FDIC NEWS RELEASE

FEDERAL DEPOSIT INSURANCE CORPORATION

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Statement by

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before the

Committee on Banking and Currency
House of Representatives
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Opening Summary

In accordance with the Committee's request, I appear today on behalf of the Federal Deposit Insurance Corporation to testify on H.R. 5700, a bill sponsored by nine of the Committee's members. The Corporation welcomes this opportunity to discuss the bill. Let me begin by summarizing our basic position.

We support the concept of increased control over interlocking directorates between competing financial institutions. The potential anticompetitive effects of such interlocks warrant prohibition. But lacking sufficient empirical data on the extent of such interlocks between smaller financial institutions, we prefer that the unequivocal prohibitions of H.R. 5700 not be adopted. Instead, the prohibitions now contained in section 8 of the Clayton Act should be broadened to prohibit such interlocks between banks, savings and loan associations, and similar financial institutions within a defined geographic area -- which should approximate more exactly the area of local competition than the present provision -- whether or not such institutions are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation. In addition, if such interlocks were prohibited generally within a statutorily defined geographic area, the three Federal bank regulatory agencies and the Federal Home Loan Bank Board should be given administrative flexibility (a) to extend the prohibition to similar relationships involving a financial institution located beyond the defined area, if an agency found that the existence of an interlocking relationship might tend to lessen competition substantially, e.g., between banks or other financial institutions which were actual or potential competitors in a national market; and (b) to permit exceptions to the general prohibition, even within the defined area, if the appropriate regulatory agency found that the existence of such an interlocking relationship was the result of common stock ownership or a scarcity of experienced financial talent within the area.

With respect to the provisions of H.R. 5700 prohibiting so-called "equity kickers," the Corporation's limited experience to date with the use of equity participations by insured State nonmember banks indicates no reason why, as a supervisory matter, this financial practice should be banned at the present time. We are aware, however, that other considerations of public policy are involved and that these considerations might well lead to a legislative judgment that equity participations should be prohibited generally. If such a legislative judgment is reached, the coverage of section 14 should in fairness be expanded to include certain other types of lending institutions which compete with those presently listed and specific exceptions for equity participations in small business investment companies and limited profit housing and community development corporations should be included.

We support the Committee's efforts to regulate insider loans but feel that the proper vehicle for such regulation exists through the enactment of legislation along the lines proposed by H.R. 7440, introduced by Mrs. Sullivan -- or as proposed by the amendment which Mr. Brasco offered to the Housing and Urban Development Act of 1970 -- that would permit the appropriate regulatory agency to deal with the problem administratively.

As I indicated on March 9 when I testified before this Committee, the Corporation supports a statutory prohibition against the receipt of brokered deposits. We continue to believe that violation of the prohibition should not be made a crime; that any civil penalty should be applied to the broker as well as to the financial institution receiving the deposits; and that authority should be given to the appropriate regulatory agency to remove or fine, administratively, anyone receiving or arranging for the receipt of such deposits on behalf of a financial institution.

The Corporation, on the other hand, does not favor the enactment of legislation that would categorically prohibit "giveaways" to attract deposits.

Finally, the Corporation wishes to withdraw its past opposition to 100 percent insurance of public funds. Any such change in insurance coverage would raise, however, a number of serious and interrelated problems in which Government agencies other than the Corporation have an interest. Speaking solely for the Corporation, we interpose no objection to the concept of 100 percent insurance of public funds, but we strongly recommend that any statutory mandate include (a) a limitation that such insurance, in the case of States and political subdivisions, extend only to the funds of public units within the State in which the financial institution is located; (b) a requirement that the aggregate amount of funds that could be deposited in banks or savings and loan associations be limited in relation to such criteria as liquidity, total deposits, and capital and that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations; and (c) a requirement that the maximum rates of interest or dividends payable on comparable deposits be the same for all banks and savings and loan associations.

