FEDERAL FINANCING BANK

PREPARED FOR THE USE OF

THE COMMITTEE ON WAYS AND MEANS

BY

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OF THE

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PROPOSAL TO ESTABLISH A FEDERAL FINANCING BANK

The administration has proposed the establishment of a Federal Financing Bank to provide for coordinated and more efficient financing of Federal and federally assisted borrowings from the public. This proposal was made in Executive Communication No. 395 on February 8, 1973.

The administration proposal is similar to the "Federal Financing Bank Act of 1972" (S. 3001) passed by the Senate on June 22, 1972, and reported, with amendments, by the Committee on Ways and Means on September 29, 1972 (H. Rept. No. 92-1478). No action was taken on S. 3001 on the House floor. (Additionally, on October 16, 1972, the Senate passed, as a floor amendment to H.R. 7577, the bill in the form reported out by the committee. This bill, however, did not go to conference in the closing days of the 92d Congress.) The administration proposal differs from the bill previously reported by the committee in two important respects, as discussed below. H.R. 5874, introduced in this session of Congress by Mr. Mills and Mr. Schneebeli, is essentially the same as the bill previously reported by the committee.

The Senate Committee on Banking, Housing, and Urban Affairs has recently considered the administration's proposal in this session of Congress and on May 21 reported S. 925, its version of the Federal Financing Bank Act of 1973. S. 925 is essentially the same as the administration proposal with certain amendments, as described below in the discussion of areas for committee consideration.

General Background

In general, the administration has proposed this legislation to allow coordination of Federal and federally assisted borrowing programs, with the objective of reducing the cost of these borrowings and minimizing their impact on financial markets.

Many Federal agencies now finance their programs directly in the securities market. As a consequence of the increase in number and amounts of financing in the securities market, the costs of agency financing have increased. Borrowing costs of the various Federal agencies' financings normally exceed Treasury borrowing costs, even though these issues are backed by the Federal Government. Borrowing costs are higher because of the proliferation of competing issues crowding each other on the financing calendar, the specialized nature of the securities, and the consequent limited markets in which they are sold. Underwriting costs are an additional cost factor. Furthermore, as agencies develop their own financing staffs, there may be increases in personnel costs. Moreover, it is argued that the need for agencies to develop financing arrangements may interfere with their principal program functions.

Under the proposal, debt-management problems could be shifted from the agencies to the Federal Financing Bank. Many obligations which are now placed directly in the private market under many Federal programs could be placed with the Bank. The Bank in turn would issue its own securities. Arguably, the Bank could develop the necessary expertise, flexibility, volume and marketing power to minimize financing costs and assure an effective flow of credit for agency programs. Additionally, it is argued that financing programs through the Bank could assure greater flexibility and a broader market for securities and also could provide coordination and planning with regard to overall credit availability.

In addition to establishing the Federal Financing Bank, the proposal would also give the Treasury the power of advance approval over the terms and conditions, timing, methods and sources of financing of most issues now placed on the market under Federal agency programs. While many of the agencies placing issues in the market are now subject to coordination with the Treasury, others are not. Additionally, it appears that some of the coordination requirements are vague or incomplete, and none require advance submission of financing plans.

Administration Proposal

The administration proposal is designed to shift debt management problems from program agencies to a Federal Financing Bank, and to coordinate the market financing activities of Federal agencies which place debt issues (or guarantee debt issues placed) in the market.

The administration proposal has two principal features:

1. It provides for a Federal Financing Bank through which the marketing of Federal and federally assisted borrowing activities can be centralized.

2. It provides for advance submission to the Secretary of the Treasury of financing plans for obligations issued, sold, or guaranteed by most Federal agencies, and for the Secretary's approval of the method and source of financing, timing, rates of interest, maturities, and all other financing terms and conditions of issues or sales of such obligations.

