Mutual-to-Stock Conversions and the Federal Home Loan Bank Board

Three actions of the Federal Home Loan Bank Board (FHLOBB) within the past year will help promote a momentous shift in the ownership structure of the many associations that comprise the federal savings and loan industry. The shift would be from mutual to guarantee stock, a realignment transferring ownership of these institutions from the current depositors to whomever purchases their stock. The FHLOBB's actions, signaling a new national policy, consisted of: (1) endorsing the administration's proposed Housing Institutions Modernization Act of 1971, which would authorize the creation of federal guarantee stock associations either by conversion or de novo; (2) allowing the Citizens Federal Savings and Loan Association, a federal mutual association, to convert to a state stock association, ostensibly as a

1. The savings and loan industry is made up of a large number of associations that specialize in making loans on real property and accepting relatively small deposits from large numbers of depositors. The federal government and each of the states charter savings and loan associations. The federal government charters only mutual savings and loan associations. A mutual association does not have any stockholders; the depositors are considered to be the owners and they have the first claim on the association's surplus. All states charter mutual savings and loan associations and twenty-one of them also charter what are called guarantee stock associations. Guarantee stock associations issue permanent capital stock and function like an ordinary corporation. No stock associations are chartered by the federal government. See T. Marvell, The Federal Home Loan Bank Board (1969), for background on the industry.

The savings and loan industry is regulated primarily by the Federal Home Loan Bank Board. The FHLOBB employs its chartering authority to regulate federal associations. Through the Federal Savings and Loan Insurance Corporation (FSLIC), which insures the deposits of almost all savings and loan associations, it regulates not only federal associations, but all large state ones as well. It reaches all federal associations, most state associations and some fiduciaries in yet another capacity—as a central banker for the twelve district home loan banks. Although most state associations have FSLIC insurance and are members of their district home loan bank they are in addition subject to whatever regulations the state which charters them imposes.

Savings and loan associations are not to be confused with mutual savings banks chartered by eighteen states, primarily on the eastern seaboard. Mutual savings banks are trusteeships in which the board of trustees is elected by a slightly larger group of self-perpetuating corporators. The trustees manage the banks for the beneficial owners, the depositors. Deposits are insured by the Federal Deposit Insurance Corporation and the banks may join the Federal Reserve System. See W. Welles, Mutual Savings Banks 3-109 (1968).

Mutual savings banks and savings and loan associations are both distinguishable from commercial banks, which have non-interest bearing demand deposits. Theoretically, deposits in the two common forms of savings institutions are time deposits, i.e., the institution may refuse to honor a withdrawal order until a specified period has passed. See A. Hart, Money, Debt, and Economic Activity 39-42 (1953).


3. S.1671, 92d Cong., 1st Sess. (1971); H.R.7809, 92d Cong., 1st Sess. (1971). The Senate Committee on Banking, Housing and Urban Affairs has held hearings on the bill. The House bill was sent to the House Committee on Banking and Currency but no hearings have been held. Neither committee has reported the bill.
“test” to devise regulations for implementing the Housing Act; 4 and (3) announcing that in April of 1973 it will issue regulations permitting federal mutual associations to convert to state associations, thus ending a nine-year moratorium on such conversions. 5

A shift in ownership structure occurring on a large scale would end the mutual form in the federal savings and loan industry. The mutual set-up is the historical norm, and its use was offered originally to justify creating these specialized savings institutions. 6 A mutual association is “owned” in a loose sense by its depositors, since it accepts deposits or issues withdrawable shares (sometimes called serial shares). 7 Whereas a mutual association is analogous to a mutual benefit society 8 a guarantee stock association resembles a common stock corporation. 9 The present statute makes no provision for federally chartered stock associations, but a federally-chartered mutual association may convert to a stock association with a state charter under specified conditions. 10

The mutual form’s demise would mean the sacrifice of significant advantages it has compared to the stock form. In the past, these advantages have not been fully realized. The responsibility for this failure rests on the FHLBB, the industry’s regulatory agency, which has failed to protect depositors’ interests. Now the FHLBB has become a leading advocate of allowing industry-wide conversion from the

