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Statement on

S. 1988

"TO EQUALIZE COMPETITION BETWEEN STATE AND NATIONAL BANKS AND FOR OTHER PURPOSES"

Presented to

Committee on Banking, Housing, and Urban Affairs
United States Senate

by

Irvine H. Sprague, Chairman
Federal Deposit Insurance Corporation

5302 Dirksen Senate Office Building
10:00 a.m.
December 17, 1979

Good morning Mr. Chairman, members of the Subcommittee.

We are here today to discuss legislation that would confer permanently on State-chartered banks the authority that national banks have enjoyed for 46 years to lend at a maximum interest rate of one percent above the discount rate, regardless of State law.

We support the thrust of this bill, S. 1988, but only as an emergency measure to meet a disruptive economic situation which some States themselves cannot deal with at this point.

We would note that at the time the national bank provision became part of the Banking Act of 1933, the Federal Government exercised no systematic supervisory or regulatory authority with regard to State-chartered banks unless such banks had voluntarily joined the Federal Reserve system. It was only with that landmark Banking Act of 1933, which established Federal deposit insurance for State-chartered as well as National banks, that Federal supervision and regulation of State non-member banks was also begun.

As a general principle, I am opposed to interfering in matters traditionally a state concern, such as usury laws. The present situation may be an exception, in a limited sense, because the current phenomenon of volatile, high market interest rates colliding with relatively low usury ceilings is causing severe distortion of fund flows.

After careful consideration, we have decided that the present circumstances justify our support of the bill with some limiting amendments. Specifically, any law should expire in July, 1981, to provide time for action by states with constitutional problems

and by July, 1980, for states that can act by legislative means. We understand that several State legislatures and the District of Columbia already have taken action this year. More are in the process.

In short, it would be poor public policy to legislate permanently to address what we hope will be one of those temporary aberrations that unfortunately occur from time to time.

Without addressing the reasons for or the merits of usury ceilings, we all know the effects when market rates rise above usury limits.

Usury laws do work. The uncontested fact is they hold down rates. They also in some instances dry up the market. If usury ceilings apply only to certain classes of borrowers, lenders will tend to shift funds to loans not covered by the ceiling when market rates exceed the usury ceiling rates. In some cases, this could involve a shift from loans to other types of investments such as Treasury or Federal Agency obligations. In other cases it may mean making loans outside a normal trade territory in another State where the usury ceilings, if any, are higher. In extreme cases in some States where the ceilings apply broadly to most loans made by specific types of financial intermediaries, loanable funds in those institutions may dry up as savers and investors shift their money to market funds which can pay higher rates because their income is not inhibited by the lower usury ceilings.

However, it should be noted that usury ceilings are not the only State laws that restrict the flow of financial resources

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and discriminate against particular lending institutions. For example, New York, which also has a relatively restrictive usury ceiling, restricts the activities of savings banks in several important ways: New York savings banks may not make automobile and certain other consumer loans; they may not accept business deposits; they are subject to a more restrictive borrowing limitation and to more restrictive branching rules than other depository institutions in the State.

PROVISIONS OF S. 1988

S. 1988, as introduced, would permit State-chartered insured banks, Federal and State-chartered insured savings and loan associations, small business investment corporations, and Federal and State-chartered insured credit unions to charge one percent over the Federal Reserve discount rate (or the rate permitted by State law if that is higher) on all loans, notwithstanding State usury statutes. The bill would be permanent, but a State could at any time after its enactment make the Federal law inapplicable in that State by adopting legislation to that effect.

The purpose of S. 1988 is to achieve parity between the loan rates that may be charged by national banks and by State-chartered banks and other financial institutions.

EMERGENCY RELIEF

I would propose that the effective life of S. 1988 parallel that of Public Law 96-104, the Arkansas interim relief law, which

provides for a temporary usury override on business and agricultural loans of $25,000 or more until July 1, 1981, unless the voters act sooner on a constitutional proposition or the State legislature reimposes the ceiling.

The July, 1981, deadline -- as well as a July, 1980, deadline for States with statutory ceilings -- is also used in the nationwide counterpart to the Arkansas usury law that is contained in H. R. 4986 the omnibus banking bill now in conference.

Both deadlines occur again in another Senate passed measure, H. R. 4998, a stopgap extension bill, which also adopts certain provisions from the bill in conference, including the nationwide Arkansas usury law provision as modified to include the separate expiration dates for States with constitutional and statutory usury ceilings. H. R. 4998, as passed by the Senate, would also authorize remote service units for Federal savings and loan associations, automatic transfer services for commercial and mutual savings banks, and share drafts for Federal credit unions -- all through March 31, 1980. Without this authority, all such services must cease at the beginning of next year under the terms of a Court of Appeals ruling last April.