Before commenting in greater detail on the bill's provisions, the Corporation wishes to note that it is now in the process of drafting amendments to the Federal Deposit Insurance Act, most of which are technical in nature. One of these amendments would make more effective the Corporation's present cease-and-desist power by authorizing an administrative proceeding for the prompt removal or fining of any director or officer who violated a cease-and-desist order which had become final or which was the subject of a written agreement between the bank and the Corporation. In view of our belief that such a modification would assist the appropriate regulatory agency in correcting some of the problems with which H.R. 5700 is concerned, the Committee may wish to consider including one or more of these amendments in any revised version of H.R. 5700 that may be reported out of Committee.

I would now like to discuss certain of the Corporation's views in greater detail.

Interlocking Relationships

Turning first to interlocking relationships, sections 2 through 9 of H.R. 5700 contain a variety of proposed prohibitions. None of them would be limited to the geographic area of actual or potential competition;

it appears that they would apply nationwide. Moreover, they are broadly written and would apply across the board to all institutions and organizations covered, unless the institutions involved were owned by a registered holding company. We believe that prohibitions of this breadth are unnecessary and inappropriate in many interlock situations.

Insofar as the holding company exemption is concerned, we make two observations. First, because there are 16 States in which holding companies are restricted or prohibited, the exemption would not be available to banks and other financial institutions in those States even if such institutions were subject to similar control through common stock ownership. Second, by proposing to accord an exemption for holding companies, the bill presupposes -- and we agree -- that not all of the interlocking relationships described are anticompetitive. We hope that to the extent new statutes are enacted which seek to restrict interlocking relationships, a similar exception could be devised for common control situations in which the acquisition of the controlling stock in question was not anticompetitive at the time of acquisition.

Under sections 2, 3, and 4, a person who was a director, trustee, officer, or employee of an insured bank, an insured institution, or a noninsured mutual savings bank would be prohibited from serving at the same time as a director, trustee, officer, or employee of certain other specified financial institutions, of insurance companies, holding companies or subsidiaries thereof, or securities brokers or dealers, or of certain companies engaged in the business of providing title insurance, appraising property, or providing services in connection with the closing of real estate transactions.

While we are concerned about the potential anticompetitive effects of the types of interlocking relationships which sections 2, 3, and 4 would proscribe, we are also concerned about the effect which such prohibitions could have on small financial institutions in small communities.

On balance, we prefer that the prohibitions presently contained in section 8(a) of the Clayton Act be broadened. That section, as you know, does not currently extend to nonmember banks, savings and loan associations, and other financial institutions not federally insured. We would retain the exception in section 8(a) for financial institutions located in a different geographic area, broadening, however, the present geographic coverage to extend to the common area in which such institutions may establish offices, i.e., the area of actual or potential local competition. In addition, we recommend that the appropriate regulatory agency be given authority to proscribe interlocking relationships even beyond such a defined area if the agency found that the existence of such a relationship might tend to lessen competition substantially. We further believe that consideration should be given to the desirability of permitting the appropriate regulatory agency to allow interlocking relationships even within the defined area where the agency found that the existence of such an interlocking relationship was the result of common control through stock ownership or the result of a scarcity of experienced financial talent within the area.

In opting for this more flexible administrative approach, we are not unmindful of the studies on interlocking relationships undertaken by the staff of the Subcommittee on Domestic Finance. Insofar as here pertinent, the first study was concerned with the 300 largest commercial banks in the United States, and the later two with 48 and 49 banks, respectively, in 10 major financial centers. The studies therefore tell us little about the several thousand other and smaller banks not surveyed. The administrative, as opposed to a prohibitory, approach would accord the appropriate regulatory agency with desirable flexibility to deal with particular factual situations that warrant an exception.

Further, on the matter of financial institutions covered by sections 2, 3, and 4, I would like to point out that at least three other types of financial institutions which lend money to the public might logically be included in any list of proscribed interlocks. These would include sales and retail finance companies, factors, and mortgage companies.

Section 9 of the bill would prohibit interlocking relationships with corporations as to which a financial institution has substantial and continuing loan relationships. This again is an area where empirical data, particularly for smaller financial institutions, is lacking. The proposed prohibition, however, appears to be too restrictive in light of what we believe to be common banking practice. The problems we have encountered in this area stem not from interlocking relationships as such, but from such items as excessive loans, loans to borrowers with poor credit standing, and loans made on preferential terms. We believe that a more refined tool for regulating loan transactions could be developed by amending our cease-and-desist and removal powers under sections 8(b) and 8(e) of the Federal Deposit Insurance Act along the lines I recommended on March 9. These could then be used to make more effective our general supervisory authority over the lending practices of insured nonmember banks.