Federal Financing Bank

The proposal would create the Federal Financing Bank as a corprate body which is an instrumentality of the U.S. Government. The Bank would be subject to the general supervision and direction of the Secretary of the Treasury. It would exist until abolished by act of Congress (Sec. 4).[1]

The Bank would be authorized to purchase and sell or make commitments to purchase and sell any obligation issued, sold or guaranteed by a Federal agency (Sec. 6(a)). All Federal agencies that issue, sell or guarantee obligations could sell them to the Bank (Sec. 6(a)). The Secretary of the Treasury would set the minimum yield to be earned by the Bank on obligations it purchases, taking into consideration current average yields on United States or Bank obligations of comparable maturity (Sec. 6(b)).

[1] These section numbers refer to the sections contained in the administration's proposal. Since the bill, H.R. 5874, introduced by Mr. Mills and Mr. Schneebeli (which is identical to the bill reported by the committee in the last Congress), is the same as the administration's proposal in most respects, these section numbers also correspond to H.R. 5874. The few substantive differences between the administration's proposal and H.R. 5874 are discussed below in areas for committee consideration.

The Bank's activities would be financed, in general, by interest earned on obligations it purchased (Sec. 6), by publicly issued obligations of the Bank (Sec. 9(a)), by Bank obligations issued to the Secretary of the Treasury (Sec. 9(b)), and by charges for its commitments and other services (Sec. 6(c)). The Secretary of the Treasury could advance up to $100 million to the Bank for initial capital, and appropriations would be authorized for this purpose (Sec. 8). The Bank would be authorized, with the approval of the Secretary of the Treasury, to publicly issue its obligations in amounts not to exceed $15 billion outstanding at any one time (Sec. 9(a)). National banks would be permitted to invest and deal in these obligations (Sec. 14), and fiduciary, trust and public funds under Federal control could invest in them (Sec. 9(d)). The Bank also could issue obligations to the Secretary of the Treasury, and could require the Secretary to purchase Bank obligations in amounts that would not cause the Secretary's holdings of required purchases to exceed $5 billion at any one time (Sec. 9(b) and (c)). The Treasury could sell its Bank obligations. These sales and its purchases would be treated as United States public debt transactions, and the Secretary could use the proceeds of public debt transactions to finance purchases of Bank obligations (Sec. 9(b)).

The Bank would determine the yield and maturity of its obligations issued to the public, and could provide for redemption before maturity of these issues (Sec. 9(a)). In the case of Bank obligations issued to the Treasury, and Treasury advances to the Bank, the Secretary of the Treasury would determine the rate of return (Sec. 8 and 9(b)). This determination would be based on current yields of outstanding United States obligations of comparable maturity (Sec. 8 and 9(b)).

Additionally, since the purchase by the Bank of local federally guaranteed obligations must not increase the borrowing costs of local public bodies, Federal agencies would be authorized to make payments to the Bank to avoid increasing local bodies' net borrowing costs as a result of purchases of local obligations by the Bank. Appropriations for such payments would be authorized (Sec. 16).

The Bank would be governed by a 5-member board of directors, serving without compensation, consisting of the Secretary of the Treasury (chairman of the board) and 4 members appointed by the President from among officers or employees of the Bank or of Federal agencies (Sec. 5). Each member of the board could designate another officer or employee of the Government to serve in his place (Sec. 5(a)). The chairman of the board would appoint the persons who would be the officers of the Bank (Sec. 5(b)). The Bank would have the usual corporate type powers (Sec. 10). It would be exempt from all taxes except for real and tangible personal property taxes (Sec. 11(a)). However, obligations issued by the Bank would be subject to Federal, State, and local taxation to the same extent as obligations of private corporations (Sec. 11(a)). Bank obligations would be exempt from certain securities law requirements (Sec. 11(b)), and these obligations could be prepared, held and delivered by the Secretary of the Treasury, who would be reimbursed for expenses incurred (Sec. 12).

Receipts and disbursements of the Bank would not be included in the Budget of the United States and would be exempt from statutory limits on expenditures and net lending (budget outlays) of the United States (Sec. 11(c)). Further, the Budget status and accounting require-

ments of Federal agencies would not be affected by their sales to the Bank (Sec. 11(c)). However, the Bank would be subject to the budget and audit provisions of the Government Corporation Control Act as they are applied to certain wholly owned Government corporations, (Sec. 15), and the Bank would report annually to the President and Congress on its activities (Sec. 13).

