities, such as the permanent capital stock of stock savings and loan associations, which are not sold on an organized stock exchange. Although many pension fund trustees invest large amounts in common

¹⁰ United States Savings and Loan League, op. cit., p. 88.
stocks, it is not likely that they will invest any substantial amount in the permanent capital stock of the savings and loan associations which operate as stock companies.

**Considerations to Savings and Loan Associations**

Most savings and loan associations are mutual organizations and, therefore, cannot sell permanent capital stock to pension fund trustees. Savings and loan associations which operate as stock companies probably would not want to sell permanent capital stock to pension fund trustees. The holders of the outstanding capital stock of a stock association are the owners of the association and have the right to vote. The stock of practically all stock associations is owned by a very limited number of stockholders who usually live within the locality of the association. Since a stock association usually has a relatively small amount of capital stock outstanding, the sale of additional voting stock would jeopardize the present stockholders' control of the association.

The sale of large amounts of permanent capital stock by a number of savings and loan associations to a pension
fund trustee may be in violation of the Savings and Loan Holding Company Act. According to this Act, the FSLIC would deny insurance coverage to the stock savings associations which sold stock to a holding company if the sale of such stock resulted in the holding company's acquiring control of more than one savings and loan association.

This Act defines a holding company as a company that owns or votes 10 per cent or more of the permanent stock of a stock savings and loan association.

The sale of permanent capital stock on a nationwide basis by stock savings and loan associations to pension fund trustees may be looked upon unfavorably by legislators, as indicated by the remarks of Representative Spence, Chairman of the House Banking and Currency Committee, who stated:

The strength of savings and loan associations, and the high regard they have acquired, is derived from their local management, local responsibility and local operation. The men who manage these institutions must be familiar with their community needs and maintain a civic responsibility. They must continue to think about what is good for the community and for the home owning families, rather than think merely of possible profit involved. We can

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hardly expect a company owned by people thousands of miles from a community to concern itself with the social and economic objectives of the community.\textsuperscript{12}

**Insured Accounts Fund, Inc.**

Insured Accounts Fund, Inc., was incorporated on March 25, 1958 under the laws of Massachusetts and is registered as an open-end management type diversified investment company under the Investment Company Act of 1940. It began the public sale of its securities immediately after a registration statement covering the Fund's securities, filed with the United States Securities and Exchange Commission, became effective on September 17, 1958.

According to its prospectus, Insured Accounts Fund, Inc. "is specifically designed to meet the requirements of investors seeking a high degree of safety and freedom from fluctuation in the value of their investments."\textsuperscript{13} In order to achieve this purpose, at least 80 per cent of the Fund's assets are invested in withdrawable accounts in savings and loan associations which are members of the FSLIC and the remainder of its assets are held in cash or


\textsuperscript{13} Insured Accounts Fund, Inc., *Prospectus*, February 1, 1960, p. 3.
short-term federal government obligations. The charter and bylaws of the Fund require that all its investments in the accounts of savings and loan associations be fully insured by the FSLIC. The Fund may not invest more than 5 per cent of the value of its assets in the accounts or securities of any one association or issuer, other than the federal government. The Fund seeks geographical dispersion and good management in those savings and loan associations selected for investment by the Fund "rather than the maximum return, and for that reason the highest rate will not be earned on all its investments." 

The present authorized capital stock of the Fund consists of 20,000 shares of common stock, each of $1 par value. Each shareholder is entitled to one vote for each share of stock held. Shares are fully paid when issued and redeemable. They are "freely transferable, subject to no assessments, have no pre-emptive, subscription or conversion rights, and in liquidation share pro rata in the assets of the Fund." 

Unlike the practice followed by most other open-end investment companies, an investor who buys shares of

14 Ibid., p. 8.
15 Ibid., p. 4.
Insured Accounts Fund, Inc. pays no "loading" or "selling charge" for these shares. The price paid by an investor for each share of the Fund's common stock originally was established at $5,000 per share and it is expected to remain at that figure. Accumulated net income of the Fund is excluded from the computation of the public offering price of the Fund's shares, which is otherwise based on net asset value. The net asset value per share of the Fund's common stock is expected to remain substantially constant since most of the Fund's investments are in insured accounts in savings and loan associations and the balance of its investments are in short-term federal government obligations. If the difference between the net asset value per share, exclusive of accumulated net income and the public offering price of each share should, however, "at any time amount to more than 1/10 of 1 per cent of the public offering price, this price will be adjusted and maintained so that it does not differ by more than 1/10 of 1 per cent from the net asset value" per share.16

The Fund's shares are distributed by a sales organization called Insured Accounts Fund Distributors, Inc. The cost of selling the shares is borne by Home Loan

16Loc. cit.
Associates, a non-profit trade association, the purpose of which is generally to promote insured savings and loan associations. As of December 31, 1959, Home Loan Associates had as members approximately 480 insured savings and loan associations located throughout the country. This organization pays the distributor of the Fund's shares a commission of 2/10 of 1 per cent of the net asset value of all shares sold by it. Home Loan Associates also provides statistical and office facilities to Insured Accounts Fund, Inc. without charge and, in addition, pays that portion of the Fund's expenses which are in excess of an amount "equal semi-annually to 1/10 of 1 per cent of the average of the public offering price of all the Fund's shares outstanding as of the last day of each of the preceding six months." 

Home Loan Associates' income is derived from dues paid to it by its members. Annual dues are paid by every member association at a rate of $5 per $1 million of assets held, with a minimum of $15 and a maximum of $150. Members also pay investment dues based on the amount invested with the members by the Fund.

Insured Accounts Fund, Inc. is managed by its officers and directors. Home Loan Associates has no

17Ibid., p. 8.

18Loc. cit.
control over the Fund's policies or operations and provides no investment advisory services to it. Old Colony Trust Company of Boston, Massachusetts acts as custodian, dividend disbursing agent, and transfer agent for the Fund. Old Colony Trust Company does not supervise the management of the Fund in such matters as portfolio investments or the payment of dividends.

