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Statement by

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before the

Subcommittee on Bank Supervision and Insurance
Committee on Banking and Currency
House of Representatives
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Mr. Chairman, I appreciate the opportunity you have afforded me to present the views of the Federal Deposit Insurance Corporation with respect to H.R. 4070, 93d Congress, a bill "To extend certain laws relating to the payment of interest on time and savings deposits, to prohibit depository institutions from permitting negotiable orders of withdrawal to be made with respect to any deposit or account on which any interest or dividends is paid, and for other purposes," and also with respect to H.R. 4719 and H.R. 4988, 93d Congress, bills "To authorize Federal savings and loan associations and national banks to own stock in and invest in loans to certain State housing corporations."

Section 1 of H.R. 4070 would extend until May 31, 1975 the statutory authority presently vested in the Board of Governors of the Federal Reserve System, the Board of Directors of the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board to regulate in a flexible manner the rates of interest or dividends payable by insured banks on time and savings deposits and by members of the Federal Home Loan Bank System (other than those the deposits of which are insured by the Federal Deposit Insurance Corporation) on deposits, shares, or withdrawable accounts. It would also extend for the same period of time the authority of the Federal Deposit Insurance Corporation and of the Federal Home Loan Bank Board to subject certain noninsured banks and institutions to interest- and dividend-rate controls comparable to those applicable to insured banks and institutions.

Section 2 of H.R. 4070 would prohibit such depository institutions as commercial and mutual savings banks, building and loan or savings and loan associations, and credit unions -- whether State or federally chartered and whether insured or noninsured -- from allowing the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable instruments for the purpose of making transfers to third parties. Any institution which violated the prohibition would be subject to a fine of \$1,000 for each violation.

Section 3 of H.R. 4070 would expand the Federal Deposit Insurance Corporation's authority to subject certain noninsured banks to interest- and dividend-rate controls by deleting those restrictions in existing law which make the authority operative only where a State bank supervisory agency does not have authority, comparable to that vested in the Corporation, to regulate the rates of interest or dividends paid by such noninsured banks on time and savings deposits, or where such authority exists but has not been exercised by that agency.

Flexible authority for regulating the rates of interest or dividends that may be paid by insured banks on time and savings deposits and by certain members of the Federal Home Loan Bank System -- most of them insured savings and loan associations -- on deposits, shares, or withdrawable accounts was first conferred upon the three regulatory agencies in September of 1966 for a one-year period. On

five different occasions, however, the authority has been extended for varying and consecutive periods of time so that it now expires, unless further extended, on May 31, 1973. The events which led to the initial enactment of legislation conferring the authority, the developments which indicated a need for repeated extensions of that authority, and the Corporation's position regarding the initial granting and all subsequent extensions of that authority are documented in previous correspondence and statements filed with the full Committee. For that reason, except to say that the Corporation supports another temporary extension of its present interest-rate control authority, I shall not recount what already is a matter of public record. I would like, however, to direct the Subcommittee's attention, instead, to a more recent innovation in banking -- the negotiable order of withdrawal (or so-called "NOW") account -- which has prompted the introduction of legislation which, on the one hand, would congressionally sanction the innovation or, on the other hand, prohibit it altogether (as section 2 of H.R. 4070 would do).

On July 28, 1970, the Consumers Savings Bank of Worcester, Massachusetts (formerly the Worcester Five Cents Savings Bank), asked the Massachusetts Commissioner of Banks for permission to offer its customers the right to withdraw funds from their savings accounts by executing negotiable withdrawal orders. This request was denied on September 28, 1970. Consumers Savings Bank thereupon filed a bill for declaratory relief with the Massachusetts Supreme Judicial Court seeking to have the Commissioner's denial

reversed. On May 2, 1972, the Massachusetts Supreme Judicial Court held that Consumers Savings Bank could legally permit its customers to withdraw funds from their savings accounts by executing negotiable withdrawal orders.^{1/}

The court was careful to point out that its ruling merely went to the method of withdrawal and not to the character of the accounts in question. Although it found that the proposed form of withdrawal order possessed all the attributes of negotiability required by Massachusetts law, the court concluded that there was nothing in the Massachusetts statutes or the bylaws of the bank which would prevent the bank's customers from using this type of instrument to withdraw funds from their savings accounts.

