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Statement by

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before the

Subcommittee on Bank Supervision and Insurance
Committee on Banking and Currency
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Opening Remarks

I welcome the opportunity to appear before the subcommittee today to present the views of the Federal Deposit Insurance Corporation regarding a Committee Print of a bill "To provide for State taxation of insured banks, to provide full deposit insurance for public units, to amend title IV of the National Housing Act concerning the ninety-day decision period with respect to acquisitions in connection with savings and loan holding companies, and to amend title IV of the National Housing Act with respect to third party loans made by subsidiary insured institutions of savings and loan holding companies."

Since titles III and IV relate to matters outside the interests or expertise of the Corporation, I will limit my comments to those provisions of the Committee Print which propose full insurance protection for public deposits or accounts and which would clarify further the authority of States and their political subdivisions to tax federally insured commercial banks.

Full Deposit Insurance for Public Units

Title II of the Committee Print would amend the Federal Deposit Insurance Act, the National Housing Act, and the Federal Credit Union Act to require the Corporation, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration 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 or share account holders. In the case of public units other than those of the United States, such insurance would be limited to the funds of public units within the State or territory in which the financial institution is located. The title would also permit the three agencies to limit the aggregate amount of public funds that could be deposited in insured banks or invested in institutions insured by either the Federal Savings and Loan Insurance Corporation or the National Credit Union Administration on the basis of the size of such banks or institutions in terms of their assets.

While the Corporation has no knowledge as to the basis for the present proposal, the assumption underlying an immediately preceding proposal for full insurance protection for public deposits or accounts -- as embodied in sections 25 and 26 of H.R. 5700, 92d Congress -- was that a number of public units had suffered substantial losses in bank failures throughout the country, with the result that Federal, State and local governments had had to increase taxes to recoup these losses. Without at this point enlisting arguments for or against the proposal for 100 percent insurance of public deposits, the Corporation wishes only to state that that assumption was not then, and is not today, supported by the evidence.

The Corporation recently completed a study of public deposits, recoveries, and losses in the 56 banks which closed during the period from January 1, 1960 to December 31, 1971. These 56 banks had 341 public depositors with a total of $54,903,584.26 on deposit. As of year-end 1971, the public units involved had recovered 99.2 percent, or $54,444,666.16, of such deposits in one way or another. An additional $343,108.57 has been or will be recovered through liquidating dividends paid by the Corporation, thereby resulting in a total recovery of 99.8 percent of the funds on deposit at the time of failure and an estimated net loss of only $115,809.53 to all public depositors in the 56 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 any 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, the Corporation believes that some of the arguments it has historically 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 (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 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 56 banks which closed during the period from January 1, 1960 to December 31, 1971, 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 56 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 $27,016,716.94 and that total recoveries to the Corporation on account of such disbursements would have amounted to $19,236,871.87. These figures produce an additional net estimated loss to the Corporation of $7,779,845.07 for the 12-year period. The study would tend to indicate that the deposit insurance fund would not be unduly burdened if legislation providing full insurance protection for deposits of public units were enacted.

The Corporation also recognizes that other issues, such as the potential effect the enactment of such legislation might have on pledging requirements, deserve careful consideration.

A majority of States require the pledging of securities by banks against the deposits of States and 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 subcommittee and the Congress are also likely to hear arguments that the enactment of legislation providing full insurance protection 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 subcommittee 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. In fact, these three agencies acted on June 23, 1970 to suspend all deposit rate ceilings on single maturity time deposits of $100,000 or more with maturities of 30 through 89 days, thereby removing the differential insofar as deposits of that size and category are concerned. These arguments would be significant today only if the public deposits were in different types of accounts or in amounts less than $100,000 (or if the authority of the three agencies to set rate ceilings were permitted to expire or if the agencies adopted differing regulations).

After weighing all of these considerations, the Corporation -- as I stated during my April 20, 1971 testimony before the House Committee on Banking and Currency regarding H.R. 5700, 92d Congress -- 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 title II of the Committee Print. It strongly recommends, however, that the title be amended so as to (1) require that the aggregate amount of public funds that could be deposited in banks or invested in savings and loan associations be limited in relation to such criteria as liquidity, total deposits, and capital -- rather than merely in relation to the size of a financial institution in terms of its assets -- and further require that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations, and (2) require that the maximum rates of interest or dividends payable on comparable deposits be the same for all insured banks and savings and loan associations.

State Taxation of Insured Banks

Title I of the Committee Print proposes to clarify further the principles governing State taxation of federally insured commercial banks.

Under the provisions of section 103 thereof, for the purposes of any tax law enacted under authority of the United States or any State, a national bank would be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located.