As of January 31, 1960, 39 shares of the Fund's common stock were outstanding. The following persons or organizations owned, of record and beneficially, the following amounts of such stock:¹⁹

United States Savings and Loan League 10 shares  
The Savings and Loan Foundation, Inc. 10 shares  
Trustees of Benj. Franklin Federal Savings and Loan Association Retirement Plan 7 shares  
Ben H. Hazen 3 shares  
Home Loan Associates 3 shares  
Helen Wolfe Back 2 shares

The Fund is qualified as a "regulated investment company" under the Internal Revenue Code. It pays substantially all of its net income to its shareholders as dividends. In conformity with the practices followed by most savings associations, dividends on the Fund's outstanding shares are paid according to the number of months they have been outstanding since dividends were

¹⁹Ibid., p. 4.
last paid by the Fund. Most savings and loan associations pay dividends semi-annually at the end of June and December. Since the Fund receives the bulk of its income in January and July it pays semi-annual dividends on its shares in these months. Shares of the Fund which are issued on or before the fifth of a month are deemed to have been outstanding as of the first of that month and the shares participate in the Fund's earnings received since the last dividend payment date, proportionally to the number of full months they have been outstanding since the beginning of the last month in which a dividend was paid by the Fund.

A shareholder of the Fund may, at any time, redeem his shares by surrenderring his share certificate to the Fund. According to the Prospectus for the Fund:

Payment for redeemed shares will be made as soon as reasonably practicable after deposit of properly endorsed certificates and must be made within seven days thereafter, except that the right of redemption may be suspended for any period during which the New York Stock Exchange is closed, or during emergencies, such as deferment of withdrawals by savings and loan associations under applicable federal or state law or regulations.20

Shares are redeemed at the then-current public offering price, plus a termination payment and less a redemption

20 Ibid., p. 8.
charge, if applicable. The termination payment in lieu of dividends is paid on shares redeemed between dividend dates and consists of a part, proportionate to the number of months since the last dividend date the share has been outstanding, of the net income per share received by the Fund since the last dividend date. The Fund may impose a redemption charge, equal to not more than 1 per cent of the then-current offering price, on shares redeemed within two years of their purchase from the Fund. This redemption charge, which is not currently in effect, may however, be "imposed only upon shares purchased after notice thereof has been provided in the Fund's then-current prospectus." 21

Considerations to Pension Trustees

Several leaders in the savings and loan industry have suggested that the common stock of Insured Accounts Fund, Inc. offers an attractive investment outlet to large investors and it may be of particular interest to pension fund trustees. 22 There is a high degree of

21 Loc. cit.

safety of principal afforded to investors who buy the shares of Insured Accounts Fund, Inc. While the Fund's shares are not directly insured, all of its assets are either insured by the FSLIC or are in government obligations or cash. This does not provide any additional incentive to a pension trustee to buy the Fund's shares since he could, according to the General Counsel of the United States Savings and Loan League, invest any amount in a multiple-beneficiary account in one savings and loan association and obtain complete insurance coverage by the FSLIC.23

Investment by pension fund trustees in the Fund's shares would reduce the administrative details and inconvenience associated with distributing large sums of money among numerous accounts in many different savings and loan associations. It should, however, be noted that other types of investment media, such as government obligations and corporate bonds, also provide pension fund trustees with the opportunity of investing large amounts with relatively little inconvenience or administrative details. The acquisition of the Fund's shares by a pension fund trustee would provide him with a security which is free from fluctuation in value, but

23 See page 196 above.
as has been pointed out before, this is not particularly significant to a pension fund trustee.

The major assets of Insured Accounts Fund, Inc. are withdrawable accounts in savings and loan associations. More than 80 per cent of its assets were invested in these accounts during the entire period between the Fund's creation and January 31, 1960.24 Although the Fund was fully invested according to its charter and virtually the entire net income of the Fund was distributed as dividends to its shareholders, the annual dividend yield for each outstanding share was 3.14 per cent for the year ended July 31, 1959 and 3.00 per cent for the six months ended January 31, 1960.25 It is difficult to determine how the Fund could ever pay a much higher yield to its shareholders unless the rate paid on accounts in savings associations is increased substantially. The potentially low yield on the common stock of Insured Accounts Fund, Inc. presents another very strong argument why the Fund's shares are not likely to be considered an attractive investment outlet by pension trustees. The present disinterest of pension

25Ibid., p. 5.
fund trustees in the shares of the Fund is indicated by the fact that the only trustees who hold any of these shares are the trustees of the Benj. Franklin Federal Savings and Loan Association Retirement Plan. Ben H. Hazen, the President and a member of the Board of Directors of Insured Accounts Fund, Inc., is also Chairman of the Executive Committee of Benj. Franklin Federal Savings and Loan Association of Portland, Oregon.

Considerations to Savings and Loan Associations

Many savings and loan associations would like Insured Accounts Fund, Inc. to hold accounts in their institutions. Except for the annual membership dues and the investment dues which they are required to pay, savings associations probably have no basic arguments against the sale of the Fund's shares to pension trustees and the investment by the Fund in savings and loan associations.

Sale of Mortgages

Mortgage loans constitute the most important type of investment of savings and loan associations. The laws of most states and federal rules and regulations authorize savings and loan associations to sell any loan at any time if the total dollar amount of loans sold

26 See page 217 above.
during the calendar year, including such sale, does not exceed 20 per cent of all loans held by the association at the beginning of such calendar year. All loans sold must, however, be sold without recourse and on a basis to provide sufficient compensation to the association to reimburse it for expenses incurred in servicing the loan. A savings and loan association legally may elect to sell its mortgage loans to pension fund trustees.

Considerations to Pension Trustees

The survey of pension funds by the United States Securities and Exchange Commission indicates that only slightly more than 2 per cent of all pension fund assets were invested in mortgages at the end of 1959. There are many reasons why pension trustees have not acquired a larger amount of real estate mortgages for the portfolios of pension funds.


One of the desirable features of real estate mortgages to many types of investors is the contractual amortization of principal which provides a steady return flow of funds. This provides a degree of liquidity to an investor's portfolio and also makes available new money for investment under varying conditions. The return flow of mortgage amortization payments is not particularly significant to a pension fund trustee, who has little worry concerning a pension fund's liquidity position. In fact, heavy receipts from mortgage amortization payments combined with the receipt of current contributions to a pension fund could aggravate the trustee's problem of investing a large amount of funds at any one time.

Another reason why pension fund trustees are reluctant to invest in home mortgages is that these trustees are oriented to corporate securities and are not inclined to change their ways. Many pension trustees argue that they prefer to invest in other investment media such as corporate securities where the investment is evidenced by one piece of paper. Added to this preference for other types of investments is the fact that many pension fund trustees lack the personnel who are
experienced in mortgage investing. James W. Rouse, a mortgage banker stated:

Pension funds, for the most part, are administered by people without previous experience in mortgage financing. The administrators have been drawn almost entirely from the investment field. It is simpler to invest in stocks and bonds than in mortgages.29

Institutional lenders that grant real estate mortgage loans usually build up some kind of a mortgage loss reserve. As noted earlier, federal income tax regulations do not allow a "qualified pension trust" to accumulate reserves for losses on any type of investment. The inability to accumulate a loss reserve has an adverse effect on the appropriateness of real estate mortgages as investment outlets for pension fund trustees.