Section 8 of the bill would prohibit interlocking relationships between any financial institution and any corporation more than 5 percent of any class of the stock of which was held with power to vote by the financial institution. The potential for violation of this prohibition, even inadvertently, is substantial. For example, a bank holding less than 5 percent of the stock of a particular corporation one day might the next find itself controlling the vote of more than 5 percent by virtue of being named executor of an estate containing such stock. The bank's fiduciary duty to the estate in question might well dictate not disposing of the stock, and it also might well be inappropriate in the circumstances to require the officer, director, or employee involved to resign from or be discharged by the bank. Another situation is one in which a bank acquires more than 5 percent of the stock of a corporation through foreclosure. The provisions of section 8 would require the bank to divest itself of this stock immediately or eliminate the interlocking relationship. Again, this points up the desirability for a more flexible approach than the bill would provide.

Section 10 relates to mutual savings banks' holding stock in other financial institutions. We believe this prohibition should apply only in those cases where interlocking relationships would be similarly prohibited; that is, where there exists a substantial potential for competition between the institutions in question.

Equity Participations Prohibited

Section 14 of the bill would prohibit insured banks, institutions insured by the Federal Savings and Loan Insurance Corporation, bank or savings and loan holding companies and their subsidiaries, noninsured mutual savings banks, and insurance companies from accepting so-called "equity kickers" in consideration of the making of loans.

The use of the equity participation, frequently called the "equity kicker," appears to be a comparatively recent phenomenon, at least in the field of banking. The practice has numerous variations, such as percentages of net profits, gross sales, or increases in the market price of the borrower's stock. Those institutions which use it claim that it is a hedge against inflation, that it permits lower interest rates on related loans, and that it provides an appropriate return to the lender where borrowers are not well-capitalized from non-bank sources. It is, moreover, a growing practice for financial institutions, as sponsors, to take an equity participation in small business investment companies and a variety of limited profit housing and community development corporations.

A recent survey of large national banks conducted by the Comptroller of the Currency disclosed that 42 national banks reported "equity kicker" loans totaling $159 million, but that those loans accounted for less than three-tenths of 1 percent of the total loan volume of the 502 banks surveyed.

In an effort to determine the extent to which insured State nonmember banks are or have engaged in the practice and whether the acceptance of equity participations has ever presented a supervisory problem for the Corporation, the Corporation recently surveyed each of its 14 Regional Directors. That survey disclosed that insured State nonmember banks make very limited use of equity participations and that their use has been no cause up to the present time for supervisory concern.

The Corporation recognizes that the indiscriminate acceptance of equity participations by an insured bank could have adverse effects upon the bank's financial condition. The expectation of a share in the anticipated profits of a borrower might influence the attitude of a bank's management toward making such a loan at all and could influence the bank to forsake normal business risks for those of a more speculative nature.

The Corporation's experience to date, however, does not indicate that these potentially adverse effects have occurred. Accordingly, from a purely supervisory point of view, there appears to be no reason at the present time for the blanket prohibition contained in H.R. 5700.

The Corporation is aware of the fact that the interest of the bill's sponsors in prohibiting the acceptance of equity participations is prompted by considerations other than those solely related to the financial condition of lenders. They have stated their belief, for example, that lenders should not become involved in the control of nonbanking businesses through the acceptance of equity participations; that equity participations which are to be liquidated through money payments in excess of principal and interest on related loans may lead to the failure of certain borrowers; that equity participations in one borrower's business may lead to decisions not to lend to a competitor of that borrower; and that the acceptance of equity participations runs counter to the philosophy underlying the 1970 amendments to the Bank Holding Company Act of 1956, that banking and commerce should be separated and that potentially anticompetitive practices in the allocation of credit within the Nation's economy should be controlled.