4. N.Y. Times, Feb. 4, 1972, at 39, col. 3. The state stock association took the name Citizens Savings and Loan Association, and will hereinafter be cited as Citizens.
6. See T. MARVELL, supra note 1, at 6-7. Bankers have periodically campaigned for the elimination of savings institutions. Bankers feel that savings institutions are favored by the tax laws and that banks would eliminate them if free competition were allowed. A special commission dominated by bankers (called the Hunt Commission) did a study for President Nixon in late 1971 and recommended substantial equalization between banks and savings institutions. Robinson, The Hunt Commission Report: A Search for Politically Feasible Solutions to the Problems of Financial Structure, 27 J. Finance 765 (1972).
8. Savings and loan associations are an outgrowth of what has been called the cooperative movement that began with the English Friendly Societies in the nineteenth century. Mutual savings banks and mutual insurance companies also trace their origins to this movement. See W. WELFLING, supra note 1, at 7.
9. Although in the past guarantee stock associations generally have been closely held, the present conversion formula necessarily dictates that for the period immediately following conversions the association’s stock will be widely distributed. Herman, Conflicts of Interest in the Savings and Loan Industry, in 2 STUDY OF THE SAVINGS AND LOAN INDUSTRY 775 (F. Friend ed. 1969) [hereinafter cited as STUDY].
10. The Home Owners’ Loan Act establishes two ways for a federal association to convert: (1) with FHLBB approval or (2) without FHLBB approval but in compliance with all state regulations governing a state-to-federal conversion in that jurisdiction. 12 U.S.C. § 1464(i) (1970). The Act was passed before stock associations existed, so it provides no special requirements for a stock conversion. The FHLBB has successfully claimed that it may regulate and even halt these stock conversions under its general regulatory powers. See 12 U.S.C. § 1464(a) (1970). Guarantee stock associations are concentrated in Ohio, Illinois, Texas and California. See FEDERAL HOME LOAN BANK Bk., 38TH ANNUAL REPORT: 1970 (1971).
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mutual to stock form. But notwithstanding the FHLBB's position, Congress should prevent widespread conversion, and consider measures to insure effective regulation, so that the mutual form can be made to work.

I. The Mutual-to-Stock Controversy

A. The Net Worth Distribution Issue

The most immediate consequence of a mutual-to-stock conversion is the transfer of legal ownership of the association's net worth from the depositors to the shareholders. Most of the controversy concerning conversions has focused on this first consequence—the distribution of net worth and the possibility that depositors' interests may not be adequately protected. Some have argued that depositors are entitled to this net worth—in effect, the accumulation of past profits—on the grounds that the depositors' deposits have generated the retained earnings. The argument runs that it is feasible to divide the net worth only among current depositors, in view of the difficulties of ferreting out all past depositors and determining their pro rata shares of the net worth.

Others have argued that distributing the net worth to depositors is wrong, because the FSLIC, as the primary risk bearer, is entitled to an association's net worth at the time of redistribution. This argument seems mistaken: the FSLIC and the entire FHLBB are supported by profits of the savings and loan associations; the federal government pays no money to support the FHLBB and bears the risk of insuring accounts in only a remote way.

It has also been argued that the net worth of an association is a community asset because the institution itself was originally designed to serve a community purpose—financing home-building—and its net worth is retained for purposes of solvency. This argument would seem to favor application of the net worth to public interest projects or distribution to the state, similar to the current practice of thrift

11. The FHLBB is the major proponent of this position. See 12 C.F.R. § 563.22-1 (1972).
12. Herman, supra note 9, in 2 STUDY at 922.
13. T. MARVELL, supra note 1, at 223.
14. FHLBB bonds are not secured by the credit of the United States Government. T. MARVELL, supra note 1, at 65. In an emergency, the FHLBB may borrow up to $750 million from the Treasury but presumably any borrowing would have to be repaid just as the original loan setting up the FHLBB has been repaid. Id. at 60. See 12 U.S.C. § 1723(1) (1970).
15. NATIONAL ASS'N OF MUTUAL SAVINGS BANKS, ANNUAL REPORT 22 (1972).
institutions in Europe. The profits of a savings and loan association, however, seem no more a community asset than those of any other savings institution, since they all use depositors' funds for similar purposes; and there seems no reason for regarding profits from home-building loans as community assets, while treating profits from other kinds of investments as purely private gain.