Under the terms of a particular pension trust indenture, a pension trustee may not be authorized to purchase mortgages for that pension fund portfolio. Even though a trustee legally may be authorized by the trust instrument to acquire mortgages, other legal considerations may complicate the investment of pension fund portfolios in mortgages. The purchase of real estate

29 Paul L. Howell, "Mortgage Loans Can Be Sold to Pension Funds and the Industry Will Have to Do the Selling," The Mortgage Banker, March, 1961, p. 27.
mortgages in a state by a pension fund trustee domiciled in another state may, for example, be considered as transactions which are intrastate in nature or which are often times referred to as "doing business." There is considerable diversity of treatment among the states as to whether or not the activities involved in negotiating, acquiring, servicing, enforcing and foreclosing upon mortgages on real estate constitute "doing business." The difficulties involved in determining what constitutes "doing business," the requirements necessary for qualification as a foreign corporation, and the penalties for non-compliance operate as a potent deterrent to out-of-state mortgage investment by corporate pension fund trustees.

The main attraction of mortgage investment to pension fund trustees occurs during periods when the rate of return on mortgages is relatively favorable as compared to that earned on other fixed-income investments. Some pension fund trustees argue, however, that in order to acquire substantial amounts of mortgages during such periods, they are forced to invest to some extent on an advance commitment and on a fairly continuous basis in other periods when the yield spread between mortgages and
corporate bonds is unfavorable to mortgage investment. Then too, pension fund trustees argue that other types of investment media can be handled with a relatively small staff while a large and competent administrative organization is necessary to manage a mortgage loan portfolio. They argue that mortgage investment would entail considerable expense due to (1) high supervisory costs of handling a large number of small mortgages, (2) delinquencies and foreclosures, (3) legal costs involved in the ownership of real estate, and (4) the costs of maintaining elaborate records. As a consequence, these expenses reduce the gross yield on mortgages so that the yield differential between mortgages and high grade corporate bonds, which require less attention and are easily bought and sold, is relatively small. The net yield on mortgages, as one pension trustee notes, "does not exert a sufficiently strong pull to overcome a certain reluctance to enter the mortgage field."

Contributing to this reluctance of pension trustees to acquire mortgages is a "long-standing prejudice against mortgages on the part of some pension trustees."

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Another consideration which has discouraged pension trustees from buying mortgages is that foreclosure action taken by a trustee on behalf of his corporate client might result in harmful publicity to the client, even though the latter may be several steps removed from the actual event. The unfavorable public relations of foreclosure might, for example, be damaging to a corporation which offers a highly advertised consumer product.

Despite the many arguments advanced by many pension fund trustees against the acquisition of mortgages, some pension fund trustees consider real estate mortgages as appropriate investment media for pension fund portfolios. This does not, however, mean that pension fund trustees, who are convinced of the suitability of mortgage investments, will necessarily acquire a sizable volume of home mortgages from savings and loan associations. On the contrary, it seems likely that mortgage loans would be purchased from other mortgage lenders, notably mortgage bankers and commercial banks.

The real estate mortgage departments of commercial banks sell some mortgages to other institutions. Since the vast majority of pension funds are bank-administered, it would seem probable that if bank trustees acquired sizable amounts of mortgages for pension fund portfolios,
they would first attempt to purchase such mortgages from their own bank's real estate department or from the mortgage departments of other banks before they acquired mortgages from a competing institution, such as savings and loan associations.

Unlike savings and loan associations, which historically have originated mortgage loans with the intention of holding them in their own portfolios, the principal activities of mortgage bankers have been to originate mortgages expressly for sale to other institutions and to service these mortgages for the institutional investor. As institutions specializing in the sale and service of mortgages, mortgage bankers have developed the knowledge, experience, and techniques required for the sale and servicing of mortgages to pension fund trustees. They have concentrated their activities in FHA and VA home mortgage loans which are the types of mortgages that most pension fund trustees have acquired. Mortgage bankers also have been fairly active in their attempts to interest pension fund trustees in mortgage investment and, in some cases, have established close and continuing contacts with them.
Considerations to Savings and Loan Associations

The outright sale of mortgage loans to interested pension fund trustees would enable a saving and loan association to secure loanable funds at a particular time when the demand for loans exceeded its available volume of investment funds. There are, however, several reasons why the sale of mortgages to pension fund trustees would not be in the best interests of savings and loan associations.

A savings and loan association that desires to sell mortgages to a pension fund trustee, during the periods when the demand for home mortgage loans exceeds its supply of loanable funds, may be forced to sell its mortgages to that trustee at other times when it would prefer not to make such a sale. A pension fund trustee would probably offer considerable sales resistance if he can purchase mortgages from a savings association only when the latter was short of funds. A savings and loan association which refused to sell its mortgages on a continuous basis may, therefore, incur the risk of severing relationships with a pension fund trustee.

Savings and loan associations usually restrict their lending to their own communities and hold the loans they
have originated in their own portfolios. According to Lawrence V. Conway, "This local aspect has been a great selling point to many prospective borrowers." In this regard, Henry A. Bubb, a savings and loan leader, stated:

We think that the homeowner finds it very advantageous to have his credit dealings with local people. He is likely to find there a greater understanding of the family's needs; and certainly in times of economic difficulty the borrower is in a much better position to receive leniency than if his mortgage is held or controlled by an absentee owner.

The fact that mortgage loans sold by a savings and loan association to a pension fund trustee are completely controlled by the latter, may, therefore, have an adverse effect upon the demand from prospective borrowers for the mortgages originated by savings and loan associations. The sale of mortgages to an absentee owner also may be considered to be in violation of the "local, mutual character" of savings and loan associations and may invite changes in the provisions of the Internal Revenue Code under which these institutions are taxed for purposes of federal corporate income tax.

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32 Conway, op. cit., p. 651.