These considerations might well lead to a legislative judgment that equity participations should be prohibited generally. If such a legislative judgment is reached, the coverage of the prohibition should in fairness be expanded to include noninsured commercial banks, building and loan associations, savings and loan associations, homestead associations (including cooperative banks), and other organizations engaged in the business of making or placing loans, all of which compete with the lending institutions already named in section 14.

"Insider" Loans and Disclosure of "Insider" Loans

In my testimony before this Committee on March 9, 1971 relating to recent bank closings, I noted the Corporation's experience with problems of bank soundness and safety related to the abuse of "insider" loans and affirmed the Corporation's interest in preventing such abuses.

Directors, officers, and employees frequently promote business for banks by bringing their own business and that of corporations which they influence or control to the bank. Such "insider" loans are not inherently harmful to the bank. H.R. 5700 would nevertheless prohibit loans to those corporations if 5 percent or more of any class of stock was owned, in the aggregate, by directors, trustees, officers, employees, or members of their immediate families.

We have no empirical data that leads us to believe that a significant portion of loans to such corporations is of poor credit quality. Our experience leads us to conclude that most such loans are repaid in a timely manner and benefit both the borrower and lender. From the standpoint of the safety and soundness of a bank, what is important is a careful and thorough credit analysis of the loan application and the ability to deny the loan if the analysis shows the corporation to be a poor credit risk, not the fact that 5 percent or more of the stock is owned by "insiders."

In addition to a thorough credit analysis, the bank should avoid giving preferential terms on a loan to someone simply because he is an "insider." Even if credit quality is good, preferential terms to an "insider" benefit that borrower at the expense of the financial institution and its shareholders. As we read H.R. 5700, preferential terms on loans to "insiders" would not be prohibited.

Since a thorough credit analysis involves a great many interrelated factors, many of which require decisions based on experience and good judgment, and since methods for giving preferential terms are numerous and frequently ingenious, the Corporation feels that a statutory prohibition based on an arbitrary percentage would be inappropriate.

The bill would also require banks to report to the Corporation, and the Corporation to make available to the public, the nature and amount of all loans to directors, officers, employees, and members of their immediate families. The purpose of public disclosure would seem better served by requiring disclosure to be made to the stockholders of the financial institution rather than to Federal regulatory agencies.

As an alternative approach to the problem of "insider" loans proposed by sections 15-18 of the bill, your Committee and the Congress might wish to consider expanding the disclosure requirements of the Securities Exchange Act of 1934 so that they would apply to banks having fewer than 500 shareholders. Pursuant to the provisions of section 12 of that Act, and with respect to publicly owned State banks registered with this Corporation or the Board of Governors of the Federal Reserve System, regulations prescribed by those two agencies require extensions of credit to bank management to be disclosed publicly unless such extensions are made in the ordinary course of business, are made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons, at no time exceed the lesser of 10 percent of the equity capital accounts of the bank or $10 million, and do not involve more than the normal risk of collectibility or present other unfavorable features.

When I appeared before your Committee on March 9, Mrs. Sullivan requested the Corporation's thoughts on extending to insured banks the provisions of her proposed amendment to the "Housing and Urban Development Act of 1970" which would have provided the Federal Home Loan Bank

Board authority to treat administratively the question of "insider" loans in federally insured savings and loan associations. We believe that the approach of Mrs. Sullivan and Mr. Brasco could resolve the problem of "insider" loans without creating additional ancillary problems, and we support their suggestion that administrative authority to regulate "insider" loans and other conflicts of interest be given to the three Federal bank regulatory agencies and to the Federal Home Loan Bank Board. We intend to submit to them and to the Committee as soon as possible specific language which in our judgment would provide these agencies with the necessary authority.

Brokered Deposits Prohibited

Sections 19 and 20 of the bill would prohibit any bank insured by the Federal Deposit Insurance Corporation and any institution insured by the Federal Savings and Loan Insurance Corporation (or any officer, director, agent, or substantial stockholder thereof) from accepting so-called "brokered deposits." The Corporation's Board of Directors and the Federal Home Loan Bank Board would be authorized to prescribe such rules and regulations as they might deem necessary to effectuate the purposes of the prohibition and to prevent evasions thereof. Any violation of the prohibition or of regulations issued pursuant thereto would subject the offending bank or institution to a penalty of not more than 10 percent of the amount of the deposit to which the violation related. Moreover, under the terms of section 21 of the bill, whoever knowingly asked, demanded, exacted, solicited, sought, accepted, received, or agreed to receive from any insured bank or institution anything of value for himself or for any other person or entity in return for obtaining or assisting in obtaining funds of another for deposit could be fined not more than $10,000 or imprisoned not more than one year, or both.