The FHLBB has accepted the contention that depositors deserve the association's net worth, and has acknowledged the need for safeguards to insure that each depositor receives the share of net worth to which he is entitled. The FHLBB imposed the 1963 moratorium on conversions after it concluded that depositors' interests could not be adequately protected under then existing guidelines. The Board's present regulations include two important requirements that would apply if conversions were permitted to resume. First, a mutual association must give its members mailed notice of a conversion vote, and second, the conversion must be approved by votes representing two-thirds of the value of the association's deposits. In addition, if the new state association is to issue guarantee stock, the conversion plan must guarantee each shareholder (depositor) an amount equal to his pro-rata share of the association's net worth. Finally, in the recent Citizens conversion, the Board imposed elaborate new safeguards to ensure that depositors received their pro-rata share of the association's net worth.

The Citizens safeguards were designed to: (1) eliminate depositor speculation by setting a record date for participation; (2) give the depositors an amount of stock reflecting the size of their deposits according to an independent appraisal of stock worth; (3) use additional stock to increase, not dilute, the capital of the association; (4) require a two-thirds vote of approval by the depositors as a prerequisite to conversion; and (5) prohibit payment of dividends on the stock for

17. Prior to 1963 an association could convert directly from the mutual to state stock form. In that year the FHLBB imposed a moratorium on conversions. Decision #72-149, Federal Home Loan Bank Board, 1, Feb. 2, 1972 [hereinafter cited as FHLBB Decision].
18. The FHLBB doubted the stability of these associations. Later experience substantiated such doubts. Herman, supra note 9, in 2 STUDY at 918-19.
21. The relevant portions of California law governing the conversion are CAL. FINAN. CODE § 6463 (West 1968) (Ratification Procedure) and 10 CAL. ADMIN. CODE § 205 (Disclosure Requirements).
22. These safeguards were originally formulated by the United States Savings and Loan League at its annual meeting in 1970. See U.S. SAVINGS & LOAN LEAGUE, ANNALS 279 (1971). The League is the largest trade association of the savings and loan industry.
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the first five years after conversion.\textsuperscript{23} In addition, the FHLBB demanded the right to approve the date of fulfillment for sale and purchase, the price, commissions and discounts, as well as the offering circular and other conversion materials. Also, it insisted that Citizens agree to enforce the terms of the plan\textsuperscript{24} in court and to allow no stock options for five years.\textsuperscript{25}

Although it is now apparent that Citizens’ depositors in fact received a pro-rata share of the association’s net worth,\textsuperscript{26} the FHLBB’s procedures failed to take account of two other risks inherent in large scale conversions. The management of Citizens or any association could have manipulated the net worth of the association over the years to understate its value.\textsuperscript{27} Also, if a large number of conversions were allowed, the FHLBB’s procedures might have functioned far less strictly or effectively. Success achieved in a single instance, under the glare of publicity, offers no guarantee of protection in the future.