The sale of mortgage loans to pension fund trustees may limit the freedom of operations of a savings and loan association in other ways. As noted earlier, the conventional type of mortgage loan is by a wide margin the predominant type of loan granted by savings and loan associations. Pension fund trustees who have acquired mortgages have limited themselves mainly to FHA and VA mortgage loans. A savings and loan association interested in selling substantial amounts of mortgages to pension fund trustees may, therefore, be somewhat compelled to grant relatively more FHA and VA loans and relatively fewer conventional loans. The association also must adapt itself to the desires of the pension fund trustee in terms of the loan documents required, reports to be furnished, property inspection, general accounting procedures, and procedures to be followed in the event of delinquency or default.

**Mortgage Loan Participations**

For several years the rules and regulations for the federal savings and loan system provided that a federally chartered savings and loan association could participate with another lender in making loans of any type that the association could otherwise make, provided that the participating lending institution was either an
instrumentality of the United States government or was insured by the FSLIC or the FDIC. Recent action by the Federal Home Loan Bank Board has liberalized these regulations. The new regulation, which became effective on March 1, 1961, permits all federally chartered savings and loan associations and all state-chartered associations that are insured by the FSLIC, and which have the necessary authority under state law, to sell a participating interest in a mortgage loan to any purchaser which is not insured by the FSLIC or the FDIC but which is exempt from federal income taxation under section 501 of the Internal Revenue Code. Since qualified pension trusts are exempt from taxation under this section of the Code, all federally chartered savings and loan associations may, therefore, elect to sell a partial ownership interest in a conventional mortgage loan to pension funds. State-chartered savings and loan associations which are members of the FSLIC may sell participation loans to pension fund trustees provided the associations have the legal power to do so under their own state statutes and regulations.

Under federal rules and regulations, a savings and loan association which is a member of the FSLIC may sell up to a maximum of 75 per cent of the interest of any loan. Insured associations which have state charters
are governed by state laws and regulations as to the maximum percentage interest which may be sold.

Considerations to Pension Trustees

In an announcement praising the recent liberalization of the participation loan program by the Federal Home Loan Bank Board, Mr. C. Elwood Knapp, President of the United States Savings and Loan League, suggested that industrial pension funds are probably ready to invest funds now in conventional loan participations. According to Mr. Knapp, "Pension funds are in need of investment diversification with safety and higher yields, and there is nothing in the entire investment field that compares in safety and yield with participation interests in home mortgage loans made by federally insured and supervised savings associations." 34

Although most savings and loan associations now have the authority to sell participating interests in conventional mortgage loans to pension fund trustees, it is extremely doubtful that pension fund trustees will purchase a significant volume of such loans because of essentially the same reasons that they are reluctant

to invest in the outright purchase of mortgages. A reasonable degree of safety of principal is an important investment criterion to pension fund trustees, and most of them undoubtedly would consider participation with savings and loan associations in conventional home mortgages a safe investment. Pension fund trustees can, however, acquire high-grade corporate bonds with very little sacrifice of safety of principal. Then too, because of the distinctive characteristics which influence pension fund investment policy, a pension fund trustee is not forced to select investments which have the relatively high degree of safety that may be required by many other types of investors.

In contrast to the legal restrictions which limit the types of investments in which savings and loan associations are authorized to invest, there are practically no formal statutory investment restrictions imposed upon pension fund trustees. They can, if they so desire, obtain wide investment diversification in pension fund portfolios without resorting to the purchase of participation loans from savings and loan associations.

Participation loans theoretically are attractive to pension fund trustees because of their relatively high rate of return compared to other types of investments. Pension fund trustees can, however, invest in common
stocks which offer a potentially higher yield than do participation loans. Compared to participation loans, common stocks also offer a greater opportunity for capital appreciation and provide a hedge against inflation.

Investing large amounts at any one time in participation loans would require considerably more time, effort, and expense on the part of a pension fund trustee than would the investment of similar amounts in corporate securities. Then, too, many pension fund trustees do not have the specialized staff or facilities which they believe are necessary to manage and maintain a pension fund portfolio which contains participation loans.

There are several other reasons why pension trustees may be reluctant to acquire participation loans from savings and loan associations. The steady inflow of monthly repayments of principal and the possibility of heavy receipts from principal prepayments complicate the trustee's problem of investing large sums at one time. The inability of trustees to accumulate an investment loss reserve makes the purchase of participation loans less attractive as an investment media. The lack of marketability of participation loans also would make it virtually impossible for a pension fund
trustee to liquidate his ownership interest in such loans. Some pension trust agreements may prohibit pension fund trustees from buying participation loans from savings and loan associations. Then, too, the numerous legal problems involved in any joint ownership transaction and the legal problems connected with the ownership of real estate by an out-of-state pension trustee complicate the investment of pension funds in participation loans.

Considerations to Savings and Loan Associations

The sale of participation loans to pension fund trustees would increase the capacity of a savings and loan association to make additional home mortgage loans during the periods when the demand for such loans exceeded the association's available volume of loanable funds. The sale of participation loans to pension fund trustees would offer an association a means for increasing its gross income through the collection of servicing fees associated with the mortgages it has originated and sold.

Another argument in favor of the sale of participation loans by savings and loan associations to pension fund trustees is that many executives of savings
associations are in accord with such a program. Many savings associations have sold participation loans to other savings and loan associations under the regulations which permitted them to purchase and sell such loans to each other. The executives of these associations have, therefore, acquired knowledge and experience as to the general procedures and details which would be involved in the sale of participation loans to pension fund trustees.

The favorable attitude of many savings association executives toward the participation loan program also may be due in part to the influence of the United States Savings and Loan League. This trade association has in several ways encouraged the expanded use of the participation loan program by savings associations. It maintains a clearing house of information on the names of savings associations that have advised it of an interest in either buying or selling participation loans and it provides this information to an association interested in loan participations. The United States Savings and Loan League has drafted illustrative forms which contain the basic provisions that should be included in a participation loan agreement. This trade association has developed a list of the basic
procedural steps involved in loan participations. It also has been instrumental "in seeking Federal Home Loan Bank Board approval to permit savings associations to sell participation loans to pension funds," according to W. O. DuVall, former President of the United States Savings and Loan League. 35

The desire of savings and loan associations to sell participation loans to pension fund trustees also may be strengthened by the attitude of the federal savings and loan supervisory authorities. The fact that these authorities are in accord with such an arrangement is, perhaps, best evidenced by the Federal Home Loan Bank Board's recent amendment of the Rules and Regulations for the Insurance of Accounts to permit insured savings and loan associations to sell participation loans to pension funds.