Brokered deposits, which the bill proposes to prohibit, are deposits placed in a bank pursuant to an arrangement with a money broker, finder, or other person and for which the depositor receives a premium over and above the interest legally authorized to be paid by the bank on his deposit. Their receipt and misuse by insured banks have posed a continuing supervisory problem to the Corporation.

Nine of the 34 insured banks which failed during the period from January 1, 1960 through December 31, 1968 had brokered deposits of $22,342,500, out of a total deposit liability of $78,205,167. In eight of the 20 bank failures occurring from January 1, 1969 to date, the misuse of brokered deposits was a major contributing factor to the closing of the banks. In all of these cases, the receipt of brokered deposits facilitated improper loans to officers, directors, or owners of the closed banks (or to their affiliated interests) or to borrowers outside the banks' normal lending areas, the collectibility of which was sufficiently in question to lead eventually to the closing of the banks.

In some instances, the receipt and misuse of brokered deposits have involved banks in financial difficulties short of closing. In most cases of difficulty, loans are linked to the brokered deposits in the sense that the deposits are placed only if certain loans are made. Brokered deposits, however, since they are not made by the borrower, cannot be used to offset the loan in the event the borrower defaults. Moreover, since most brokered deposits are placed at approximately the same time and are therefore subject to withdrawal on approximately the same date, a bank entering into such a "package" transaction may have to sell other assets in order to meet withdrawals unless it carefully matches deposit and loan maturities. Thus, the bank receiving and misusing brokered deposits may find itself saddled with bad loans or with a liquidity problem, or both, when the deposits are withdrawn from the bank. Almost all of these linked-loan transactions, then, contain potentials which can be extremely hazardous to the bank involved, particularly smaller banks. At the same time, because of the speed with which such transactions are entered into, they are difficult to supervise adequately in a timely way.

Last August, in an effort to determine the extent of "money brokering" activities in the Nation's banking system and to learn why banks attempt to obtain brokered deposits, the three Federal bank regulatory agencies transmitted a special questionnaire to all insured banks which called for the reporting of certain activities engaged in as of July 31, 1970. The questionnaire asked, first, whether the banks had brokered deposits as of July 31, 1970 and, second, whether they had made loans linked to these deposits.

Even though our analysis of the answers to the questionnaire disclosed that the number of banks receiving brokered deposits is small in relation to the total number of insured banks and that the dollar amount of brokered deposits appears to be minimal when compared with the total deposit figure for all insured banks in the country, the Corporation is not convinced that any essential banking service is performed through "money brokering" activities that could not be performed in some other way. The difficulties that a bank may experience through the misuse of brokered deposits by a bank management which makes poor loans with those deposits or is insensitive to the need for matching deposit and loan maturities far outweigh any benefits which might flow from the use of brokered deposits.

For these reasons, the Corporation favors the enactment of legislation along the lines proposed by sections 19 and 20 of the bill that would prohibit the receipt by insured banks and certain other institutions of brokered deposits. We suggest, however, that any proscriptive legislation enacted in this area (a) not make violation of the prohibition a crime, as proposed by section 21 of the bill, since that form of punishment seems to us to be too severe; (b) apply a civil penalty for violation of the prohibition, such as a fine, to the broker as well as to the bank or other institution receiving the deposits, since they are both equally at fault in the misuse of brokered deposits; and (c) authorize an administrative proceeding for the prompt removal or fining of any director, officer, or employee who receives or arranges for the receipt of brokered deposits on behalf of an insured bank or other insured financial institution, since personal responsibility for a bank's deteriorating financial condition is likely to produce a greater degree of self-enforcement.