\begin{itemize}
\item \textsuperscript{23} Id. at 279-89.
\item \textsuperscript{24} Depositors in the association as of March 20, 1970 were eligible to receive stock pro rata based on their share of the net worth. One share of stock was issued for each $250 of deposits, but no one received less than ten shares. A depositor with less than $250 in deposits had the option of selling his shares through a broker to another bidder or buying enough shares to bring him up to ten, but not over 1,000. After this offering the holders of ten or more shares had the option of selling all, selling part, or buying an amount, but their total could not exceed 1,000. Next, individuals who were borrower members or who became depositors after March 20 were entitled to purchase up to 1,000 shares. See Citizens Savings and Loan Ass’n, Offering Circular, March 8, 1972. The price on the stock was the lower of the net offering price (the price set by the public sale of stock minus brokerage fees) and the maximum purchase price (the price set by the association after consultation with one or two “major investment banking firms”). The depositors were determined to own 1,577,078 shares on the record date and the association issued 250,000 new shares of stock. If the depositors and borrowers had bought all the new stock there would not have been a public offering and the depositors would have bought and sold shares at the maximum purchase price because no offering price would have existed. If the net offering price had turned out to be less than the maximum purchase price there would also have been no public offering because no one would have wanted the stock at that price. The active management received 2,750 shares or less than 3/4\% of the offering since by the terms of the plan it could not make additional purchases. Plan for Converting Citizens Federal Savings and Loan Ass’n to Citizens Savings and Loan Ass’n, January 4, 1971, at 33-39.
\item \textsuperscript{25} FHLBB Decision, supra note 17, at 2.
\item \textsuperscript{26} On April 13, 1972 a consortium of brokerage houses offered the unwanted Citizens stock on the open market at $31.50 per share. The brokerages sold the 466,344 shares offered and the depositors received $28.50 per share. The depositors who stayed in purchased 250,000 shares over their account value. Wall St. J., Apr. 14, 1972, at 29, col. 1.
\item \textsuperscript{27} An association may desire to overvalue property to increase the size of a loan to a party or increase capital to avoid dividend or borrowing restrictions by the district home loan bank. It may want to undervalue an asset to keep a borrower within the one-borrower limit (10% of assets) or to decrease net worth prior to a conversion. All of these types of juggling are hard to regulate because the FHLBB does not want its associations to value a loan or property at its prevailing market price. In 1966 the FHLBB issued a long policy statement on appraisals, attempting to establish criteria in the area. 12 C.F.R. § 571.1 (1972). More recently, the FHLBB proposed a regulation that the book value of the property should be regarded as market value at the time of closing. See 35 Fed. Reg. 6080 (1970).
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B. The Stock and Mutual Forms Compared

More fundamental than the question of how to distribute net worth is the issue of which form is preferable, mutual or stock. From the standpoint of management, five reasons are usually given in favor of the stock form:28 (1) stock associations generate larger amounts of capital, which provide a cushion during periods of heavy withdrawals, and more working capital for growth in ordinary times; (2) the stock form makes management more accountable and reduces management personnel turnover; (3) the stock form allows an association to operate in holding company form; (4) executives can receive deferred compensation via stock options, and thus develop a proprietary interest in their association; and (5) stock associations are more profitable and grow more quickly.

These reasons are unpersuasive. Mutual associations already generate sufficient capital;29 in fact, most of them have excess capital.30 During the 1966 money squeeze, stock associations tended to have less money available to meet the liquidity crisis.31 Savings and loan associations already have the right to issue subordinated debentures (in effect, common stock)32 but none has taken advantage of this right.33 It may be argued that subordinated debentures cannot be marketed because the debenture holder will be last in line in case of liquidation. But the stockholder's status is of no higher priority, raising the question of why stock would be expected to sell and de-

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28. This analysis is based on conversations with five savings and loan association executives in Boston, New Haven and Cincinnati, who declined to be identified either by name or by association.
29. Theoretically an established stock association could raise new capital by an offering. But the Brigham and Pettit study indicates that "relatively little" new capital has been raised in this fashion; most new capital has been generated by retention of earnings. The study found nonetheless that it was easier to start up a stock association than a mutual. Brigham & Pettit, Effects of Structure on Performance in The Savings and Loan Industry, in 3 SRUW at 1166-68. To promote creation of new mutual banks, a Central Industry Fund was established in 1961 using capital contributed by established banks to start new banks. WELFLING, supra note 1, at 157. See also Klein, On Causes and Consequences of Savings and Loan Deposit Rate Inflexibility, 27 J. Finance 79 (1972).
30. The existence of excess reserves at one particular time is not necessarily proof that an association or group of associations is generating enough capital. However, the fact that an excess of reserves has always been held by savings and loan associations is good evidence for that proposition. See FHLBB REPORT, supra note 10, at 16-17, 114-15. Interestingly, the commercial banking industry has concluded that large capital reserves are undesirable. In fact, there has been a tendency during this century to gradually diminish capital requirements. P. HAHN, THE CAPITAL ADEQUACY OF COMMERCIAL BANKS 203-04 (1969).
31. T. MARVELL, supra note 1, at 205-06.
32. Subordinated debentures are long-term debt securities that rest on the general credit of the corporation and are subordinated to whatever debt is specified to be senior in the subordination agreement. W. CARY, CASES AND MATERIALS ON CORPORATIONS 1182, 1283-85 (unabridged 1969).
33. Hearings on S 1671, supra note 2, at 33.
bentures would not. Moreover, some savings banks in the most competitive market for savings (the Northeast) have successfully sold such debentures.  