There are, however, arguments against the sale of participation loans by savings and loan associations to pension trustees. The task of locating pension fund trustees who are interested in such loans probably will require the expenditure of considerable amounts of time, effort and expense on the part of savings associations.

35"Pension Funds Eyes as New Mortgage Market," Burroughs Clearing House, July, 1960, p. 3.
In order to maintain a permanent relationship with a pension fund trustee, a savings and loan association may be forced to sell him participation loans during periods when the association has an excess of loanable funds. The sale of participation loans by savings associations, which operate principally as local institutions, to pension trustees located in other regions of the country does not contribute to the preservation of the local character of these associations.

**Collateral Trust Notes**

A plan was devised, and presently is used, by the mutual savings banks of the State of New York to provide a procedure by which pension funds could be invested in mutual savings banks. This plan could be adopted by savings and loan associations as a method to channel the accumulations of pension funds to savings and loan associations.

Under the plan originated by the New York mutual savings banks, an organization called Instlcorp, Inc. was incorporated in 1957 under the laws of the state of New York. All of the capital stock of this corporation is held by Institutional Securities Corporation which, in turn, is wholly owned by the mutual savings banks of
the state of New York. Instlcorp, Inc. is authorized to issue collateral trust notes, which are secured by a pledge of specific mortgages, to "pension funds under administration by a bank or trust company organized under the laws of the state of New York, or a national bank having its principal place of business in the state of New York."\(^{36}\)

A collateral trust note issued by Instlcorp, Inc. is an agreement to pay to the holder on the fifteenth day of each month a pro rata share of all principal repayments and interest received from the pledged mortgages, after deducting management fees, servicing agent fees, and trustee fees and expenses, as set forth in the trust indenture. The maturity of a collateral trust note is a date subsequent, usually six months, to the longest maturity of the related mortgages which are pledged as security for the note. The collateral trust notes are transferable. They are issued in separate series and in denominations as requested. No interest rate is specified on the collateral trust notes so that their investment yield is directly related to the yield returned by the specific mortgages which

are pledged as security. The notes are sold to the purchaser at the price that is paid for the related mortgages, plus a mortgage acquisition fee of 1/2 per cent to defray acquisition costs. These costs include opinions of counsel in regard to "doing business" in a state, property inspections, legal examination of mortgage documents, and other miscellaneous expenses. Prior to the acquisition of the mortgages and prior to the issuance of collateral trust notes to a pension fund trustee, Instlcorp, Inc. obtains a commitment from the trustee as to the amount of funds he wants to invest in its collateral trust notes. Instlcorp, Inc. then takes the necessary steps to acquire that particular amount of mortgages. In this regard, a pension fund trustee may specify standards as to the type and location of the properties securing the mortgages.

The activities involved in selecting and assembling the mortgages, inspecting the underlying properties, and examining the credit standing of the mortgagors are performed for Instlcorp, Inc. by Institutional Securities Corporation. Instlcorp, Inc. buys the mortgages outright from mutual savings banks, entering into an arrangement for the latter to do the servicing for which they are paid a servicing fee. Institutional
Securities Corporation supervises and periodically examines all mortgage originating institutions. The specific mortgages, which are pledged as the security for the collateral trust notes, are held in trust by Savings Bank Trust Company, which also is wholly owned by the mutual savings banks of the state of New York. The collateral trust notes, in effect, represent a beneficial interest in a specific group of mortgages.

Savings and loan associations could form an independent organization similar in nature and function to Instlcorp, Inc. This new organization presumably would purchase mortgages outright from various savings and loan associations and sell collateral trust notes, which are secured by the mortgages, to pension fund trustees.

**Consideration to Pension Trustees**

The purchase of collateral trust notes by pension fund trustees from an independent organization, formed by savings and loan associations, would enable these trustees to obtain the potentially high yield from investment in conventional mortgages without incurring many of the problems associated with mortgage portfolio management. Under such a plan, a pension fund trustee would be freed from the functions of (1) establishing
continuous relationships with separate mortgage originating and servicing savings and loan associations, (2) setting up property inspection and acquisition procedures, (3) foreclosing in his own name, and (4) developing a staff organization to handle the administrative tasks inherent in the management of a mortgage portfolio.

The mortgages, which are pledged as security for the collateral trust notes, would be owned by an independent organization and not by pension fund trustees. The purchase of these collateral trust notes by pension trustees would permit them to invest indirectly in mortgages which are originated by an out-of-state savings and loan association, without being involved directly in the legal complexities of "doing business" in that state. The purchase of collateral trust notes would, in effect, give pension fund trustees geographical dispersion of mortgage investment without the need to acquire mortgages from originating institutions located in different areas of the country.

Pension fund trustees could invest large amounts in collateral trust notes quickly and with relatively little inconvenience. Then, too, pension trustees may prefer to invest in collateral trust notes rather than to invest
directly in mortgages since the former gives them the advantage of buying one piece of paper, which is similar in many respects to that with which they are most likely to be familiar.

The extent to which pension fund trustees would invest in these collateral trust notes would depend largely upon whether or not (1) the net yield on such notes is higher than can be earned by pension trustees on other types of fixed-income investments; (2) the pension trust agreements authorize pension trustees to make such investments; (3) the problem of investing the steady receipts from amortization is regarded as serious by pension trustees; (4) the extent to which a pension fund trustee is willing to delegate the responsibility to other organizations for the investigation, selection and service of mortgages which are pledged as the security for the notes; and (5) the degree to which a pension fund trustee is willing to sacrifice the opportunity for capital appreciation and maintenance of purchasing power which potentially are obtainable from common stock investment.
Considerations to Savings and Loan Associations

This arrangement, by which savings and loan associations would sell mortgages to an independent organization which, in turn, would sell collateral trust notes to pension fund trustees, would seem to overcome some of the objections that pension fund trustees have to (1) the outright purchase of mortgages from savings and loan associations and (2) the joint ownership of mortgages with these institutions. Under this plan, the mortgages sold by a savings and loan association would be acquired by an organization that is likely to be sympathetic to the managerial procedures which normally are followed by that association in servicing a mortgage loan. Then, too, a savings and loan association would not need to establish and maintain relationships with pension fund trustees. The association would not, therefore, be forced to sell its mortgages at times when its supply of loanable funds exceeded the demand of borrowers for home mortgage loans. Furthermore, the sale of mortgages to an out-of-state institution, even though it is owned by savings and loan associations, may be considered to be in violation of the local character of savings and loan associations.
Term Loans