Advance Treasury Approval of Financing Plans—in addition to the Federal Financing Bank

In addition to establishing the Federal Financing Bank, the proposal would require most Federal agencies issuing, selling and guaranteeing obligations to submit financing plans to the Secretary of the Treasury. The approval of the Secretary would be required of financing plans including the terms, conditions, timing, methods, and sources of financing. The Secretary could not withhold his approval for more than 120 days unless he submits a timely detailed explanation to the Congress of his reasons for doing so (Sec. 7).

Advance approval would not be required for obligations issued or sold under an act of Congress which expressly prohibits any U.S. guarantee of these obligations. The Treasury has indicated that under this provision, advance approval would not be required for obligations issued by the Tennessee Valley Authority. Furthermore, advance approval would not be required for obligations guaranteed in connection with certain programs involving the guarantee of large numbers of individual obligations that are originated and serviced by local lending institutions. For example, the Treasury has indicated that under this provision, advance approval would not be required for individual home mortgage obligations guaranteed by the Federal Housing Administration or the Veterans Administration.

Effective Date

The section of the proposal providing for advance Treasury approval of Federal agency financing plans would become effective 30 days after enactment. All other sections would become effective upon enactment (Sec. 19).

Areas for Committee Consideration

The administration proposal differs from the bill reported by the committee in the last session of Congress in two important respects. First, the proposal would require the prior approval of the Secretary of the Treasury of financing terms and conditions for debt issued, sold, or guaranteed by most Federal agencies. The bill previously reported by the committee did not require prior approval for guaranteed obligations. Second, the proposal provides that obligations issued by the Federal Financing Bank would be subject to Federal, State, and local taxation. The bill previously reported by the committee provided that these obligations would be subject only to Federal taxation. These differences between the administration proposal and the bill previously reported by the committee are discussed below, along with other areas for consideration by the committee.

Advance Treasury Approval of Financing Plans

1. Guaranteed obligations

The administration proposal would require the prior approval of the Secretary of the Treasury of financing terms and conditions for debt issued, sold, or *guaranteed* by most Federal agencies. The bill previously reported by the committee did not require prior approval for guaranteed obligations. In this respect, the bill previously reported by the committee was the same as the bill passed by the Senate, on June 22, 1972.

The Treasury believes that if the advance approval requirement applied only to securities issued or sold (but not guaranteed) by the government, there would be a technical distinction made between securities. In this case, securities acquired by an agency before sale would be subject to advance approval, but where sale of the securities is arranged by the agency, and the securities are guaranteed but not acquired by the agency, advance approval would not be required. (Only where an agency actually acquires the security before it is sold on the market will a security be treated as "issued" or "sold" by a Federal agency.) Consequently, it is argued that there could be a substantial volume of government-backed securities flowing to the market without any overall debt management coordination, if guaranteed obligations were not subject to the advance approval requirement.

During the hearings, questions were raised about the effect on agency programs of requiring advance approval for guarantee securities. It was argued that giving the Treasury the power to determine the scope and extent of financing of guaranteed securities would allow the Treasury to affect substantive decisions, since there are many Federal guarantee programs which require financing. In addition there were questions whether the added administrative level would raise problems that could affect borrowing. Several witnesses pointed out that the financing arrangements under certain guarantee programs are complex, require substantial expertise in the substantive area, and may involve decisions that must be implemented rapidly. It was suggested that the advance approval requirement may involve administrative delays necessarily associated with the addition of another agency (initially, unfamiliar with the program) in the decision process, and these delays could slow down and hinder financing arrangements to the detriment of the guarantee programs involved.

Questions also were raised about the effect of advance approval of sources of financing on established securities markets for guaranteed issues. Witnesses pointed out that financial markets now work well for certain types of federally guaranteed securities. Furthermore, although the Federal Financing Bank facilities would be available on a voluntary basis, under the advance approval requirement the Secretary of the Treasury could require that securities subject to advance approval be financed through the Federal Financing Bank. If this occurred, existing markets for some securities could be weakened or eliminated, forcing the issuers to become dependent upon the Federal Financing Bank, and thus the Federal Government, for their funds.