Section 104 would authorize a State or political subdivision thereof to impose on any insured commercial bank having its principal office within the State any tax (except a tax on intangible personal property owned by the bank) that is imposed generally on a nondiscriminatory basis throughout the jurisdiction of the taxing authority. Nothing in the section, however, would prohibit a State or political subdivision thereof from taxing intangible personal property held by a bank in a fiduciary capacity to the beneficial owner thereof. For the purposes of the prohibition and the exception thereto, the term "intangible personal property" would include any mortgage, bond, note, share of stock, warrant, currency, coin, check, credit card, credit card account, deposit, contract, account receivable, judgment, or other evidence of a claim on another. The section would also authorize a State to include interest on obligations of the United States in determining the income of any insured commercial bank for purposes of any tax which the section would authorize to be imposed.

Section 105 of the Committee Print would authorize a State and its political subdivisions to impose certain specified taxes of their own on any insured commercial bank not having its principal office within the State, if such taxes are imposed generally throughout the taxing jurisdiction on a nondiscriminatory basis. For example, nondomiciliary States and their political subdivisions could impose (1) sales taxes and use taxes complementary thereto upon purchases, sales, and use within the taxing jurisdiction; (2) taxes on real property or on the occupancy of real property located within the taxing jurisdiction; (3) taxes (including documentary stamp taxes) on the execution, delivery, or recordation of documents within the taxing jurisdiction; (4) taxes on tangible personal property located within the taxing jurisdiction; (5) license, registration, transfer, excise, or other fees or taxes imposed on the ownership, use, or transfer of tangible personal property located within the taxing jurisdiction; and (6) payroll taxes based on persons employed in the taxing jurisdiction.

Finally, title I of the Committee Print would repeal in its entirety the existing Federal statute -- section 5219 of the Revised Statutes of the United States -- which prescribes the manner in which State and local governments may tax national banks.

Title I of the Committee Print is apparently designed to strengthen the principle of parity between State-chartered commercial banks and national banks with respect to State and local taxation, a principle which the Corporation has consistently supported. It is also designed to forestall some of the inequities and adverse economic consequences which might result if the so-called "permanent amendment" to section 5219 of the Revised Statutes were permitted to go into effect, as scheduled on December 31, 1972, without amendment. This "permanent amendment" now provides only that a national bank will be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located for the purposes of any tax law enacted under authority of the United States or any State.

For the most part, the changes in existing law proposed by title I of the Committee Print comport with recommendations of the Board of Governors of the Federal Reserve System, contained in its report to the Congress pursuant to section 4 of the Act of December 24, 1969 (Pub. L. No. 91-156; 83 Stat. 435), that, prior to December 31, 1972, the Congress enact legislation which will (1) continue to prohibit States and their political subdivisions from imposing taxes on intangible personal property owned by national banks and extend the prohibition to intangible personal property owned by State banks and other depositary institutions such as savings banks, savings and loan associations, and credit unions; (2) limit the circumstances in which insured banks and other depositary institutions are subject to taxes imposed by State and local governments on or measured by net income, gross receipts, or capital stock or to other "doing business" taxes in States other than those in which their principal offices are located; (3) prohibit the imposition of discriminatory or more onerous license, privilege, or other similar "doing business" taxes upon nondomiciliary depositary institutions than might be imposed upon those institutions if they were chartered under the authority of the taxing jurisdiction; (4) permit States to include interest on obligations of the United States in determining the income of any bank or other depositary institution for purposes of any tax which the States might otherwise be authorized to impose; and (5) classify coins and paper currency as intangible personal property for the purposes of any tax imposed under the authority of any State or local government.

The Board of Governors' principal recommendation -- that is, that intangible personal property of banks and other depositary institutions be exempt from State and local taxes -- is based upon its concern that, since virtually all of the assets of such institutions are in the form of intangibles, a general tax on intangibles would impose a heavier burden on banks and other depositary institutions than on nonfinancial businesses. Moreover, the Board of Governors fears that a tax on intangible assets might cause banks and other depositary institutions to reorganize their asset portfolios in the sense that they might be induced to divert funds from taxable to tax-exempt forms of assets -- that is, from the financing of consumers and businesses, particularly local businesses, to the acquisition of Federal, State, and local obligations. The Corporation defers to the views of the Board of Governors on these matters in view of its special study and evaluation of the problem. For that reason, the Corporation would favor the enactment of those provisions of title I of the Committee Print which would continue to deny to States and their political subdivisions authority to tax intangible personal property owned by national banks and which would extend that denial of authority, as well, to intangible personal property owned by any insured commercial bank.