Savings and loan associations are authorized to borrow money from either the Federal Home Loan Bank or other sources. The amount which a federally chartered association may borrow from sources other than a Federal Home Loan Bank cannot exceed 10 per cent of its total savings accounts. Many state savings and loan codes simply provide that savings associations may borrow money in accordance with rules and regulations of the Federal Home Loan Bank System.37 Savings and loan associations are, therefore, legally authorized to borrow money from pension fund trustees upon such terms and conditions as may be required by both groups. The loan contract, under which such a loan would be made by a pension trustee to a savings and loan association, might be executed on the basis of a term loan contract, similar to those that are granted by commercial banks and life insurance companies to manufacturing concerns. In any event, the loan contract would have to specify the loan maturity, the rate of interest, the amount of the loan, the manner of repayment, whether lump sum or

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37 Lawrence V. Conway, Savings and Loan Principles (Chicago: American Savings and Loan Institute Press, 1960, p. 322.)
installments, the security required, if any, and the other provisions that may be required by the savings association or the pension trustee.

**Considerations to Pension Trustees**

Pension trustees probably would not be interested in making term loans to savings and loan associations. These loans would not provide the trustee with an opportunity for capital appreciation or the maintenance of purchasing power. They would not offer the potential yield that a pension trustee may obtain from common stocks. The provisions of pension trust agreements may prohibit many pension trustees from granting term loans. Establishing relationships with savings and loan associations that wanted to borrow funds would be time consuming and expensive. If a pension trustee grants a large number of term loans to savings associations and the loans are paid off in installments, he has the problem of reinvesting a relatively large number of small amounts. The FSLIC would provide no insurance coverage to the trustee on loans granted to savings associations. The trustee would incur administrative problems in allocating a term loan among the many different pension funds which he may administer. Term loans are not a
traditional investment outlet for pension trustees and
the latter are likely to be reluctant to grant such loans
to savings and loan associations. Another factor con­
tributing to this reluctance is that many pension
trustees are bank trustees and have, to some extent,
a negative attitude toward savings and loan associations.

Considerations to Savings
and Loan Associations

The extent to which savings and loan associations
would be interested in borrowing money from pension
fund trustees on a term loan contract would depend
largely upon the terms of the contract. It would appear,
however, that the interest rate that savings associations
would have to pay on such loans, in order to overcome the
reluctance of pension trustees to grant them term loans,
is likely to be substantially higher than savings and
loan associations would be willing to pay for borrowed
funds.
CHAPTER VI
SUMMARY AND CONCLUSIONS

Savings and loan associations and noninsured corporate pension funds are two types of financial intermediaries which have grown at a very rapid rate in recent years. Savings and loan leaders have suggested that savings associations can obtain funds from pension funds to finance additional homes.

Summary

This study was made to determine whether or not savings and loan associations are likely to obtain funds from noninsured corporate pension funds and whether or not savings associations offer an attractive investment outlet for pension funds. The specific objectives of this study were (1) to present the essential characteristics of savings and loan associations which are requisite to an evaluation of these institutions as investment outlets for pension funds, (2) to identify the basic features of pension plans and the investment practices of pension funds which are significant to an evaluation of their investment in savings associations, and (3) to evaluate
ways of channeling the accumulations of pension funds into savings and loan associations.

Nature of Savings and Loan Associations

The two principal objectives of savings and loan associations are to accumulate savings and to finance homes. The charter which authorizes these institutions to perform these functions is granted by either the Federal Home Loan Bank Board or a state supervisory authority. Savings and loan associations are formed either as mutual organizations or as permanent stock companies. Federal regulations require that all federally chartered associations be of the mutual type. Most of the states permit only mutual organizations but some authorize both mutual and permanent stock companies. Most of the state associations are of the mutual type.

Savings and loan associations operate principally as local institutions. Most of their savers live near the association, most of their loans are granted only on property which is located within a short distance of the institution, and the board of directors of these associations is comprised primarily of local people.

The bulk of the assets of savings associations is in the form of mortgage loans. These loans may differ in several ways, such as the purpose for which the loan was
granted, the presence or absence of insurance or guaranty provisions, the size of the loan, the interest rate, and the term or maturity of the loan.

Savings and loan associations obtain the bulk of their funds from mortgage loan repayments and savings customers. A saver may place his money in a savings association through one or more of three different types of accounts depending upon the particular association chosen. These include the savings share account, the deposit account, and the investment certificate. In practice, savings and loan associations pay withdrawal requests immediately upon demand, but they have a legal right to demand a written notice.

The income received by account holders is fully taxable under the federal income tax laws. Dividends or interest paid out by savings and loan associations or credited to the accounts of savers are considered as business expenses of savings associations for purposes of the federal corporate income taxes. The Internal Revenue Code also allows a savings and loan association, in determining the amount of taxable income, to deduct any amount it adds to reserves for future losses until the amount of such reserves, when added to its surplus, undivided profits, and other reserves, equals 12 per cent of the total deposits or withdrawable accounts of its depositors.
at the close of the year. As a result of the growing volume of savings and the liberal dividend payments, practically all savings and loan associations avoid the payment of federal corporate income taxes.

Most savings and loan associations are members of the Federal Home Loan Bank System. The major components of the System include the (1) Federal Home Loan Bank Board, (2) eleven regional Federal Home Loan Banks, and (3) the member institutions. All federally chartered savings and loan associations must be members. State-chartered associations may become members upon application and approval of the Federal Home Loan Bank Board.

The majority of savings and loan associations also are members of the Federal Savings and Loan Insurance Corporation (FSLIC). Membership in the FSLIC is mandatory for all federally chartered associations. State-chartered associations which qualify are eligible to become members. An amount held by an insured saver in an association, which is a member of the FSLIC, is insured up to but not exceeding $10,000. In the event of a default by any insured institution, settlement on each insured account is made by the FSLIC as soon as possible either (1) by cash payment or (2) by making available to each insured member a transferred account in a newly formed institution in the same
community or in another insured institution in an amount equal to the insured account of such insured member.

Practically every phase of the operations of a savings and loan association is covered by legislation or regulation whether it is a federal association or a state-chartered institution. These institutions are also closely supervised to determine the extent of compliance with laws and regulations, financial condition, integrity and accuracy of records, and the safety and efficiency of methods and procedures employed in the conduct of operations.

Nature of Noninsured Corporate Pension Plans

A noninsured corporate pension plan is one in which the contributions to provide pension benefits are deposited with a trustee, other than an insurance company. Certain basic provisions are common to most noninsured corporate pension plans. These include participation requirements, eligibility requirements, vesting provisions, benefit structure, source of contributions, method of financing, and pension plan administration.