The Senate Committee on Banking, Housing, and Urban Affairs included guaranteed issues in the advance approval requirement in S. 925 [2] because it believed that excluding them would not be consistent with the purpose of the bill (to coordinate securities market financing by Federal agencies) since many guaranteed obligations financed on the securities markets (S. Rept. 93–166). Additionally the Senate Banking Committee believed that the differences between direct issues and guaranteed issues was largely technical, and the committee was satisfied that the current administration proposal would not include guarantees of individual obligations not financed on the securities markets, such as individual home mortgages financing.[3]

If the committee decides to include guaranteed obligations in the requirement of advance approval, it may want to consider special questions regarding this requirement that have been set forth for two industries:

Maritime Industry.—Concern was expressed that the effect of the advance approval requirement might be to delay ship construction financing, which could be inconsistent with the purpose of the Merchant Marine Act of 1970. Additionally, witnesses have raised questions about the jurisdiction of the committee to make changes with respect to an Act which is under the jursidiction of another committee.

Housing.—Concern was expressed that the provision in the advance approval requirement which is intended to exclude, in general, most single family FHA and VA guaranteed mortgages is vaguely drawn, and in addition would not exempt much of the back-up financing for these programs provided by the mortgage-backed guarantee program of the Government National Mortgage Association.

2. Withholding advance approval

The proposal for advance Treasury approval of financing terms and conditions is intended to assure debt management coordination of Federal and federally guaranteed borrowing activities. (This requirement was in the version of the bill reported by the committee last year.) The Treasury has stated that the advance approval requirement would provide a focal point for early recognition of the volume and timing of the proposed level of government assisted credit, and its likely impact on financial markets. However, the proposal for advance approval necessarily implies that the Treasury may not approve some proposed financing plans.

The proposal for advance Treasury approval of the terms and conditions of financing appears to allow the Secretary of the Treasury to withhold approval for an indefinite period as long as he submits to the Congress a detailed explanation of his reasons for doing so within 120 days of receipt of a request for approval. It has been suggested that the requirement of submitting an explanation is an insufficient

[2] In the last Congress the Senate Committee on Banking eliminated advance approval for guaranteed obligations from the administration's proposal because it believed that the requirement gave the Secretary of the Treasury too much control over operational aspects of loan guarantee programs and weakened the authority of Federal agency heads to carry out the responsibilities assigned to them by Congress. (S. Rept. 92–853). In addition, the Senate Committee believed advance approval was not necessary nor administratively feasible for individual loan guarantees.

[3] In his additional views in the Senate Banking Committee report (S. Rept. No. 93–166), Senator Proxmire argued that it is inappropriate to give overall control of Federal credit programs to the Secretary of Treasury since the Treasury cannot be an "impartial traffic cop when it accounts for most of the traffic." Additionally, Senator Proxmire argued that control of guaranteed issues would disporportionately affect housing and urban development programs, would frustrate the intent of Congress in authorizing the Government National Mortgage Association (GNMA) to guarantee mortgage-backed securities to provide funds for housing during credit shortages, and would encumber programs in additional red tape.

limitation on the powers of the Secretary of the Treasury to control the financing of Federal agency programs, and thereby control substantive aspects of these programs.

The Senate Banking Committee bill, S. 925, would prohibit the Secretary from withholding advance approval for more than 120 days of receipt of a request for approval. In addition, the Senate Banking Committee's bill would require the Secretary to report to Congress within 60 days of receiving a request for approval (instead of 120 days as proposed by the administration) if he does not approve the request within that period. Also, this bill would provide that "to the maximum extent practical" the Secretary would withhold his approval in a manner "not disproportionately detrimental to the funding of any particular type of Federal program." This is intended to mean that if the Secretary of the Treasury determines that some agency financing must be delayed because of the market situation at the time, the Secretary should hold up various types of obligations on a more or less proportionate basis.

As an alternative to the Senate Banking Committee action, the committee could require the Secretary to take action to expedite the proposed borrowing program if he does not approve of the specific financing program submitted. For example, the committee could provide that the Secretary be required to propose (within a stated period of time from the date of receipt of request for approval) an alternate financing program that will meet the needs and purposes of the proposed financing program, will not unduly delay or increase the cost of the financing program, and that can readily be implemented by the agency. If an alternative program were not submitted by the Secretary to the agency within the required period of time, it could be provided that the original proposal will be deemed approved.