Giveaways

Tight-money conditions during recent years have increased competition among financial institutions for funds, encouraging, in turn, the greater use of promotional campaigns. Constrained by interest-rate ceilings, banks have been persuaded to compete for funds through premium offers primarily because withdrawals by a large number of depositors could have impaired their liquidity positions and might have necessitated the sale at depreciated values of bank-owned securities or other assets.

Promotional "giveaways" can serve as an effective means for encouraging thrift. They can also be useful in promoting goodwill among customers and in promoting the opening of new institutions or new branches. Bank and savings and loan association customers seem to like them, although many managements and retailers oppose the practice. Moreover, while numerous "giveaway" campaigns by different institutions in geographic proximity may result in the "churning" of accounts by smaller depositors, we have reason to believe that the dollar retention rate is high enough, nevertheless, to make such campaigns worthwhile to the institutions that engage in the practice.

According to the Corporation's Regional Directors, the use of promotional campaigns by insured banks varies from FDIC Region to FDIC Region. The extent of the practice is limited in most places, but large banks in major metropolitan areas appear to make fairly widespread use of the practice. The survey showed rather unequivocally that the use of "giveaway" campaigns has not resulted in supervisory problems.

Existing regulations of the Corporation now prohibit the payment of interest on demand deposits by insured nonmember banks and prescribe maximum rates of interest or dividends that may be paid on time and savings deposits by insured nonmember commercial and mutual savings banks. As a supplement to those regulations, the Corporation adopted a statement of policy, most recently reissued in February 1970, announcing that, in applying those regulations, a premium given to a depositor -- whether in the form of merchandise, credit, or cash -- will be regarded as an advertising or promotional expense rather than as a payment of interest or dividends if the premium is given to a new depositor, is not given on a recurring basis, and the value of the premium (or in the case of articles of merchandise, the wholesale cost excluding shipping and packaging costs) does not exceed $5.00 except that, if the amount of the deposit is $5,000 or more, the wholesale cost of the premium may be not more than $10.00. This policy is enforced by our review of invoices and by our investigation of the complaints of competitors who call abuses to our attention. The Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board have adopted similar statements of policy, while the Comptroller of the Currency permits national banks to offer such premiums if they are "nominal" in value.

For all of these reasons, the Corporation opposes the enactment of legislation that would categorically prohibit the types of giveaways now permitted by agency regulation.

Full Deposit Insurance for Public Units

Sections 25 and 26 of the bill would amend the Federal Deposit Insurance Act and Title IV of the National Housing Act to require the Corporation and the Federal Savings and Loan Insurance Corporation to insure the deposits and accounts of public units for the full aggregate amount of such deposits or accounts, rather than to the maximum amount of $20,000 currently provided for other depositors. They would permit the two agencies to limit the aggregate amount of funds that could be deposited in insured banks or invested in institutions insured by the Federal Savings and Loan Insurance Corporation.

According to the bill's sponsors, the theory underlying the proposal for full insurance of public deposits or accounts is that, as bank failures have "increased," a number of public units have suffered substantial losses, with the result that Federal, State, and local governments have had to increase taxes to recoup these losses. Without at this point enlisting arguments for or against the proposal, the Corporation wishes only to state that this theory is not supported by the evidence.

The Corporation recently completed a study of public deposits, recoveries, and losses in the 50 banks which closed from January 1, 1960 to December 31, 1970. Those 50 banks had 270 public depositors with a total of $37,224,130.16 on deposit. As of year-end 1970, the public units involved had recovered 98.3 percent, or $36,595,750.84, of such deposits in one way or another. An additional $553,791.63 has been or will be recovered through liquidating dividends paid by the FDIC, thereby resulting in a total recovery of 99.8 percent and an estimated net loss of only $74,587.69 to all public depositors in the 50 banks. We believe this evidence clearly refutes the argument that a number of such public units have suffered substantial losses in cases where deposits were not secured or where the deposits of a closed bank were not assumed 100 percent by another institution. It is possible, of course, that recovery of their deposits was delayed and a source of inconvenience. We have no knowledge, however, that Federal, State or local taxes had to be increased to recoup losses resulting from bank failures.

