Statement of
Chairman K. A. Randall
Federal Deposit Insurance Corporation
before the
Subcommittee on Financial Institutions
of the
Senate Committee on Banking and Currency
September 10, 1969

The Federal Deposit Insurance Corporation appreciates the opportunity to appear before the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency to present its views on S. 2577, a bill "To provide additional mortgage credit, and for other purposes." My comments today will be confined to those provisions of S. 2577 which are pertinent to the statutory responsibilities of the Corporation.

Section 1 of S. 2577 would extend for an additional one-year period the statutory flexible authority for regulating interest and dividend rates on time and savings deposits or shares or withdrawable accounts payable by insured banks and by savings and loan associations that are members of the Federal Home Loan Bank System. The authority was originally granted the Federal bank regulatory agencies and the Federal Home Loan Bank Board by the Act of September 21, 1966 and has been twice extended. This flexible authority has enabled the agencies to act more effectively to moderate excessive competition between various types of financial institutions for savings during periods of "disintermediation" in the money and capital markets and to minimize disruptive flows of savings between institutions. It has proved most valuable in coping both with the problems that faced the regulatory agencies at the time the more flexible authority was conferred as well as with the types of situations that arose subsequently and reasonably may be expected to develop in the future. It makes possible prompt and appropriate action whenever needed.

The three-year period during which the rate authority has been in effect has demonstrated clearly the need for, and the value of, such authority. The flexible rate authority, moreover, has enabled commercial banks as well as mutual savings banks and savings and loan associations to maintain a continued flow of funds into housing--an area in which commercial banks in particular have become more active in recent years. Accordingly, the Corporation recommends that the flexible rate authority over FDIC-insured banks and member institutions of the Federal Home Loan Bank System be made permanent, rather than extended for an additional one-year period as provided for in section 1 of S. 2577.

Section 2 of S. 2577 would extend the flexible rate authority of the Federal Deposit Insurance Corporation to "noninsured nonmember banks (including...noninsured mutual savings banks)." It would also provide enforcement powers in the form of authority to enjoin violations of rate ceiling regulations or to enforce compliance with such regulations issued under the Corporation's broadened authority to regulate payment or advertisement of interest or dividends on deposits by noninsured banks.

Certain banks not insured by the FDIC and certain noninsured non-bank financial institutions--some of them quite large--are currently outside the scope of the Federal regulatory authority relating to the payment of interest or dividends on time and savings deposits or shares or withdrawable accounts. To the extent that such institutions are a significant factor in a particular savings market or submarket, the effectiveness of rate regulations is subject to some significant constraints, particularly during periods of strong credit demands and fiscal and monetary restraints such as the economy is currently experiencing.

When the current interest rate legislation was originally enacted into law in September 1966, the fact that some financial institutions escaped the reach of federal interest rate regulations did not present any major supervisory problems because the rates paid by many of these institutions were below the rate ceilings that were established. As market rates of interest have continued to move up in the course of the current expansion, however, the presence of institutions not subject to the rate ceilings tends to make it more difficult for the regulatory agencies to administer the flexible rate authority in a broad, nondiscriminatory manner.

There is some evidence that the rate differentials between certain institutions subject to the rate ceilings and those not subject to the ceilings have become significant enough in some cases to cause some diversion of funds away from institutions under rate controls in certain areas. To date, however, these rate differentials have not caused massive shifts of funds. Nevertheless, over time, the cumulative effect of a persistent "nibbling away" of new and existing deposits from insured institutions by the offer of slightly more attractive rates tends to erode the competitive position of these institutions. This "nibbling" process tends to undermine the interest rate structure fixed by regulation for similar institutions across the nation--particularly since the account holders probably most affected are the larger and more interest-sensitive depositors. If this type of situation is permitted to continue for an extended period of time, institutions adhering to the rate ceilings are disadvantaged in the competition for savings, their growth rate tends to be slowed, or they suffer an actual drain of deposits or share accounts to higher paying institutions. Some institutions are forced to exercise other options, such as borrowing to obtain funds for business purposes. These pressures, moreover, are in addition to those emanating from the money and capital markets. The small saver, who cannot shift his funds around easily, and the institutions that have opted for federal deposit or share account insurance as protection for their depositors or shareholders suffer the most in this type of situation.