Federal Financing Bank

1. Taxation of Federal Financing Bank obligations by State and local governments.

The administration proposal provides that obligations issued by the Federal Financing Bank will be subject to Federal, State, and local taxation. The bill previously reported by the committee provided that the obligations would be subject only to Federal taxation. The committee did not believe the Bank's obligations should be subject to taxation by State and local governments, since this changes, in general, existing law regarding the taxation of Federal obligations.

The bill reported by the Senate Banking Committee is the same as the bill previously reported by the Committee on Ways and Means, with respect to taxation of Federal Financing Bank obligations. Under S. 925 these obligations would be subject to Federal taxation but not to State or local taxation.

The administration favors allowing State and local governments to tax interest on obligations issued by the Federal Financing Bank because it expects that much of the debt purchased by the Bank will be federally guaranteed obligations now subject to tax by most State and local governments. Consequently, the administration believes that by exempting Federal Financing Bank obligations from State and local taxation, these governments would be deprived of revenue they otherwise would receive, as compared to the present methods of financing guaranteed obligations.

2. Effect on agency borrowing or guarantee authority.

In testimony before the Committee, the administration witness stated that the proposal would not increase the authority of Federal agencies to issue, sell or guarantee obligations. He also stated that the administration would prepare clarifying language to make this aspect of the proposal explicit, and this has been submitted to the committee.

3. Budgetary relationship

Under the proposal receipts and disbursements of the Federal Financing Bank would not be included in the budget of the United States and would be exempt from statutory limits on expenditures and net lending (budget outlays) of the United States. However, the Bank would be required to annually report to the President and the Congress on its operations and activities. In order to provide Congress with full information on and control over Bank activities, the committee may wish to provide that total Bank receipts and disbursements, as well as a breakdown of agency financing programs handled by the Bank, be included in the budget.

Special industry problems

Several individual industry situations were discussed by witnesses.

Tennessee Valley Authority.—The administration witness stated that the requirement of advance approval excludes securities issued by the Tennessee Valley Authority. This is in accord with the bill reported by the committee in the last Congress.

United States Postal Service.—The administration witness testified that with respect to the Postal Service, the proposal would simply provide an additional optional method of financing Postal obligations. In this respect, the administration proposal is the same as the bill reported by the committee in the last Congress, and is agreed to by the United States Postal Service.

State and local governments.—During the tax reform hearings, a proposal was made to offer State and local governments the option of issuing securities taxable by the Federal Government, with the Federal Government paying an interest subsidy. Questions were raised during the Federal Financing Bank hearings as to whether such taxable State and local securities should be included in the Bank program. It was suggested that inclusion would not be proper and the Bank should not be able to acquire taxable option securities, because a purpose of the taxable bond option would be to broaden the market for State and local securities.

The administration witness stated that the Treasury does not intend to cover taxable option securities in the Federal Financing Bank. In addition, he suggested that exclusion of these securities could be specifically provided for in the future if the taxable bond option was adopted, or that the exclusion could be added now in anticipation of later action.

Section-by-Section Summary of Proposal

Sec. 1. Short title.—The act may be cited as the "Federal Financing Bank Act of 1973."

Sec. 2. Findings and declaration of purpose.—Findings: That demands for funds through Federal and federally assisted borrowing

programs are increasing faster than the total supply of credit, and that such borrowings are not adequately coordinated with overall Federal fiscal and debt management policies.

Purpose: To assure coordination of these programs with the overall economic and fiscal policies of the Government, to reduce the costs of Federal and federally assisted borrowings from the public, and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions.

Sec. 3. Definitions.—"Federal agency," "obligation," and "guarantee" would be defined in a manner which would include all debt obligations issued, guaranteed, insured or otherwise secured by an agency of the United States.

Sec. 4. Creation of bank.—A Federal Financing Bank would be established as an instrumentality of the U.S. Government subject to the general supervision and direction of the Secretary of the Treasury. The Bank would be authorized to maintain such offices as appropriate to carry out its purposes.