In reevaluating its position with respect to the enactment of legislation that would provide full insurance protection for public deposits or accounts, the Corporation believes that some of the arguments it had advanced in opposition to such proposals are no longer convincing. There is little evidence, for example, to support the argument that a system of limited insurance causes depositors or share account holders (other than the largest ones) to select their depositories only after considering the management characteristics and capital adequacy of the various financial institutions immediately available to them or to support the argument that such a system imposes disciplinary restraint upon bankers who might otherwise succumb to presumed competitive or economic pressures which might develop as a result of the enactment of legislation providing full protection. Moreover, there may indeed be a basis for differentiating between public depositors and other depositors or share account holders in determining the amount of insurance coverage that should be applicable to their deposits, since public deposits represent deposits by the taxpaying public, which has no direct voice in the selection of the depository.

In an effort to determine the impact that full insurance protection for deposits of public units might have upon the FDIC's deposit insurance fund, the Corporation, as a supplement to its recent study of public deposits, recoveries, and losses in the 50 banks which closed during the period from January 1, 1960 to December 31, 1970, estimated the additional disbursements, recoveries, and losses which would have resulted if 100 percent insurance for public deposits had been applicable during that same period. In arriving at our estimates, we assumed that full payments would have been made to all public depositors in the 50 closed banks during the period studied and that the Corporation would have been subrogated to their rights against assets being liquidated. We found that the Corporation would have been required to disburse additional sums totaling $20,546,534.41, and that total recoveries to the Corporation on account of such disbursements would have amounted to

$14,630,782.68. These figures produce an additional net estimated loss to the Corporation of $5,915,751.73 for the 11-year period. The study would tend to indicate that the deposit insurance fund would not be unduly burdened if legislation providing full insurance for deposits of public units were enacted.

In reevaluating its position with respect to the enactment of legislation that would provide full insurance protection for deposits of public units, the Corporation also recognizes that other issues, such as the proposed legislation's potential effect on pledging requirements, deserve careful consideration.

Approximately 30 States require the pledging of securities by banks against State deposits and deposits by political subdivisions. Similarly, Federal statutes require that United States Government deposits in banks be secured by the pledge of Government obligations or certain other securities. In large part, deposits of State and local governments in States requiring the pledging of securities against those deposits are secured by obligations of State and local governments. To the extent that full insurance protection for public deposits might influence some States to repeal their pledging requirements, and to the extent that repealing those requirements might induce some banks -- which are by far the largest holders of municipal securities -- to dispose of a portion of the municipal securities in their portfolios, the enactment of legislation providing full insurance coverage for public deposits could have a disruptive impact on the market for obligations of State and local governments, many of which already are experiencing substantial difficulties in obtaining adequate financing for essential services. It is conceivable, also, that the alternative investments made with the funds freed by the repeal of pledging requirements could run counter to the monetary policy being pursued at the time by the Board of Governors of the Federal Reserve System.

Your Committee and the Congress are also likely to hear arguments that the enactment of legislation providing full insurance for deposits of public units would give savings and loan associations a competitive advantage over banks, since savings and loan associations have generally been permitted to pay higher rates of interest or dividends than banks have been permitted to pay and therefore would be able to attract more public deposits because of the differential. As your Committee knows, however, under their existing flexible interest-rate authority -- pursuant to which different rates on different classes of deposits can be prescribed -- the Corporation, the Board of Governors of the Federal Reserve System, and the Federal Home Loan Bank Board could act to "equalize" the rates paid by banks and savings and loan associations. Therefore, these arguments would be significant only if that authority were permitted to expire or if the agencies adopted differing regulations.

After reexamining its position and weighing all of these considerations, the Corporation wishes to withdraw its past objection to 100 percent insurance of public funds and to interpose no objection to the enactment of legislation along the lines proposed by sections 25 and 26 of the bill. It strongly recommends, however, that these sections of the bill be amended so as to (a) limit such insurance, in the case of States and political subdivisions, to the funds of public units within the State in which the financial institution is located; (b) require that the aggregate amount of funds that could be deposited in banks or savings and loan associations be limited in relation to such criteria as liquidity, total deposits, and capital and that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations; and (c) require that the maximum rates of interest or dividends payable on comparable deposits be the same for all banks and savings and loan associations.