There are two other provisions in the stopgap bill, both similar to language in the H. R. 4986 omnibus bill. One would preempt State usury ceilings for certain loans secured by residential mortgages, although States would be permitted to reimpose such ceilings within two years of the bill's enactment. Unlike H. R. 4986, the version in the stopgap bill, H. R. 4998, would give the Federal Home Loan Bank Board authority to make rules and issue interpretations

concerning the usury provision, and H. R. 4998 would give institutions six months after enactment to make commitments to lend without regard to any reimposition of usury ceilings by State law, so long as the loan is made within two years of enactment. Finally, H. R. 4998 would require a 45-day study (instead of 90 days as in H. R. 4986) of difficulties faced by depository institutions with sizable portfolios of low-yielding mortgages.

The House counterpart to the Senate amended H. R. 4998 was introduced last Tuesday and was scheduled for Floor action today. H. R. 6100 would simply extend authority for remote service units, automatic transfer services and share drafts through March 31, 1980. I understand that the motion today under suspension will be to repass H. R. 4998 with the text of H. R. 6100 substituted for the Senate language.

The July, 1980, and July, 1981, usury preemption dates have been twice passed by the full Senate. It would seem appropriate in considering S. 1988 to follow precedent. Further, by the very act of incorporating an expiration date for the usury override authority, we would make it clear that the Federal intention in S. 1988 is to gain time for States to address the problems on their own. Perhaps this will force States to reconsider usury ceilings for whatever decision States wish to make.

It is true that a usury ceiling has the same effect whether it is imposed constitutionally or statutorily. It is also true that

States with constitutional ceilings cannot change them without going through the lengthy, deliberate process that includes a vote by the people. States with constitutional ceilings do not have the option, for example, of calling a special session of the legislature to address the usury question. So it would seem fair to provide states with constitutional ceilings with an extra year in which to address their problem.

A bill revised as we have suggested would focus its relief primarily on one state in severe need. The new Arkansas usury law -- Pub. L. 96-104 -- does offer relief with regard to business and agricultural loans of $25,000 or more and H. R. 4986 and H. R. 4998 would make this nationwide, but the situation in Arkansas for other important loans -- including mortgage and consumer -- is nothing short of critical.

I have asked Arkansas State Bank Commissioner Beverly J. Lambert, Jr., to keep us provided with up-to-date information on the lending situation in Arkansas.

With the discount rate currently at 12 percent, the effect of Federal law is that, except for loans covered by Pub. L. 96-104, National banks can lend at 13 percent, but State banks are held to the 10 percent constitutional ceiling.

Mr. Lambert tells me that lending by State-chartered banks has come almost to a standstill in Arkansas. He says that such banks are making virtually no mortgage loans and very few consumer loans or small loans to the people who really need it most.

Mr. Lambert says that state banks have put much of their money into participations in large corporate loans with national banks. National banks, of course, were able to charge above the usury ceiling even before Pub. L. 96-104 provided interim relief for business and agricultural loans of $25,000 or more.

Mr. Lambert says that a number of the 192 State-chartered banks in the State may convert to national charter next year if there is no remedy.

I also asked our Regional Director who supervises Arkansas banks to spot-check three different areas in Arkansas to determine what loan rates were being charged by competing National and State banks.

He reported that business and agricultural loans of $25,000 or more, which are exempted by Pub. L. 96-104 from the State usury ceiling, are being made generally in the 15 percent interest range by both National and State-chartered banks in all three areas. Some State banks also were making other commercial loans at 10 percent in the three areas. National banks were making commercial and agricultural loans of less than $25,000 for 13 percent in all three areas.

Personal loans in the three areas were being made at the respective limits -- 13 percent by National banks and 10 percent by State banks.

Real estate loans were not being made in any of the three areas by State banks. National banks were extending real estate credit in only two of the three areas and charging 13 percent.

Arkansas, in the spirit of PL 96-104, already has set about addressing the usury ceiling question on its own. The Arkansas legislature, which was not scheduled to meet again until January, 1981, did not adjourn this year and will continue the general session early in January to consider the drafting of a proposed usury amendment to the Arkansas Constitution. Legislators will consider four proposals to (1) remove the usury ceiling completely, (2) set the ceiling at five points over the discount rate, (3) set the ceiling three points over the discount rate, or (4) authorize the State Legislature to set the usury ceiling. Any amendment approved by the State legislature would have to be submitted to a referendum.