As of February 28, 1973, 56 out of 167 mutual savings banks in Massachusetts were offering NOW accounts to their customers. Of the 56 banks offering such accounts, only seven are insured by the FDIC. The remaining 49 banks are insured by the Mutual Savings Central Fund, Inc., a State-run insurance corporation.^{2/} While the mutual savings banks in Massachusetts which currently offer NOW accounts comprise only one-third of the total number of mutual savings banks in that State, their total

^{1/} Consumers Savings Bank v. Commissioner of Banks, 282 N.E.2d 416 (Mass. 1972).

^{2/} The Mutual Savings Central Fund also insures excess deposits in the seven banks insured by the FDIC.

deposits account for about 60 percent of the total deposits in all such mutual savings banks.

In Massachusetts, mutual savings banks account for a larger share of total bank deposits and, particularly, of total time and savings deposits, than do mutual savings banks in most other States. As of June 30, 1972, mutual savings bank deposits were approximately 54 percent of the combined total of commercial and mutual savings bank deposits in Massachusetts. Mutual savings banks in the State had about 77 percent of total time and savings deposits and about 83 percent of these deposits in accounts of less than \$100,000.

As of February 28, 1973, it is estimated that there were approximately 37,200 individual NOW accounts in Massachusetts mutual savings banks with an average balance of slightly more than \$1,900. This represents an approximate total of \$71.5 million in NOW accounts which, in turn, represents about three-fourths of one percent of the total savings deposits in all Massachusetts mutual savings banks (\$9,571 million as of December 31, 1972).^{3/}

NOW accounts are also being offered by mutual savings banks in New Hampshire. As of March 2, 1973, 11 of the 30 mutual savings banks in New Hampshire were offering NOW accounts to their customers.

^{3/} Although NOW account deposits still represent a very small percentage of total savings deposits in all Massachusetts mutual savings banks, they have increased at a substantial rate. There was an approximate total of only \$11 million in NOW accounts on September 30, 1972. By December 31, this total had increased to slightly less than \$45 million, and stood at approximately \$71.5 million on February 28, 1973.

Mutual savings banks in New Hampshire also account for a substantial share of total bank deposits, particularly time and savings deposits. As of June 30, 1972, New Hampshire mutual savings bank deposits accounted for approximately 52 percent of the combined total of commercial and mutual savings bank deposits in that State, while their time and savings deposits were about 66 percent of total time and savings deposits.

As of March 2, 1973, there were just under 2,900 individual NOW accounts in New Hampshire mutual savings banks with an average balance of about \$550. This represents a total of approximately \$1.5 million which is approximately one-seventh of one percent of the total savings deposits in all New Hampshire mutual savings banks (\$1,019 million as of June 30, 1972).

Individual NOW accounts in New Hampshire mutual savings banks are smaller and appear to be substantially more active on the average than those in Massachusetts mutual savings banks. Mutual savings banks in Massachusetts report that an average of only five negotiable withdrawal orders were drawn on each account each month during the last three months of 1972. In contrast, the largest mutual savings bank in New Hampshire offering NOW accounts reported an average of 15 negotiable withdrawal orders per account each month.^{4/} This difference appears to be based on the fact that the New

^{4/} On January 31, 1973, this bank had 1,750 NOW accounts out of a total of just under 2,300 NOW accounts for the entire State, and total deposits in NOW accounts of \$900,000 out of the State total of \$1,150,000. Its accounts thus represented virtually the entire NOW account market in New Hampshire at the end of January 1973. We are currently endeavoring to obtain comparable figures for NOW account activity in other New Hampshire banks.