The problem is well illustrated by the situation in Massachusetts where a significant segment of participants in the savings market are exempt from Federal rate ceilings. The situation is complex and a number of different factors are involved. Nevertheless, there is evidence that points to the conclusion that the ability of the savings banks not insured by the FDIC but insured under a state system to offer dividend yields above the present 5 percent Federal ceiling has impaired the competitive position of the FDIC-insured savings banks. For example, ever since late 1966 when Federal rate ceilings were imposed, the deposit growth of the eight FDIC-insured mutual savings banks--out of the 176 mutuals in the state--lagged behind the growth of the Massachusetts-insured savings banks as a group (see attached table). Moreover, as the competing mutuals not insured by the Corporation began to offer rates in excess of the 5 percent ceiling prescribed for insured mutuals, the latter eight institutions showed an absolute deposit decline in contrast to the gain by their non-FDIC-insured competitors.

To prevent further deterioration in their competitive positions, the Corporation on April 14, 1969 granted a local rate exemption to the eight banks which in effect permitted them to pay up to 5½ percent on 90-day special notice accounts--a rate being offered by a number of the non-FDIC-insured institutions. In May, the eight FDIC-insured institutions appear to have been able to recoup some of their losses but a slower rate of deposit gain resumed in the following months--possibly because of the limited scope of the exemption granted.

As long as the effective interest or dividend rates paid on deposits or share accounts subject to Federal regulation are limited by the legal ceilings, financial institutions operating under substantially the same economic conditions should in fairness be subject to comparable regulatory burdens. Accordingly, the Corporation favors the provisions of section 2 of S. 2577 that would extend the discretionary and flexible rate control authority to noninsured institutions and provide the Corporation with enforcement powers for violations by noninsured institutions. The provisions of section 2 that would amend section 5B of the Federal Home Loan Bank Act are designed to deal with essentially the same problem.

At the same time, the Corporation would like to recommend an amendment to section 18(g) of the Federal Deposit Insurance Act that would permit its Board of Directors to define for rate control purposes bank obligations other than deposits of insured nonmember banks (and of noninsured banks if section 2 of S. 2577 is enacted into law by Congress). Deposits are already defined in section 3(1) of the Federal Deposit Insurance Act for deposit insurance purposes and includes such other obligations as the Board of Directors shall find to be deposit liabilities by general usage. However, there are bank obligations other than deposits that are or may be used primarily as devices to avoid the effect of interest rate controls and it is this type of transaction that the Corporation may wish to bring under its rate control authority in order to make ceilings effective. The proposed amendment, which is attached as an appendix to this statement, would extend the provisions of section 18(g), in the discretion of the Corporation's Board of Directors, to obligations--other than deposits--that are undertaken by nonmember banks (including noninsured banks) principally for the purpose of obtaining funds to be used in the banking business.

In addition, the Corporation would like to recommend another amendment to section 18(g) of the Federal Deposit Insurance Act to include "dividends" as well as "interest" in the prohibition of payment of interest on demand deposits and to make some other changes for the purpose of clarification. These changes would permit consistent treatment of both insured commercial and mutual savings banks under section 18(g).

In summary, the Corporation favors making permanent the flexible authority for regulation of interest or dividend rates, although a one-year extension would be acceptable if Congress so decides. It also favors those provisions of S. 2577 that would subject noninsured banks and institutions to interest and dividend rate controls in the same manner that insured banks and institutions are subject to such controls.

Attachments

Table
Appendix

Table

Deposit Performance of Mutual Savings Banks in Massachusetts

(Deposits in millions of dollars)

Period	8 FDIC-insured mutuals	All non-FDIC insured mutuals
	(Percentage change in deposits)	
December 1966 to December 1967	+ 5.7	+ 7.2
December 1967 to December 1968	+ 3.6	+ 6.4
December 1968 to March 1969	+ 1.8	+ 2.4
March 1969 to April 1969	- 0.4	+ 0.6
April 1969 to May 1969	+ 0.7	+ 0.6
May 1969 to June 1969	+ 0.4	+ 0.8
June 1969 to July 1969	+ 0.5	+ 1.0

Source: Federal Deposit Insurance Corporation

APPENDIX

Subsection (g) of section 18 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1828(g)), is amended by adding the following new sentences at the end thereof:

> "The provisions of this subsection, and of regulations issued thereunder, shall also apply, in the discretion of the Board of Directors, to obligations, other than deposits, which are undertaken by insured nonmember banks and by noninsured banks principally for the purpose of obtaining funds to be used in the banking business. Such discretion shall be exercised by the Board of Directors (after consulting with the Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board) in whatever manner is deemed necessary to carry out the purposes of this subsection and may be subject to exceptions consistent therewith."