Another proposed amendment dealing with the usury issue already has been drafted by an Arkansas constitutional convention which met last summer. The convention is scheduled to review the draft and put it into a final version in June. The convention's proposal, which is scheduled to be submitted to a voter referendum in the November, 1980, election would give voters the choice between keeping the 10 percent limit or approving a ceiling that would float five points above the discount rate.

OTHER PROPOSED AMENDMENTS

Finally, I would propose three technical amendments to S. 1988. In the interest of equity, we recommend that the Committee modify S. 1988 to include insured foreign bank branches. And we recommend these other technical changes:

Section 101 proposes a new Section 26 to the Federal Deposit Insurance Act. Since our Act already contains a Section 26, the new section should be 27.

Section 202 of S. 1988 would add a new Subsection 18(2) to the Act. The proper sequence would be Section 18(m).

FDIC REGIONAL SURVEY

In order to obtain up-to-date information on the situation around the country, I had my staff conduct a telephone survey of our 14 Regional Offices last week. The following information was obtained from our Regional Directors. Listed by Region are those States which impose usury rates of less than 13 percent on one or more significant categories of loans. Comments contain an indication of the type of loan subject to the more stringent usury limit, but since State laws vary so with respect to definition of loan type and frequently include numerous exceptions, the comments are somewhat general.

The most severe problem appears to exist in Arkansas and is well publicized. Twenty-two other States have a restrictive usury rate on one or more types of loans but, in several of these States, there do exist enough exceptions or opportunities

with respect to other types of loans to give State banks some flexibility by structuring loans properly. For instance, if the single payment rate is overly restrictive, the bank might be able to offer an installment loan.

Following are capsule summaries of the situation in the 23 States:

NOTE: REM = Real Estate Mortgages M = Thousands

Region	State	Comments
Memphis	Arkansas	10% maximum on all loans. Some relief recently obtained on business and agricultural loans over $25,000
	Mississippi	Some smaller consumer loans limited to 10%.
Minneapolis	Minnesota Montana	Several rates more limited than 13% Consumer loans generally limited to 12%
	South Dakota	Consumer loans generally limited to 12%
	North Dakota	Consumer loans generally limited to 12%
New York	New York	REM (single family) limited to 10 1/4% + 1/4 additional each 3 months
	New Jersey	REM (single family) limited to 10 1/2%
Omaha	Nebraska Iowa	Loans generally limited to 12 1/2% Has floating rate keyed to U.S. Treasury securities - currently at 12 1/4%
Richmond	South Carolina North Carolina	Loans to farmers limited to 9 1/2% Consumer loans under 25M limited to 12%

Region	State	Comments
San Francisco	Arizona	Consumer loans (including mortgages) over 5,000 - 12%
	Oregon	Owner occupied purchase money mortgages - 12%
	Washington	Consumer loans for personal property (includes mortgages) and commercial loans under 50M - 12%
Atlanta	No States with usury limit problems	
Boston	Vermont	12% on personal and mortgages - National banks thought to be holding at 12% also
Chicago	No States with usury limit problems	
Columbus	Ohio	8% except for mortgages, loans over 100M, and Corporations. Other exceptions also exist
	West Virginia	11.5% on personal loans
Dallas	New Mexico	10% secured - 12% unsecured
	Texas	10% to individuals (personal and business) - 12% on REM's
Kansas City	Missouri	Based on U.S. Treasury rate - currently 11.4%; goes to 12.8% in 1980
Madison	Wisconsin	12% basic ceiling rate
Philadelphia	Maryland	12% rate on single payment loans of over 3,500

As the above table shows, it is difficult to determine the precise impact of usury ceilings on the competitive position of State banks. One important reason for this is that we cannot know exactly how many National banks are able to use their rate-ceiling edge to advantage and to make loans which are uneconomical for State banks. In addition, interest rate-ceilings affect individual State banks differently, depending on the demand for

particular kinds of loans and the availability of alternative methods by which State banks can meet these credit needs.

CONCLUSION

The FDIC regards S. 1988 as a needed form of relief during a time when economic conditions are placing many financial institutions, particularly the smaller ones, in a cost squeeze and are drying up funds for borrowers. We believe, however, that the usury override authority should be temporary giving States time to respond.

Thank you for this opportunity to testify.