Hampshire mutual savings banks offering NOW accounts pay interest on such accounts at the rate of only three or four percent (as opposed to a maximum rate of five percent for regular savings accounts) but do not impose a service charge for items drawn on them, whereas the Massachusetts mutual savings banks offering NOW accounts pay interest at the rate of 5.25 percent and were imposing a service charge of 15 cents for each withdrawal order on December 31, 1972.^{5/}

It has been said that the ability to offer NOW accounts gives mutual savings banks in Massachusetts and New Hampshire a competitive advantage over commercial banks and savings and loan associations in the same market. While we have data indicating that savings deposits in Massachusetts mutual savings banks that offer NOW accounts have increased more rapidly than those in Massachusetts mutual savings banks without NOW accounts, particularly in the Boston area where savings deposits in mutual savings banks without NOW accounts actually declined in the last five months of 1972, we have no data indicating a significant competitive impact vis-a-vis commercial banks and savings and loan associations. Should the data we are collecting indicate a significant change in competitive impact in Massachusetts in the future with respect to commercial banks and savings and loan associations, we will promptly inform you. We are presently trying to obtain comparable data for New Hampshire.

^{5/} Massachusetts commercial banks have generally eliminated service charges for checks drawn on demand deposits.

Section 18(g) of the Federal Deposit Insurance Act (12 U.S.C. § 1828(g)) requires that the Board of Directors of the FDIC "prohibit [by regulation] the payment of interest or dividends on demand deposits in insured nonmember banks and for such purpose . . . define the term 'demand deposits' [subject to those exceptions prescribed by statute or by regulation of the Board of Governors of the Federal Reserve System]." The Board of Directors has adopted regulations barring the payment of interest on demand deposits (12 C.F.R. § 329.2). It has also adopted regulations defining a "demand deposit" as any deposit which is not a "time deposit" or a "savings deposit" (12 C.F.R. § 329.1(a)). A "savings deposit" is defined, in part, as any deposit with respect to which an insured nonmember bank may require 30 days' written notice prior to withdrawal (12 C.F.R. § 329.1(e)(ii)). The Federal Reserve has adopted a similar definition for savings deposits in its member banks (12 C.F.R. § 217.1(e)(2)).

NOW accounts would be classified as savings deposits under present FDIC regulations because the bank may require 30 days' written notice prior to withdrawal. Although our regulations further restrict the manner in which funds may be withdrawn from savings accounts, and effectively preclude the use of negotiable orders of withdrawal, these restrictions currently apply only to commercial banks and not to insured nonmember mutual savings banks.

Placing all institutions on an equal footing with respect to NOW accounts remains an elusive goal under existing law in part because the

vast majority of mutual savings banks in Massachusetts are not insured by the FDIC. As of February 28, 1973, there were only eight mutual savings banks in Massachusetts insured by the FDIC but 159 mutual savings banks insured exclusively by the Mutual Savings Central Fund. As I pointed out earlier, 49 of these State-insured savings banks are presently offering NOW accounts to their customers. The FDIC, as you know, has no authority at the present time to limit -- or prohibit -- the payment of interest or dividends on NOW accounts offered by mutual savings banks in Massachusetts which are not insured by the FDIC. This is due to the tenth sentence of section 18(g) of the Federal Deposit Insurance Act which provides:

"The authority conferred by this subsection [which includes the authority to prohibit the payment of interest or dividends on demand deposits and to limit the rate of interest paid on savings deposits] shall also apply to noninsured banks in any State if (1) the total amount of time and savings deposits held in all such banks in the State, plus the total amount of deposits, shares, and withdrawable accounts held in all building and loan, savings and loan, and homestead associations (including cooperative banks) in the State which are not members of a Federal home loan bank, is more than 20 per centum of the total amount of such deposits, shares, and withdrawable accounts held in all banks, and building and loan, savings and loan, and homestead associations (including cooperative banks) in the State, and (2) there does not exist under the laws of such State a bank supervisory agency with authority comparable to that conferred by this subsection, including specifically the authority to regulate the rates of interest and dividends paid by such noninsured banks on time and savings deposits, or if such agency exists it has not issued regulations in the exercise of that authority." (Emphasis added.)