As for accountability, all currently proposed conversion plans envision wide public ownership of the stock, and management is likely to be even less accountable under such arrangements. The availability of the holding company form seems a questionable advantage. Strong reservations have been expressed about its desirability and in 1967 Congress authorized more stringent investigation and regulation of such holding companies.  

In providing management incentives, stock ownership probably would be no more effective than the current system, since executives already may deposit over $150,000 in their associations through various devices. Stock associations may enable deferred management compensation but there is little support for the claim that increased compensation would prevent discontinuity and turnover in management. Available data suggests that mutual officers are compensated at a slightly higher rate than stock officers. High turnover of management personnel, if it exists, is due more likely to state “branching” laws that prevent associations from growing and therefore limit opportunities for management personnel to advance.  

Very little evidence supports the contention that stock associations are more profitable and grow more quickly. Federal mutual associations are still growing in the most competitive markets. Indeed, the FHLBB recently commissioned a report on profitability, and the Chairman of the FHLBB told a congressional committee: “Now, I

34. *Hearings on S.1671*, supra note 2, at 241, 245. The FHLBB issued proposed regulations in October which would control the issuance of these debentures. See 37 Fed. Reg. 21178 (1972). In so doing, it announced that it hoped the issuance of such debentures would help to provide the associations with needed capital. N.Y. Times, Oct. 6, 1972, at 59, col. 5.  
36. For a detailed discussion of the effects of holding company ownership, see Brigham & Pettit, supra note 29, in 3 Study at 1128-42. See also 37 Fed. Reg. 23289 (1972).  
38. In spite of FSLIC’s limitation on the amount of insurance each individual may have, the various rules governing joint accounts and trusts make it possible for a family of three to deposit $150,000 and be fully insured. T. Marvell, supra note 1, at 110.  
39. Herman, supra note 9, in 2 Study at 897.  
40. Comparative growth statistics on federal and state stock savings and loan associations are unavailable. The yearly publication of the United States Savings and Loan League suggests that the mutual associations are doing well in the states where the stock form is most prevalent. See *Annals, supra* note 22, at 221-23; *U.S. Savings and Loan League, Annals* 247-49 (1972).  
41. Brigham and Pettit, supra note 29, in 3 Study at 971.
The committee will see that [the results of the study] . . . really go to a great similarity in the operating results of these two kinds of institutions.”

From the depositors’ standpoint, the mutual form may well have substantial advantages over the stock form. Designed as a democratic alternative to the commercial savings bank, the mutual association incorporated mechanisms of depositor control that theoretically made it far more responsive to the needs of individuals with small amounts of money to save or invest. Each individual was given at least one vote in association matters, and none was allowed to wield more than fifty votes. The charters of most associations limited borrowing rights to depositors. Over the years, mutual associations have been highly stable. Indeed, the FHLBB’s recent study concluded that stock associations have proven somewhat riskier than mutual associations, without yielding any higher rate of return. The two forms have not differed significantly in their record of profitability.

The savings and loan industry has changed substantially from the time of its founding, and the pious ideology of the mutual associations’ founders may be unrealistic today. An institution like Citizens, with 470,000 depositors, cannot be managed as an ideal “depositors’ democracy.” The number of depositors in such institutions and the amount of money held in deposits is enormous and still growing rapidly. Even before this growth, many devices of the theoretical depositors’ democracy had atrophied.

The mutual form’s advantages, however, might still be realizable if the FHLBB were determined to make the mutual form work. A pure depositors’ democracy, as originally conceived, may no longer be practical. But the devices of depositors’ control, as well as the mutual form’s other features, might be revived to a significant degree through appropriate regulatory intervention. The government’s responsibility for regulation of the associations is already well-recognized: it charters them, grants them limited monopoly powers, etc.

42. Hearings on S.1671, supra note 2, at 31.
44. Brigham & Pettit, supra note 29, in 3 Study at 981-82.
45. Id. at 1182-86.
49. The federal government in effect gives associations limited monopoly power by making it very difficult to start a new association or to open a branch office. One of the stated considerations in ruling on an application is the present availability of savings and loan services. This aspect of FHLBB policy is overseen by the “Office of Industry Development.” See FHLBB Report, supra note 10, at 79.
and protects their rate of return through interest rate control and special tax treatment. The industry's enormity has put it beyond effective state control for some time. Indeed, many malfunctions of the mutual form may be traced in large part to the FHLBB's regulatory failures. And reviving the mutual form will depend directly on reorienting FHLBB regulation.