Participation requirements refer to the qualifications which a new employee must fulfill in order to be covered by the plan. As soon as an employee is eligible to participate in a plan he (1) starts accruing pension benefits,
(2) starts accumulating credited service to be applied in vesting, early retirement, and other provisions, and (3) starts making contributions if the plan is contributory. Participation in a pension plan frequently is limited to those employees who meet certain requirements, which include (1) length of service, (2) age, (3) mode of compensation, and (4) level of compensation.

The actual receipt of retirement benefits by eligible employees is governed by the specific provisions of the pension plan which prescribe the requirements and conditions of normal retirement, deferred retirement, and termination of employment before normal retirement. The rights and eligibility requirements of those workers who terminate their employment before reaching normal retirement are governed by the provisions of the pension plan which relate to early retirement, death before retirement, and disability retirement.

Vesting provisions refer to the right of an employee to retain all or part of the employer's contributions made in his behalf should his employment be terminated before he becomes eligible for retirement benefits. Vesting never refers to the right of the worker to the return of any contributions he personally may have made. These contributions remain his property and the right to them is unquestioned.
The actual amount of pension income to be received by the employee who has fulfilled all the necessary requirements at normal retirement age is determined by the benefit formula provided in the plan. There are many types of benefit formulas written in noninsured pension plans but they can be broadly classified into two main categories: (1) those in which benefits are expressed as a rate of compensation, and (2) those in which benefits are stated as a fixed sum of money.

The cost of providing the pension benefits according to the terms of a pension plan may be borne entirely by the employer or jointly by the employer and the participants. Contributory plans require that part of the cost of the program be borne by employee contributions with the employer and pension fund earnings assuming the cost of the remaining portion. Under a noncontributory plan the employee is not required to make contributions to the cost of the program.

A pension plan which provides for the accumulation of a pension fund from which the future payment of pension benefits may be made is known as a funded plan. Plans which do not require the accumulation of a pension fund are described as unfunded plans. Various techniques are used to accumulate the fund required in a funded plan or to budget the money required to pay for the benefits.
provided in an unfunded pension plan. These techniques may be referred to as methods of financing. These methods fall into three general groups: cash disbursement, terminal funding, and advance funding.

The method of financing used in most pension plans is referred to as advance funding. This term is applied to any arrangement under which predetermined amounts intended for the payment of retirement benefits are set aside irrevocably in advance of the date of actual employee retirement. Virtually all pension plans which use the advance funding method set aside each year sufficient funds to meet the pension obligations created during that year, plus a portion of the past service pension liability.

The amount of contributions an employer must place in the pension fund to provide the benefits according to the provisions of the pension plan is based upon actuarial assumptions and computations. In determining this amount, the actuary gives consideration to such factors as (1) mortality of employees, (2) personnel turnovers, (3) expenses of operation, (4) age of retirement, (5) investment yield, (6) changes in rate of compensation, and (7) employee contributions.

The administration of a pension plan can be broadly divided into two major areas of responsibility: (1) administration of the plan and (2) administration of funding.
The scope of activity involved in the administration of the plan includes (1) developing, amending and enforcing rules and regulations for the operation of the plan; (2) interpreting the contractual provisions of the plan; (3) maintaining employee records; (4) providing such forms as may be needed in the plan: (5) processing applications; and (6) explaining the plan and options to employees. The administration of funding involves those activities which are related to the financial management of the fund which is created under the provisions of the pension plan. This area of responsibility includes (1) selecting the medium of funding, (2) adopting the method of financing, (3) selecting the actuary and other advisory assistance, (4) determining the amount of contributions, (5) investing the funds, and (6) distributing pension payments to retired workers.

Under the majority of pension plans, the over-all policies regarding the administration of both the plan and the fund are formulated by the employer or by a body created especially for this purpose. This body usually is referred to as the "pension committee." Many of the activities involved in the day-by-day administration of the plan and the fund are delegated to the pension trustee. Certain activities may, however, be assigned to a department within the employer's company.
Investments of Noninsured Corporate Pension Funds

There are many factors which exert a significant influence on pension fund investment policy. These include (1) the nature of pension fund obligations, (2) the lack of necessity to distinguish between principal and investment income, (3) the threat of continued inflation, (4) the pressure on pension trustees to increase pension benefits or reduce costs, (5) the expected long life of pension funds, (6) the magnitude of net cash inflow to pension funds, (7) the regularity of inflow, (8) the predictability of a pension fund's cash needs, (9) the influence of accounting practices, (10) the exemption of pension funds from federal income taxation, (11) the size of pension funds, (12) the nature of the pension trust agreement, (13) the absence of statutory investment restrictions, (14) the type of trustee appointed, and (15) the investment attitude of the trustee.

As a result of these factors, it is not essential that pension fund trustees select investments which (1) are free from fluctuation in value, (2) offer a high degree of liquidity, (3) provide certainty or regularity of income, or (4) are exempt from federal income taxes. The types of investments that are most attractive to pension trustees are those that offer attractive return possibilities, whether through yield or capital appreciation; maintain the
purchasing power of some of the funds invested; provide an opportunity to invest large amounts; are fairly marketable; can be made with relatively little inconvenience or administrative details; are relatively safe; are considered to be traditional investments for pension trustees; and, if they have maturity dates, mature at different times.

**Pension Fund Investment in Savings and Loan Associations**

Several methods could be used for the purpose of channeling the accumulations of pension funds into savings and loan associations. Pension fund trustees could invest in savings and loan associations by (1) placing funds in one of the types of savings accounts; (2) buying the permanent capital stock of stock savings and loan associations; (3) acquiring the shares of Insured Accounts Fund, Inc., which, in turn, would place funds in accounts in savings associations; (4) purchasing mortgage loans from savings and loan associations; (5) participating with savings associations in the joint ownership of mortgage loans; (6) buying collateral trust notes from an organization owned by savings and loan associations, and (7) granting term loans to savings associations.

**Conclusions**

Accounts in savings and loan associations are not particularly desirable investment media for pension fund
trustees. Such accounts do not provide them with an opportunity for capital appreciation or the maintenance of purchasing power. Trustees can earn more on the type of investments presently held than they can earn on funds in accounts in savings associations. Neither the regularity of return nor the liquidity offered by such accounts is significant to trustees. Placing funds in several different insured associations, in order to obtain diversification, would entail a considerable amount of administrative details, expense and inconvenience on the part of the trustee. Savings and loan associations are competitors of commercial banks and bank trustees are likely to be reluctant toward placing funds in savings and loan accounts. An account in a savings association is not a traditional investment outlet for pension trustees, who usually select securities as investment media.

