

Statement of Wm. McC. Martin, Jr., Chairman,
Board of Governors of the Federal Reserve System,
before the
Committee on Banking and Currency, House of Representatives,
December 13, 1963

I understand that the principal purpose of my appearance this morning is to answer questions from the Members of the Committee. With your permission, however, I should like to make a brief statement concerning H.R. 5845, the bill to grant limited authority to national and State member banks to underwrite and deal in revenue bonds.

In view of the voluminous testimony you have received on the revenue bond question, no purpose would be served in repeating this morning all the reasons why the Board of Governors opposes enactment of H.R. 5845 in its present form. Rather, I have just two points to submit for your consideration.

The first point relates to the extent to which State and local taxpayers may expect to save money if this bill is enacted. In my earlier statement to the Committee on H.R. 5845, I reported the results of a staff study of A-rated general obligation and revenue bond issues of \$2 million or more that came to market in the first half of 1963. This survey indicated that the average yield at which various maturities of revenue bonds were reoffered to the public was about one-eighth of one percent higher than for general obligations of comparable quality, and that underwriting spreads (in terms of basis points) averaged somewhat higher for the general obligations than for the revenue issues, despite bank competition for the former.

By reciting these figures, I did not mean to imply either that one-eighth of one percent is an insignificant amount, or that enactment of H.R. 5845 would lower interest rates on tax-exempt bonds by that amount. If the dominant attraction of State and local securities is the tax-exemption feature, then the amount of funds available for such investment at any particular level of rates will be determined by a complex set of external

factors, including marginal tax rates and relative interest rates prevailing in the market for both taxable and tax-exempt securities. Under these circumstances, more aggressive promotion of securities in one sector of the tax-exempt market--for revenue issues--probably would absorb funds that otherwise would have gone into general obligations, tending to raise the relative rates necessary to sell these issues.

It is in this context, where potential interest savings on revenue bonds seem likely to be offset to some extent by larger costs for issuers of general obligations, that the Board has considered the proposed legislation. Our judgment is that the prospective over-all interest savings would not justify the hazards of additional bank involvement in the underwriting field.

The second point I hope you will consider is that there is a pressing need for action to end the confusion that now prevails as to the role of commercial banks in municipal bond financing. Because of the conflicting interpretations of the meaning of the term "general obligations of any State or of any political subdivision" in the existing statute, the rules that apply to national banks are different from those that apply to State member banks, despite the obvious intent of Congress that the same rules should apply to both.

Under the Comptroller of the Currency's recent interpretations, a substantial segment of the revenue bonds coming on the market would be "general obligations" and more of them could readily be given that status by a mere change in form. Since "general obligations" are exempt from all of the restrictions of section 5136 of the Revised Statutes, the Comptroller's interpretation of this statute purports to exempt national banks even

from the restrictions as to amount and quality that would apply under H.R. 5845. That is, national banks could underwrite and invest in such revenue bonds without regard to the 10 percent limit prescribed by H.R. 5845 and there would be no statutory requirement that they confine their underwriting to issues that are eligible for bank investment.

Under the Board's interpretation of the "general obligations" provision, however, State member banks are not authorized to underwrite revenue bonds of any kind, in any amount.

If you conclude that banks should underwrite revenue bonds, but subject to limitations as to quantity and quality, H.R. 5845 should be amended and passed to establish clear limitations for national and State member banks alike. While the Board does not favor such a policy, if you decide upon that course we recommend certain clarifying amendments submitted to you earlier. If, on the other hand, you agree with the Board that commercial banks should not underwrite revenue bonds and that section 5136 of the Revised Statutes was intended to prohibit such underwriting, section 5136 should be amended so as to settle any doubt on that score. This should be done to end an inequitable competitive advantage now enjoyed by national banks, and, more importantly, to move toward greater consistency in the administration of our banking laws. The Board recommends that this be done by adding to section 5136 the definition of the term "general obligation" that we previously submitted to the Committee.