II. Reorienting the FHLBB

A. The Record of Regulatory Failure

The FHLBB's strong support for conversions indicates that it has already abandoned hope of reviving the mutual form. In testimony before Congress, the most recent FHLBB Chairman argued strongly for legislation that would move the entire industry toward adoption of the stock form. The Board's treatment of the Citizens conversion indicates that it will support other conversions in the future. And if this particular "test" is any guide, the regulations to be issued in April may be expected to encourage the trend.

The Board's failure to protect and update the mutual form is shown by its record over the past twenty years. Consistently, it has been more concerned with the interests of management than those of depositors. It has: (1) allowed the mutual depositors' franchise to atrophy; (2) discouraged depositors from asserting their rights by, for example, supporting management's refusal to give depositors association membership lists; (3) failed to move effectively against conflicts of interest; and (4) given officials elected by local industry tremendous power in the supervisory system.

FHLBB policy has made the depositors' franchise, as defined in the mandatory charters of the federal associations, a meaningless provision. The FHLBB has refused to require that depositors receive an adequate annual report, and has never issued effective proxy regulations. In addition, it has permitted management to organize annual meetings in a way that stifles depositor participation.

Present regulations require only that an association print a vaguely defined "statement of condition" yearly. The Board has declined

51. See Hearings on S.1671, supra note 2, at 21-92.
52. The moratorium will not officially end until the FHLBB issues final conversion regulations in April. N.Y. Times, Sep. 26, 1972, at 63, col. 4.
thus far to adopt recently proposed revisions that would compel each insured association to submit a detailed annual report to its de-
positors. Until 1971, the FHLBB allowed associations to use proxies without any limitation on solicitation, scope, duration or revoca-
bility. This latitude, coupled with exemption from the Securities Act of 1933 for withdrawable shares of regulated savings and loan associations, gave management virtually untrammeled power to amass controlling blocks of undated irrevocable proxies and sell control of their associations to successor managements. In the absence of FHLBB action, courts attempted unsuccessfully to intervene. The regulations finally imposed by the Board in 1971 are still deficient in a number of respects. They stipulate that all proxies must be revocable and clearly labeled. No corporation may hold a proxy, and no association may solicit an undated proxy or misrepresent a material fact. But no limitation is placed on proxy duration and no provision is made for disclosure of insider finances in proxy statements.

Annual and special meetings are theoretically the primary occasion for the depositor to exercise his franchise, but under existing rules, members need not be informed individually of the time or place of an annual meeting or even that they are entitled to attend. The mandatory by-laws of a federal association provide that notice to members may be by mail or by publication in a newspaper of "general circulation." No minimum number of members present and voting is required for a quorum; consequently management does not even have to collect proxies unless it fears a raid.

The FHLBB's tendency to inhibit assertion of depositors' rights is illustrated by its negative policy on depositor inspection of association membership lists. For years, the FHLBB rejected the notion that a depositor had a common law right of inspection. After two federal courts established the right's existence, the FHLBB issued

57. T. MARVELL, supra note 1, at 14; Herman, supra note 9, in 2 STUDY at 798-800.
60. Herman, supra note 9, in 2 STUDY at 791.
63. Herman, supra note 9, in 2 STUDY at 794.
64. The Federal Home Loan Bank of Philadelphia declined to allow a depositor to see a membership list and the depositor unsuccessfully sued to compel disclosure. Daurelle v. Traders Fed. Sav. & Loan Ass'n, 143 W. Va. 674, 104 S.E.2d 320 (1958).
a "suggested" by-law on communications among members. The by-law is optional, and allows an association adopting it to deny a member access for any purpose that the association deems "improper." 60

The FHLBB's record on conflicts of interest is the most serious evidence of its deference to management. Conflicts of interest stem primarily from ancillary activities of officers and directors and conveyances of association control. 67 A conflict may be direct, involving an insider dealing with his association; or indirect, involving a deal through an intermediary controlled by, or linked to, an insider. 68 Regulations on direct conflicts are numerous but haphazardly enforced. 69 Although the FHLBB requires a federal association, for example, to guarantee "reasonable freedom of choice" in the purchase of hazard insurance after a mortgage closing, 70 it rarely insists on the rule. 71 All of the direct conflicts now prohibited can be accomplished through a dummy. The idea of freedom of choice lacks content, and the FHLBB's examiners do not have complete information on the finances of insiders. More importantly, virtually no regulations exist on indirect conflicts.

