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Proposal to Authorize National Banks, Federally Insured State-Chartered Banks, and Federally Insured Savings and Loan Associations to Charge Interest Rates to Corporate Borrowers at Rates Reflecting Present Market Conditions.

Statement by

Frank Wille, Chairman
Federal Deposit Insurance Corporation

submitted to the

Subcommittee on Financial Institutions
of the
Committee on Banking, Housing and Urban Affairs
United States Senate

July 31, 1974

I. Title II Title: Interest rates ...

The Federal Deposit Insurance Corporation appreciates this opportunity to submit its views with respect to S. 3817 and other proposals to amend the National Bank Act, the Federal Deposit Insurance Act and the National Housing Act to authorize national banks, Federally insured State-chartered banks and Federally insured savings and loan associations to charge interest rates to corporate borrowers at rates reflecting present market conditions.

S. 3817 would permit all commercial banks insured by this Corporation (whether national or State-chartered) to charge up to 5 percent above the Federal Reserve discount rate on loans to corporate borrowers irrespective of a more restrictive State constitutional or statutory provision. Presently, national banks are limited by Federal law (12 U.S.C. 85) to the greater of either 1 percent above the Federal Reserve discount rate or the rate permitted by applicable State law (or 7 percent if no rate is fixed by State law). State banks are at present governed exclusively by State law in this regard.

It can be persuasively argued that usury ceilings, whether imposed by Federal or State law, are a particularly inadequate and inequitable form of price-control legislation which can have the practical effect of diverting available funds away from their intended beneficiaries and into loans and investments not subject to such ceilings. They can also result in more onerous terms as to noninterest rate features than might be the case with higher interest rate limits. Such artificial restraints on the free flow of available credit may in some circumstances cause certain segments of the economy to be more severely hurt than others when the overall supply of credit is curtailed.

The FDIC is in the process of reviewing the available data as to recent credit flows in States like Tennessee, Arkansas and Montana that might be affected by the proposed legislation and will file this information with the Subcommittee as soon as possible. Most State usury laws, however, already exempt loans to corporate borrowers from the ceilings they impose and others have significantly higher limits for corporate borrowers than the usury limits of the three States mentioned. Four States in the latter category, with ceiling rates for corporate borrowers apparently set by statute at 12 percent per annum, could also be immediately affected by the proposed legislation since it would authorize a corporate usury ceiling higher than 12 percent per annum at least initially.

Our natural preference would lie in a reevaluation by each State of the competitiveness of credit markets affected by its usury ceilings.

When it appears that competition in such markets is adequate to protect the public interest, usury ceilings could gradually be removed, in a manner similar to that recommended in the December 1972 report of the National Commission on Consumer Finance, so as to foster the free flow of available credit within a competitive market structure. S. 3817, by limiting the duration of its provisions to three years, concedes the desirability of such a State-by-State review but also recognizes the fact that obtaining such a review and then implementing it effectively might not be feasible in time to alleviate immediate lending dislocations in a number of States because of legislative or constitutional procedures which might apply. The provisions of S. 3817 would, however, be limited to only a small number of States in immediate impact and would not constitute an undesirable precedent for Federal preemption of State usury ceilings generally or permanently.

In lieu of tying the higher, temporary Federal usury ceiling to the Federal Reserve discount rate, we would suggest that better results might be obtained by using a market-determined rate, such as the prime commercial paper rate or the Treasury bill discount rate. Changes in the Federal Reserve discount rate are made with a number of factors in mind and have frequently lagged behind market rate movements. The rate today appears substantially out of line with market rates applicable to both short-term and long-term loans to corporate borrowers. Some of this problem is, of course, overcome by setting the permissible Federal rate 5 percent above the Federal Reserve discount rate.

However, whether the Subcommittee adopts this suggestion as to the base rate to be utilized or not, the Corporation would strongly support enactment of S. 3817 or a bill of similar substance under present economic conditions.