Deposits held in State-insured mutual savings banks in Massachusetts meet the test established by clause (1) of the passage just quoted and, if that clause stood alone, such deposits would be subject to regulation as to dividends and interest by the FDIC. However, under Massachusetts law the Commissioner of Banks has authority to regulate the rates of interest and dividends paid by State-insured mutual savings banks (Annotated Laws of Massachusetts, c. 167, § 18B) and the Commissioner has issued regulations in the exercise of that authority. Therefore, clause (2) bars the FDIC from using its authority to regulate NOW accounts in mutual savings banks in Massachusetts which are not insured by the FDIC. With rate control divided as it is between the FDIC and the Massachusetts Commissioner, uniformity in treatment between competing institutions becomes impossible unless (i) the two agencies agree on the desirability of the same course of action, and (ii) the same rules apply in neighboring States where financial institutions are subject to deposit competition from mutual savings banks in Massachusetts. The Massachusetts Commissioner is, of course, under no obligation to consider the interstate ramifications of a particular set of rules, and the rates applicable to mutual savings banks in Massachusetts are in fact different today than those applicable elsewhere in the country.

The use of NOW accounts by mutual savings banks in Massachusetts and New Hampshire illustrates one of the problems facing the Federal banking agencies in their attempts to administer interest rate controls. Congress could con-

ceivably decide that the best way to deal with NOW accounts would be to classify them, by statute, as demand deposits and bar the payment of interest thereon. However, this would get at only part of the problem. There are other means of avoiding the prohibition against paying interest on demand deposits. For example, commercial banks can permit their customers to draw checks on a more or less overdraft basis up to the amounts in their savings accounts. The overdraft would be treated as an interest-free loan so long as the depositor repays the loan within a stipulated period of time. Repayment of the loan may not be made automatically or through any prearranged procedure from the savings account, but of course normal withdrawals from the savings account could in fact be used to repay the loan. This arrangement has the same advantages as a NOW account, yet it avoids the prohibition against paying interest on demand deposits under any readily conceivable statutory definition of the term "demand deposit." Innovative minds could undoubtedly devise other variants which would accomplish the same ends and yet stay clear of statutory prohibitions.

If a statutory definition of precisely what constitutes a demand deposit were avoided and if section 18(g) were amended so as to delete the aforementioned clause (2), the FDIC would then have the authority -- after consulting with the Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board -- to regulate generally the payment of interest or dividends by State-insured mutual savings banks in

Massachusetts, and to regulate specifically NOW accounts in those banks.^{6/} This would give the FDIC a number of options:

1. The FDIC could take no action whatever. In that event mutual savings banks could continue to offer NOW accounts to their customers in those States like Massachusetts and New Hampshire where such accounts are legally permitted. However, commercial banks would not be allowed to offer NOW accounts to their customers because FDIC and Federal Reserve regulations currently bar the transfer of funds in commercial bank savings accounts to third parties by check or other order.

2. The FDIC could prohibit mutual savings banks in States other than Massachusetts and New Hampshire from offering NOW accounts. This would have the effect of freezing the current situation, subject only to the spread of

^{6/} If section 18(g) were amended by deleting the clause (2), the sentence immediately following clause (2) should also be deleted. This sentence reads:

"Such authority shall only be exercised by the Board of Directors with respect to such noninsured banks prior to July 31, 1970, to limit the rates of interest or dividends which such banks may pay on time and savings deposits to maximum rates not lower than 5 1/2 per centum per annum."

The above sentence was added in order to prevent the FDIC from reducing to less than 5 1/2% the maximum interest rate which might be paid on regular savings accounts (passbook accounts) by State-insured mutual savings banks in Massachusetts prior to July 31, 1970. However, the sentence is confusing and might be construed in such a way as to impede future efforts to regulate these banks. By its terms, the sentence is no longer effective.

NOW accounts to other mutual savings banks in Massachusetts and New Hampshire.

3. The FDIC could define NOW accounts as a form of demand deposit. This would not only prevent mutual savings banks from paying interest on such accounts but would preclude their use altogether in States such as Massachusetts which do not authorize mutual savings banks to accept demand deposits.

4. The FDIC could permit mutual savings banks to continue to offer NOW accounts to their customers but limit the interest payable on such accounts to a rate lower than the maximum permissible rate for regular savings accounts, or even set a rate of zero percent.

5. The FDIC could bar the use of NOW accounts but permit mutual savings banks to offer some sort of limited third-party payment system in their place. This might take the form of a nonnegotiable, nontransferable withdrawal order -- similar to that authorized for use by Federal savings and loan associations under current regulations of the Federal Home Loan Bank Board -- which could be used only to make certain types of payments such as mortgage payments or payments on utility bills.