The FHLBB has recognized the inadequacy of its present regulations on conflicts of interest. In fact, the FHLBB recently proposed a more stringent set of regulations. 72 But the Board retreated after the suggested revisions stimulated an "unprecedented volume of public comment." 73

to the list existed under Pennsylvania law. In Murphy v. Colonial Fed. Sav. & Loan Ass'n, 338 F.2d 609 (2d Cir. 1967) a federal common law right was recognized.

65. 12 C.F.R. § 544.6 (1972).
66. See Herman, supra note 9, in 2 STRy at 764-69. The most common tie-in arrangements are between associations and insurance agencies, law firms, real estate brokers, building materials suppliers and land developers. Id. at 812.
67. Direct conflicts are more prevalent than indirect ones. Affiliated persons may lease an office to an association at an inflated rental. An association's president on retiring may convey his proxies to the new management and sell the association's building or any other asset for its value plus a premium for control of the association. Id. at 799-801, 813-17.
69. Through the FSLIC, the FHLBB attempts to regulate conflicts of interest in insured state associations. Consistent with the idea of "reasonable freedom of choice," the FHLBB forbids an insured association to condition a loan or service on the purchase of materials or services from any specific supplier. 12 C.F.R. § 563.35 (1972). The FHLBB has stated that the extant insurance regulations are not exhaustive; omission does not connote approval. 12 C.F.R. § 571.7 (1972).
71. See 12 C.F.R. §§ 555.5 (1972). The FHLBB has recently allowed federal associations to form service corporations which may sell insurance under certain circumstances. See 12 C.F.R. § 545.9-1 (1972).
72. The proposed regulations generally forbid transactions with affiliated persons.
73. Hearings on H.R. 5700 Before the House Comm. on Banking and Currency, 92d Cong., 1st Sess. at 38-39 (1971). The FHLBB has revised these regulations to specify the particular dealings an affiliated person may have with his association and to delegate approval power on insider deals to the district supervisory agent. See 36 Fed. Reg. 7535 (1971).
While avoiding the conflicts of interest problem, the FHLBB has decentralized its supervisory system in a way that undermines the independence of regulatory officials and discourages vigorous scrutiny. Examinations and audits are the principal means of FHLBB supervision. In addition to submitting various reports, each association must conduct an internal audit yearly and is subjected to periodic surprise examinations. Each federal home loan bank district has a district supervisory agent responsible for reviewing all examinations and audits, applications for new branch offices and all reports submitted by associations. Under the present FHLBB system, the agent is also the president of the district home loan bank, and is elected by the board of directors of the bank, two-thirds of whom are elected by officials of the local industry. Almost inevitably, he is beholden to the local industry for his job.

B. Regulatory Reform

In response to this record of regulatory failure, Congress might consider revising the three basic statutes that created the FHLBB and defined its duties with the aim of improving depositors' affirmative rights and building a regulatory structure that will be sympathetic to depositors. The first step would be for the FHLBB to halt conversions.

Depositors might be given greater voice in the associations by requiring more frequent votes and distribution of more information. To widen and secure the franchise, Congress might require each association to obtain the approval of two-thirds of depositors attending a meeting for any major association decision. The proxy regulations recently adopted might be toughened to mandate fuller disclosure of pertinent financial information. A depositor might be given a statutory right to inspect membership lists and receive detailed an-
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Additional measures might be considered to improve the integrity and efficiency of regulation. Congress might impress on the FHLBB its concern about conflicts of interest, for example, by specifically directing the FHLBB to search for and extirpate such conflicts. As a first step to ensure the independence of the supervisory apparatus, it might make the district supervisory agent an appointive post.