The Board's second recommendation that the Congress enact legislation which would limit the circumstances in which insured banks and other depositary institutions are subject to taxes imposed by State and local governments on or measured by net income, gross receipts, or capital stock or to other "doing business" taxes in States other than those in which their principal offices are located stems from the problems that might be involved in attempting to divide a fixed tax base between the State of a bank's principal office and other States in which the bank does business. The Board of Governors noted that, with interstate division of the tax base, there are no assurances that the sum of the taxable base on which two or more States levy taxes will not exceed 100 percent of the actual base. It also went on to note, however, that, even where the limit is not exceeded, serious burdens may result where two or more States use different methods for interstate division of the tax base and require different kinds of records and reports, with the result that, in some instances, the added costs of acquiring technical competence regarding differing tax laws and procedures of all States where a bank engages in business, maintaining records needed to determine which taxes are applicable and the amount of liability, and preparing and filing returns in all affected States may be even greater than the taxes.

Title I of the Committee Print recognizes that the problems associated with interstate division of a bank's tax base are not insurmountable, for the declaration of policy states, in pertinent part, that --

> ". . . Application of taxes measured by income or receipts, or other 'doing business' taxes, in States outside the home State should be deferred until such time as uniform and equitable methods may be developed for determining jurisdiction to tax and for dividing the tax base among States."

Based on the assumption that the problem will receive additional study leading to the early enactment of legislation that would prevent nonuniform State legislation or the taxation of more than 100 percent of the tax base of depositary institutions, the Corporation has no objection to the enactment, as an interim measure, of legislation along the lines proposed by section 105 of the Committee Print, under the terms of which a State other than the State in which a bank's principal office is located could impose only certain specified taxes -- generally associated with real or tangible personal property owned by the bank or with certain transactions engaged in by the bank -- on a nondomiciliary insured commercial bank.

The Board of Governors' third recommendation seeks to prohibit States and their political subdivisions from imposing heavier license, privilege, or other similar "doing business" taxes on out-of-State depositary institutions than on depositary institutions incorporated and existing under authority of the taxing jurisdiction or from discriminating between State and federally chartered institutions with respect to taxation. In the Corporation's view, it is essential that the Board of Governors' recommendation regarding nondiscriminatory taxation be acted upon if the Nation's dual banking system is to remain strong and viable, and if depositary institutions are to be competitive and free from barriers to interstate credit operations. The language of sections 104 and 105 of the Committee Print, under the terms of which both domiciliary and nondomiciliary States could impose certain taxes that are imposed generally on a nondiscriminatory basis throughout their jurisdictions, purports to express the sense of the Congress on the issue of nondiscriminatory taxation. While we recognize that the specific language of the sections derives from the so-called "temporary amendment" to section 5219 of the Revised Statutes, it is still not clear whether the purpose of the language is to prohibit discrimination with respect to taxation only between different classes of banks -- i.e., between home-State and out-of-State banks or between State and federally chartered banks -- or to prohibit discrimination between different classes of banks _as well as_ between banks and other business corporations. Unless the language is clarified, or unless the intent of the language is fully explained in the legislative history of these sections of title I, it is likely to be interpreted by some banks, with resulting litigation, as prohibiting discrimination with respect to taxation not only between different classes of banks but between banks and other business corporations. If your subcommittee and the Congress desire such a result, it would be wise to make this clear.

Regarding the Board's fourth recommendation, which the last sentence of section 104 of the Committee Print would implement, the Corporation respectfully defers to the views of the Department of the Treasury on the question whether a State, in determining the income of any insured commercial bank for tax purposes, should be authorized to include interest on obligations of the United States. It favors the enactment of those provisions of section 106(2) of the Committee Print, implementing the Board's fifth recommendation, under the terms of which coins and paper currency would be considered intangible personal property for purposes of any tax imposed under the authority of any State or local government.

In concluding, I wish to note that, in its report to the Congress, the Board of Governors recommended that any additional Federal legislation dealing with State and local authority to tax national banks address itself to a larger group of financial intermediaries. Specifically, it stated that --

> ". . . In view of the declared Congressional policy of seeking equal treatment of State and national banks under State tax laws, and the close competition between banks and other depositary institutions, it would be desirable that the restrictions proposed in our recommendations apply to all commercial banks (national and State) and all other depositary institutions (savings banks, savings and loan associations, and credit unions)."

Title I of the Committee Print, however, would apply the restrictions proposed in the Board's recommendations only to insured commercial banks (national and State). Should your subcommittee and the Congress decide that the Board's recommendation in this matter deserves implementation, the Corporation's staff stands ready to assist the subcommittee staff in redrafting Title I of the Committee Print so that the restrictions proposed therein would apply to all depositary institutions.