6. Finally, the FDIC could take joint action with the Federal Reserve to permit member and insured nonmember commercial banks as well as mutual savings banks to offer NOW accounts, subject possibly to a lower maximum interest rate than that established for regular savings accounts, or to the type of restriction described in (5) above. However, such joint action would introduce a new disparity between commercial and mutual savings banks on the one hand and

Federal savings and loan associations on the other, since savings accounts in Federal savings and loan associations may not be transferred or withdrawn by negotiable or transferable order or authorization.^{7/} In order to avoid such a disparity, the FDIC and the Federal Reserve would have to subject NOW accounts to the type of restriction described in option (5), or the statutory restriction on transferring funds in savings accounts in Federal savings and loan associations would have to be removed.

In any event, section 18(g) of the Federal Deposit Insurance Act requires that our Board of Directors consult with the Board of Governors of the Federal Reserve System and the Federal Home Loan Bank Board before prescribing any rules which would limit the rate of interest paid on NOW accounts by insured nonmember banks. I believe that each of the options which I mentioned should be thoroughly explored by all three agencies before any particular course of action is decided upon. We would no doubt have to consider what the probable effect of any particular course of action would be on the present structure of the banking system and the competitive implications for commercial banks and savings and loan associations as well as savings banks. Also, we would take cognizance of any expressions of opinion as to preferable courses of action which might

^{7/} Section 5(b) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. § 1464(b)(1)(1970)).

be voiced by Congress in its deliberations on proposed legislation extending the rate control authority of the three Federal agencies (currently due to expire June 1, 1973) or in its deliberations on proposed legislation to implement some or all of the recommendations of the Presidential Commission on Financial Structure and Regulation.

Turning to H.R. 4719 and H.R. 4988, these are identical bills which would amend section 5136 of the Revised Statutes (12 U.S.C. § 24) to authorize national banks to invest in the stock of any "State housing corporation" incorporated in the State where the investing national bank is located and to limit the aggregate of such stock investments and loans and commitments to make loans to State housing corporations to five percent of the bank's paid-in and unimpaired capital stock and surplus. The bills would also authorize any Federal savings and loan association having general reserves, surplus and undivided profits exceeding five percent of its withdrawable accounts to make stock investments in and loans and commitments to any such State housing corporation in the same manner and to the same extent as permitted by State law for State savings and loan associations, but not to exceed one-quarter of one percent of the association's total assets in the case of such stock investments and one percent of the association's total outstanding loans in the case of uninsured loans and commitments to State housing corporations.

Since section 9 of the Federal Reserve Act (12 U.S.C. § 335) subjects State banks which are members of the Federal Reserve System to the same restrictions with respect to purchasing securities as are applicable to

national banks under section 5136 (including the general stock purchase prohibition therein), the bills' authorization for national banks to invest in the stock of State housing corporations would automatically make the stock purchase prohibition in section 5136 inapplicable to the acquisition of such stock by State member banks, thereby permitting State member banks to acquire stock in such corporations if authorized by applicable State law. The bills would have no effect on the powers of State nonmember banks, whose authority to acquire such stock is and would continue to be governed exclusively by State law. To the extent, therefore, that State statutes presently permit State banks to invest in the stock of State housing corporations, enactment of this legislation would permit State member banks to make such investments. To the extent State statutes do not permit such investments by State banks, enactment of the proposed legislation might lead a number of State legislatures to consider authorizing such investments. If enabling legislation is then passed at the State level, State nonmember banks as well as State member banks would gain the broader investment powers which the bills would grant to national banks.

Apart from the indication in section 1 of the proposed legislation that its purpose is "to provide a means whereby private financial institutions can assist in providing housing, particularly for families of low or moderate income," there is nothing in the bills which would clarify the meaning of the term "State housing corporation." The Corporation supports the objective of this proposed legislation and would

interpose no objection to its enactment. We would suggest, however, that Congress might want to consider incorporating in the proposed legislation a definition of the term "State housing corporation."