The effectiveness of the FHLBB's regulations would be enhanced if they applied to all mutual institutions—state-chartered mutual savings banks, as well as mutual associations. At present, the state-chartered mutual savings banks are subject only to the controls of the Federal Deposit Insurance Corporation. Since these banks contain over one-quarter of all the funds deposited in savings institutions, they exert significant leverage on the policies of the entire industry. Bringing them under the FHLBB's control would increase the Board's enforcement power, as well as add to its constituency a group of banks and bankers who are committed to the mutual form.

83. For a typical instance of the FHLBB's resistance to judicial intrusion, see Reich v. Webb, 336 F.2d 153 (9th Cir. 1964).
84. See p. 570 supra.
85. MARVELL, supra note 1, at 30.
86. An interesting example is the periodic pressure exerted on the FHLBB and Congress to liberalize the portfolio rules for associations. The savings and loan associations, in conjunction with the mutual savings banks, jointly sponsored a measure (the proposed Federal Savings Association Act) which would have allowed savings and loan associations to retain their present form but widen their portfolios to the extent normally enjoyed by savings banks. The measure thus would have permitted their portfolios to include corporate securities and unsecured personal loans. See Hearings on H.R. 15, H.R. 10745, H.R. 11139 Before the House Subcomm. on Bank Supervision and Insurance of the House Comm. on Banking and Currency, 90th Cong., 1st Sess. (1967). Some congressmen have perceived that the associations have been able to dilute FHLBB policies by citing the laxer controls applied to state chartered mutual savings banks. In the last session of Congress, three bills were introduced dealing with the problem of conflicts of interest in the savings and banking industries. See Hearings on H.R. 5700, supra note 73, at 1-14. In testimony before the committee, the chairman of the FHLBB declined to endorse any of the bills on the grounds that (1) conflicts could not be regulated by "strict statutory rules," (2) enforcement should be flexible with the FHLBB bearing responsibility and (3) regulations could be based on cooperation between all banking agencies. Id. at 39.
87. The Federal Reserve Board (FRB) would undoubtedly resist this change on the ground that it would reduce the effectiveness of its monetary policies. The FRB and the FHLBB are not barred from cooperation and consultation. The Interest Rate Control Act requires the FHLBB to confer with the FDIC and FRB before changing interest rates. Also the FHLBB occasionally consults with the FRB when it intends to expand or contract advances (loans) to its member banks. MARVELL, supra note 1, at 38. In addition, the Treasury has the power to forbid the FHLBB from issuing its bonds and debentures. Id. at 22. To forestall the FRB's objection to this change Congress could amend the Federal Home Loan Bank Act to require the FHLBB to ask permission from the FRB Open-Market Committee before it expands advances by some fixed standard, e.g., more than 2 per cent in one month.
88. Through the savings bank trade association, these bankers have opposed the proposed Housing Institutions Modernization Act of 1972, S.1671, see note 2 supra, thus demonstrating their support for retention of the mutual form. See ANNUAL REPORT, supra note 15, at 22.
III. Conclusion

Beyond statutory reforms adopted by Congress, the FHLBB's future direction will depend heavily on the backgrounds, interests and personalities of the particular individuals on the Board. As a matter of practical politics, the President plays a preeminent role in shaping the FHLBB's policies through his formal powers of appointment and through less visible modes of influence ranging from public statements to private conversation. Avoidance of involvement on his part is as important a policy as direct intervention. His involvement, if exerted on behalf of depositors and the general public, could be an important force for reorientation of the entire regulatory mechanism.

It may be argued that broader structural reform, designed to secure the independence of the Board, will be necessary to insulate it from political pressure and special interests. In this respect, comparisons are often made between the FHLBB\textsuperscript{89} and its counterpart, the Federal Reserve Board,\textsuperscript{90} whose members are more numerous (seven instead of three) and whose terms are longer (fourteen years instead of four). But this argument is undermined by the nation's experience with regulation. Critics of regulatory agencies have cogently observed that statutory independence in no way guarantees real independence from special interests. The records of these agencies, including the FRB, are too checkered to justify recommending structural reform as a panacea. In the end, the critical factor may be the President's commitment to reform.

\textsuperscript{89} MARVELL, supra note 1, at 40.