Sec. 5. Board of Directors.—The Board of Directors would determine the general policies of the Bank and would consist of five members, including the Secretary of the Treasury or his designee as Chairman and four other members appointed by the President from officers and employees of the United States.

Sec. 6. Functions.—The Bank would be authorized to purchase and sell any obligation issued, sold, or guaranteed by a Federal agency at a rate not less than a rate determined by the Secretary of the Treasury taking into consideration current average yields on outstanding obligations of the United States or of the Bank of comparable maturity. The Bank would be authorized to charge fees to provide for expenses and reserves.

Sec. 7. Treasury approval.—Federal agencies issuing, selling, or guaranteeing obligations would be required to submit financing plans to the Secretary. However, obligations issued by a Federal agency would not be subject to review if they were issued or sold pursuant to an Act of Congress that prohibits any guarantee of the obligations by the United States. In addition, advance approval would not be required for obligations guaranteed in connection with certain programs involving the guarantee of large numbers of individual obligations originated and serviced by local lending institutions. The approval of the Secretary would be required of agency financing plans including the terms, conditions, timing, methods, and sources of financing. The Secretary could not withhold his approval for more than 120 days unless he has submitted a detailed explanation to the Congress of his reasons for so doing.

Sec. 8. Initial capital.—The Secretary of the Treasury would be authorized to advance up to $100 million to the Bank which would bear interest at a rate determined by the Secretary of the Treasury taking into consideration the current average yield on outstanding Treasury obligations of comparable maturity. Appropriations would be authorized for this purpose.

Sec. 9. Obligations of the Bank.—The Bank would be authorized, with the approval of the Secretary of the Treasury, to issue its obligations to the public in amounts not to exceed $15 billion outstanding at any one time.

The Bank would also be authorized to issue obligations to the Secretary of the Treasury, and the Secretary would be authorized to use the proceeds of public debt transactions to finance such purchases.

The Bank could require the Secretary of the Treasury to purchase its obligations in such amounts as will not cause the Secretary's holdings resulting from required purchases to exceed $5 billion at any one time.

Obligations of the Bank would be lawful investments for fiduciary, trust, and public funds under Federal control.

Sec. 10. General powers.—The Bank would have the usual corporate-type powers.

Sec. 11. Exemptions.—The Bank and its income would be exempt from all taxes except real and tangible personal property taxes. Obligations issued by the Bank, would be subject to Federal, State, and local taxation to the same extent as obligations of private corporations.

Obligations issued by the Bank would be exempt from certain securities law requirements.

The budget status of agencies selling obligations to the Bank would not be affected. Receipts and disbursements of the Bank would not be included in the budget of the U.S. Government and would be exempted from statutory limitations on expenditures and net lending (budget outlays) of the United States.

Sec. 12. Preparation of obligations.—The Secretary of the Treasury would be authorized to prepare, hold, and deliver obligations for the Bank on a reimbursable basis.

Sec. 13. Annual report.—The Bank would be required to transmit to the President and Congress an annual report of its operations and activities.

Sec. 14. Obligations eligible for purchase by national banks.—National banks would be permitted to invest in or deal in obligations of the Bank.

Sec. 15. Government Corporation Control Act.—The Bank would be subject to the budget and audit provisions of the Government Corporation Control Act in the same manner as they are applied to certain wholly owned Government corporations.

Sec. 16. Payments on behalf of public bodies.—Federal agencies would be authorized to make payments to the Bank on behalf of a local public body or agency to avoid increasing net costs to any such body as a result of purchases of local obligations by the Bank. Appropriations for such payments would be authorized.

Sec. 17. No impairment.—The act would not impair any authority of the President or Secretary of the Treasury under any other provision of law, nor would the act affect the right of Federal agencies to sell obligations to the Secretary of the Treasury or the authority or obligation of the Secretary of the Treasury to purchase such obligations.

Sec. 18. Separability.—The remaining provisions and validity of the act would not be affected if any provision is held invalid.

Sec. 19. Effective date.—Section 7 of the act would become effective 30 days after enactment. Other sections would become effective immediately.

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