C. 1
C.
Spch
FDIC
W

FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

FOR RELEASE ON DELIVERY

PR-43-74 (7-15-74)

[Citicorp proposed bill under Regulation Q.]

Statement by

Frank Wille, Chairman
Federal Deposit Insurance Corporation

before the

Committee on Banking and Currency,
House of Representatives,

July 15, 1974.

5p.

FEDERAL DEPOSIT INSURANCE CORPORATION, 550 Seventeenth St. N.W., Washington, D.C. 20429 • 202-389-4221

The proposed Citicorp note issue represents a creative and imaginative financing plan for its issuer since it is likely to reduce the average cost and lengthen the average maturity of Citicorp's funds. In its original form and in its presently revised form, the issue is also designed to appeal to a broad range of investors and savers. These include many who have been consistent depositors at the nation's thrift institutions and smaller commercial banks -- and therein lies the rub.

The nation's thrift institutions and smaller commercial banks have been the principal suppliers of funds for residential home mortgages, with savings and loan associations having the highest percentage of the three types of institutions in total assets committed to residential home mortgages and mutual savings banks the second highest percentage of assets so committed. Both forms of thrift institutions in recent months have been hard hit by a slowdown of incoming funds available for housing investment. In the case of mutual savings banks (most of whom are supervised and examined at the Federal level by the FDIC), preliminary deposit projections indicate record net outflows of funds for the current month. Additionally, these banks suffered a net outflow of approximately $350 million last month -- the worst June figures ever recorded. The Federal Home Loan Bank Board can, I am sure, give you the details of deposit trends among the nation's Federally insured savings and loan associations.

Thrift institutions and banks which have already found themselves unable to attract funds effectively in the current high interest rate environment now face the added competitive challenge of proposed issues, like Citicorp's, which will have undoubted appeal to their traditional customers -- a challenge which cannot be realistically answered in the case of the thrift institutions by some dramatic, across-the-board increase in deposit rate ceilings because the earnings of such institutions would not permit the payment of the much higher rates presently needed to attract deposit funds.

As you know, Regulation Q and comparable provisions of FDIC and FHLBB regulations presently limit the rates of interest which can be paid by most depositary institutions to their deposit customers. Rates of interest on deposits of $100,000 or more are presently unregulated, but passbook savings rates below that amount cannot exceed 5% per annum for commercial banks and 5 1/4% for the nation's thrift institutions. Certificate accounts pay more, depending on maturity and denomination, ranging up to 7 1/4% per annum for commercial bank time deposits of $1,000 or more held on deposit for four years or more and up to 7 1/2% per annum for a comparable thrift institution certificate. Substantial interest rate penalties are imposed if the depositor seeks early redemption. In addition, under the regulations of all three rate-setting agencies, the ceiling rates apply to nondeposit obligations of insured banks and associations unless they fall into certain specified categories. The only subordinated note category which is excepted are those which have "an original maturity of seven years or more" and which are "in an amount of at least $500" (so long as other technical requirements are met, the purpose of which is to distinguish such notes from deposit instruments of the same institution).

The proposed Citicorp note is not a deposit, but it will obviously compete with a deposit along with other market instruments presently available to the public. What makes the Citicorp note, even in revised form, look more like a deposit than other market instruments is its relatively low denomination ($5,000 initially but $1,000 subsequently), its issuance by a bank holding company whose principal affiliate and public identification is synonymous with the nation's second largest insured bank, and its optional redemption features which are available to an investor long before its potential 15-year maturity. While all of these features have a bearing on the competitive threat which some of the nation's depositary institutions see in the Citicorp note, and others like which may be issued in the future, it is the early redemption feature at the holder's option which most directly competes with the time deposits which presently can be offered by the nation's thrift institutions and banks.

To illustrate, a time deposit of a mutual savings bank or a Federally insured savings and loan association, issued for the 23 months presently contemplated as the required term before the earliest permitted redemption of the Citicorp note, could carry a maximum interest rate of 6 1/2% per annum for thrifts and a maximum interest rate of 6% per annum for commercial banks under Regulation Q. Even if the earliest permitted redemption were extended to four years rather than 23 months, the maximum permitted rate under Regulation Q would be 7 1/2% for thrifts and 7 1/4% for commercial banks. Only at the seven-year point would a competing bank be able to offer an instrument of comparable attractiveness. Put another way, if an insured bank or association were to copy word for word the terms of the Citicorp note and were able to pay the rates required, it would find that the optional redemption could not be exercisable under our present regulations until seven years had passed.

Of course, the agencies have the option, under existing law, of changing their "seven-year" rule for subordinated note issues and the option of permitting a variable-rate time deposit somewhat similar to the Citicorp note, a suggestion which I put forward for comment on behalf of the FDIC in May. But almost no thrift institution would have the earnings power at present to pay a 9.70% per annum rate for long on any significant proportion of its total deposits. To remedy this basic problem of the thrift institutions, it is apparent that the long-run legislative objective should be to improve the potential earnings power of the nation's thrift institutions, thereby enabling them to attract funds in our increasingly competitive financial markets and enabling them to continue their present commitment to the nation's housing and mortgage market.

As to the bill presently before the Committee, its terms go far beyond any provisions necessary to deal with the potential mischief to the flow of funds to the nation's thrift institutions and to housing which may be caused by the optional redemption features of the proposed Citicorp note. The FDIC therefore opposes its enactment. A more limited bill dealing exclusively with the proposed early redemption feature can be drawn, however, and may appeal to the members of this Committee if it believes the Citicorp change announced last Friday does not go sufficiently far to distinguish the proposed note from a deposit account subject to Regulation Q ceilings.