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FEDERAL DEPOSIT INSURANCE
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Statement on

H. R. 2515

a bill "To authorize on a temporary basis certain
business and agricultural loans, notwithstanding
interest limitations in State constitutions or
statutes, and for other purposes."

Presented to

Subcommittee on Financial Institutions Supervision,
Regulation and Insurance

of the

House Committee on Banking, Finance and Urban Affairs
U. S. House of Representatives

by

Irvine H. Sprague, Chairman
Federal Deposit Insurance Corporation

April 3, 1979

10:00 a. m.

2128 Rayburn House Office Bldg.

Mr. Chairman, we appreciate this opportunity to testify on H. R. 2515, a bill "To authorize on a temporary basis certain business and agricultural loans, notwithstanding interest limitations in State constitutions or statutes, and for other purposes."

H. R. 2515 would permit all federally insured banks and savings and loan associations, as well as small business investment corporations and federally chartered land banks and production credit associations, to charge up to five percent over the Federal Reserve discount rate on business and agricultural loans of \$25,000 or more, irrespective of a more restrictive State constitutional or statutory provision. The bill would also make clear that depositors and other obligors of insured commercial banks and savings and loan associations can receive interest from such institutions without regard to interest rate limitations otherwise applicable under State law. The provisions of H. R. 2515 would expire on December 31, 1980.

H. R. 2515 is very similar to Public Law 93-501 which was in effect from October 29, 1974 until July 1, 1977. This legislation was enacted in 1974 when high interest rates caused interest limits in Arkansas, Montana and Tennessee to severely distort the flow of credit in those States. While Tennessee and Montana have since relaxed their ceilings, Arkansas's constitutionally imposed ten-percent ceiling is still in effect. Arkansas has convened a constitutional convention and is drafting an interest rate provision aimed at providing comprehensive relief. The new constitution is scheduled to be submitted to voters in the general

election next year.

We will defer to the Federal Home Loan Bank Board as to the effect of this proposed legislation on savings and loan associations and to the Farm Credit Administration and the Small Business Administration as to whether its provisions should be applied to farm credit institutions and small business investment companies. Our remarks will be confined to H. R. 2515's impact on insured banks.

At present, national banks are limited by Federal law (12 U.S.C. 85) to the greater of either one percent above the Federal Reserve discount rate or the rate permitted by applicable State law (or seven percent if no rate is fixed by State law). State banks are at present governed exclusively by State law in this regard.

Most State laws already exempt loans to corporate borrowers from the ceilings they impose and others have significantly higher limits for corporate borrowers than for individual borrowers.

Mr. Chairman, H. R. 2515 is tailored to provide temporary redress to the situation in Arkansas today, until the people of Arkansas themselves have the opportunity to pass judgment on a comprehensive solution next year.

The credit crunch in which Arkansas now finds itself is very real. Relief for the state is in order while the drafting of the new constitution is in process. The Federal Deposit Insurance Corporation supports interim legislative relief and urges enactment of a measure that will give the people of Arkansas the time to work their will.

There is no question that Arkansas has a problem.

It is not necessary for you to have lived with it in Arkansas to know it. All you have to do is open the daily newspapers and look at the key interest rates in the nation's money markets.

The prime rate, which is what the big money-center commercial banks charge their best business customers, is 11 1/2 to 11 3/4 percent. The rate for negotiable certificates of deposit, that is, those of \$100,000 denomination and more issued by major banks, is just shy of 10 percent for a three-month instrument, between 10 and 10.3 percent for six-months, and 10 percent-plus for one year.

These are the going rates for money in the places where you have to go to buy money when you need it. It doesn't take much to see, on the face of it, that you can't lend money for 10 percent or less when it costs you 10 percent or more to buy it.

That is the situation that Arkansas finds itself in today. Through no fault of its own, the state of Arkansas is a victim of economic forces that have conjoined to drive interest rates up.

When you have a situation in a state in which the major lenders can't lend, and the major borrowers can't borrow, you have major trouble.

These forces not only constrict the flow of funds into the state; but also encourage the state's own home-grown wealth -- the gain generated by the farmers and businesses of Arkansas -- to flow out of the state in search of better returns elsewhere.

All investors would naturally seek to put their money where it will earn the highest safe return.

James Hobgood, President of the Arkansas Bankers Association and Chairman of Merchants and Planters Bank and Trust Company of Arkadelphia, put it very well when he said in an address to the 1979 Customer Service/Contact Workshop: "We need to be attracting outside money into our area rather than promoting the outflow of cash to other states. The only way we can do this is to be competitive in the national money market."

If the major economic institutions in the state are hindered by tight credit, the smaller borrower is going to suffer, too. I'm talking now about the farmer and the worker and the small businessman and the other people who make up the heart of the state of Arkansas and who are its true strength and wealth.

It is a mistake for an individual to think that he or she is not affected by the credit pinch simply because he or she is not borrowing money or because his or her borrowings are exempt from the provisions of H. R. 2515. The fact is that the cost of money must be paid and those firms which must borrow in order to operate their businesses pass the cost along to the general public in the form of hidden charges. Quite often credit costs may be incorporated into the price of goods and services.

For example, the Arkansas Banker magazine in its February 1979 issue, described a price comparison survey showing that items commonly sold on retail revolving credit in Arkansas are priced appreciably higher than in neighboring states because sellers need higher prices to recover their credit costs.

Last October, the Arkansas Banker ran an article entitled "Arkansas and Its Crippled Economy", surveying the effects on various sectors of the Arkansas economy and on people's lives. The article said that farm implement dealers in many areas of Arkansas report severe problems in financing machinery for their farm customers, especially the small and marginal farmers who need help the most. The article also discussed effects on consumers, retail merchants, workers and others.

The article quoted W. H. Fox, of Pine Bluff, President of the Associated Industries of Arkansas, who wrote to Arkansas' Senators in Washington, saying: "The citizens of Arkansas are directly affected, many in the assurance of their jobs and others in their ability to borrow funds to meet the needs of their families."

The banking industry would say that this measure is somewhat like a bridge loan. It just tides you over. We in the bank supervisory sector support and recommend enactment of legislation providing interim relief from a very difficult credit situation in Arkansas so that the people themselves can have a chance to deal with the problem on a more permanent basis.