STATEMENT OF ROBERT M. HANES
CHAIRMAN, COMMITTEE ON FEDERAL LEGISLATION
REPRESENTING THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association urges that no further extension be granted of the date upon which the prohibition of the payment of interest on demand public deposits becomes effective. The two-year extension from the effective date of the Banking Act of 1935 provided ample time for the states and their political subdivisions to bring their laws and ordinances, wherever necessary, into harmony with the Federal law. During such period at least one regular session of the legislature of each state has been held with the result that in only six states no action has been taken towards conforming with the Federal statute. This legislation, therefore, appears to be designed to benefit only those few states which have been dilatory in changing their laws.

We submit that it is unfair to the states which have already acted in good faith in anticipation of the prohibition becoming effective on August 23, 1937, to now enable the few states which have not acted to continue to receive interest on demand deposits.

Furthermore, we believe that the payment of interest on demand deposits is contrary to the maintenance of a sound banking system in the light of present and foreseeable future conditions in this country and that any continuance of this practice, no matter whether limited as to extent or as to time, will prove harmful to the interests of the public. Statements made by Federal banking supervisory authorities and others during the hearings on the Banking Acts of 1933 and '35 were to the effect that it was the

intended national policy to abolish the payment of interest on all demand deposits so as to prevent unsound competition which wrecked so many banks. It was also stated that this policy would enable banks to be in a position through the savings thus effected, to safely contribute to the Federal Deposit Insurance Fund, so that the Corporation would have adequate means for its successful operations. Thus Congress gave recognition to the shrinkage in bank earnings, necessitating compensating reduction in expenses.

This shrinkage, while aggravated by the depression conditions existing during the years immediately following 1929, resulted primarily from certain fundamental changes in the nature of bank assets, which appear to be more or less permanent. Until the recent past the bulk of a bank's liquid assets were in profitable short-term loans made to finance current operations of business and industry. Today these short-term loans, form only a minor part of a bank's total assets, the major portion being represented by cash and government securities, producing either no earnings or a substantially lower return than had formerly been obtained from loans. Some of the reasons for the changes are :-

(1) the increase in reserve requirements;

(2) the practice of industrial and business corporations in maintaining substantial cash reserves to care for current needs;

(3) the abnormal growth in bank deposits necessitating the maintenance of a substantially larger proportion of cash or short-time, low yielding securities in order to meet the withdrawal of excess deposits when required by increased business activity; and,

(4) the large holdings of government bonds bearing extremely low rates of interest.

All of these factors have contributed to the shrinkage in earnings.

Since there is no immediate prospect of a bank increasing its earnings through the medium of investments, it must seek means of paring

down its expenses if it is to continue as a going concern. Statistics show that interest paid on deposits has been one of the largest items of a bank's expense. The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation have recognized this condition and by regulation have required a substantial reduction in interest rates paid on time deposits.

The absence of restrictions on the payment of interest on demand public deposits encourages banks, especially in the smaller communities, to compete for these deposits through the payment of rates of interest totally out of line with their ability to earn. Such a course is an incentive to banks to invest in high-yield low-grade securities and sub-standard loans, with the resulting danger of failures which accompany such practice.

Every bank to be sound must earn a reasonable return and any unsound practice which causes a loss to the bank reacts unfairly to the interest of all the depositors.

Demand public deposits, less than any other, deserve the payment of interest because in practically all states they are protected by insurance and the deposit of acceptable security, whereas, generally speaking, other demand deposits are protected only to the extent of the insurance. No bank, today, can accept the risks that attend bond holdings, which must be held to protect public deposits, and at the same time pay interest on these deposits.

Moreover, any division of government can obtain interest on its

deposits, if they are at all stable, by placing them on time, whereas if they are only temporary they deserve no interest and no bank, under present conditions, can afford to pay interest on them.

Congress, in the Banking Act of 1935, repealed all Federal laws requiring the payment of interest on demand deposits of Federal funds. We, therefore, believe that no preference should be given to other demand public deposits. It is true that a few states and municipalities, through their lack of diligence, have created a problem for themselves, but we earnestly submit that Congress should not be asked to alleviate this self-incurred condition. These public bodies, which claim they need your assistance, have it within their own power to correct their situations.

In conclusion, we should like to point out very emphatically the latent danger contained in this legislation. The granting of an additional two years to enable the few states which have not acted to bring their laws into conformity with the Federal statute would only mean that the same legislation will be again requested two years hence. Not only this, but if the prohibition is extended we believe it will mean that other demand depositors will be encouraged to seek an exemption as to the payment of interest on their deposits, which would eliminate one of the most constructive features of recent banking legislation.

We urge that the maintenance of a strong banking system requires the permanent prohibition of interest on all demand deposits without exception.

A schedule showing the present status of interest on public deposits legislation in the various states is submitted herewith.