Savings and loan associations may not want to accept accounts from pension trustees. The latter probably would want to place relatively large amounts in one account or in a number of accounts in one association. This would present a constant threat to the association that requests from trustees to withdraw large sums may be received at any time. Large withdrawals could seriously affect the liquidity position of the association. Pension trustees also may exert pressure on a savings association for it
to increase the rate paid to account holders. This may tend to encourage the association to assume additional risk in its mortgage loan portfolio or to reduce its liquid assets in favor of higher yielding investments. An association which reduces the seriousness of these potential dangers by refusing to accept large amounts from one trustee probably would curtail the latter's interest in having an account in that association.

Pension fund trustees are not likely to have the opportunity to invest large amounts in the permanent capital stock of stock savings and loan associations since the relatively small amount of capital stock outstanding is owned by a very limited number of local stockholders. Then, too, some trust agreements prohibit trustees from acquiring corporate securities which are not listed on an organized stock exchange. Furthermore, sale of permanent capital stock on a nationwide basis by stock associations to trustees would be looked upon unfavorably by legislators and savings and loan supervisory authorities who consider savings associations as local institutions. Also, issuance of stock to trustees may be in violation of the Savings and Loan Holding Company Act.

The common stock of Insured Accounts Fund, Inc., an investment company whose investment portfolio consists primarily of savings accounts in savings and loan
associations, is not an attractive investment outlet to pension trustees because the yield is not attractive.

There are many reasons why pension trustees have not acquired a larger amount of real estate mortgages for the portfolios of pension funds. Many trustees are oriented to corporate securities and prefer to invest in outlets in which the investment is evidenced by one piece of paper. Many pension trustees lack the personnel who are experienced in mortgage investing. The liquidity provided by the return flow of mortgage amortization payments is not particularly significant to pension trustees. In fact, such receipts could aggravate the problem of investing a large amount of funds at any one time. The inability of tax-exempt pension funds to accumulate a loss reserve has an adverse effect on the appropriateness of mortgages as investment media for pension fund trustees. The legal difficulties involved in determining what constitutes "doing business," the requirements which may be necessary if the trustee has to qualify as a foreign corporation, and the penalties for noncompliance operate as potent deterrents to out-of-state mortgage investment by corporate trustees. Furthermore, a pension trust indenture may not authorize the trustee to purchase mortgages.

Mortgage investment would entail considerable expense due to the high supervisory costs of handling a large number
of small mortgages, the legal costs involved in the ownership of real estate, the operational costs of maintaining records, and the costs connected with delinquencies and foreclosures. These expenses reduce the yield on mortgages so that the yield differential between mortgages and high grade corporate bonds, which require less attention and are easily bought and sold, is relatively small. Then, too, in order to acquire substantial amounts of mortgages during the periods when the rate of return on mortgages is relatively favorable as compared to that earned on other fixed-income investments, pension trustees may be forced to buy mortgages on an advance commitment and on a fairly continuous basis during periods when the rate is unfavorable to mortgage investment.

Despite these arguments against the purchase of mortgages, some pension trustees may consider mortgages as appropriate investments for pension fund portfolios. These trustees probably would acquire the bulk of these mortgages from their own bank's real estate department or from the mortgage departments of other banks before they would acquire them from savings and loan associations.

The sale of mortgages to pension trustees may not be in the best interests of savings and loan associations. The sale of mortgages to an absentee owner may have an adverse effect upon the demand from prospective borrowers
for the mortgages originated by savings and loan associations. It also may be considered to be in violation of the local, mutual character of these institutions and may invite changes in the way in which they are taxed for purposes of federal corporate income tax.

In order to maintain relationships with a trustee, a savings association may be forced to sell its mortgages to that trustee at times when it would prefer to hold its mortgages, such as during periods when its supply of loanable funds exceeded the demand from borrowers for home mortgage loans. The association also must adapt itself to the desires of the trustee in terms of the loan documents required, reports to be furnished, property inspections, general accounting procedures, and procedures to be followed in the event of delinquency or default.

Most savings and loan associations now have the authority to sell participating interests in conventional mortgage loans to pension fund trustees. It is extremely doubtful that trustees will acquire a large volume of such loans for the same reasons that were discussed above in connection with the outright purchase of mortgages by pension trustees.

The purchase of collateral trust notes by pension trustees, from an independent organization that would purchase mortgages from savings associations, would enable
trustees to invest indirectly in out-of-state mortgages without being involved directly in the legal complexities of "doing business," and to invest large amounts quickly and with relatively little inconvenience. Under such a plan, a trustee would be freed from the functions of establishing continuous relationships with separate mortgage originators, setting up property inspection and acquisition procedures, foreclosing in his own name, and developing a staff organization to manage a mortgage portfolio. The extent to which trustees would invest in these collateral trust notes depends largely upon whether or not the net yield on such notes is higher than can be earned on other types of fixed-income investments and the degree to which they are willing to sacrifice the opportunity for capital appreciation which potentially is obtainable on common stocks.

Pension trustees probably would not be interested in granting term loans to savings and loan associations. Such loans would not offer the trustee an opportunity for capital appreciation, maintenance of purchasing power, insurance coverage by the FSLIC, or the potential yield of common stocks. Establishing relationships with savings associations that wanted to borrow funds, reinvesting a large number of small loan repayments, and allocating a term loan among the many different pension funds would be
time consuming and expensive. The provisions of pension trust agreements may prohibit many trustees from granting term loans. Then too, many pension trustees are bank trustees and have, to some extent, a negative attitude toward savings and loan associations.

The extent to which savings associations would be interested in obtaining term loans from pension trustees would depend largely upon the terms of the contract. The interest rate that savings and loan associations would have to pay on such loans is, however, likely to be substantially higher than they would be willing to pay for borrowed funds.

For the reasons discussed above, it is doubtful that pension trustees would consider any of the methods, which could be used to channel the accumulations of noninsured corporate pension funds into savings and loan associations, as particularly attractive investment outlets for pension fund portfolios. It is, therefore, improbable that any of these alternatives could be used to channel sizable amounts of money from pension funds to savings associations. Some of the savings and loan associations themselves would not favor some of the methods discussed.
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