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Statement by

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Vice Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Banking and Currency

House of Representatives

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Mr. Chairman and members of the Committee, the Board welcomes the opportunity to appear today and comment on the proper role for public policy in responding to financing initiatives along the lines of the floating rate note proposed by Citicorp. In various public statements recently, the Board has indicated that the implications of securities offerings of the type proposed by Citicorp deserve intensive consideration by appropriate Government officials and the Congress so that the best interests of all segments of the public may be served.

The characteristics of the Citicorp issue have been developed with the individual saver-investor in mind. The note as now modified would include an interest rate that varies over time with the yield on 90-day Treasury bills, and would, after June 1, 1976, provide the holder with the option of presenting the notes for redemption semi-annually on 30 days' notice. The new security would be listed on the New York Stock Exchange and would be marketed by brokers all over the country. The offering would compete with a variety of alternatives, but particularly with Treasury bills and certificates of deposit in banks and thrift institutions.

The Board believes that there is much in the Citicorp initiative--especially in the form now proposed--that offers promise of significant public benefits, in the form of improved opportunities

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for individual savers-investors and reduced pressures on the commercial paper market, and a stronger financial condition for issuing bank holding companies.

On the other hand, the amount of disintermediation involving banks and thrift institutions could be significant if the volume of offerings of this type were to become large. It should be noted, however, that there would not be a dollar-for-dollar transfer of funds out of depository institutions and into such issues, since a sizable proportion of the subscriptions to such issues undoubtedly would represent shifts from other market instruments. Moreover, there is no way of predicting in advance the probable effect on the flow of mortgage funds or the deposits of banks and thrift institutions in a particular area, because the notes are to be marketed nationally through dealers, not locally from banking offices. Moreover, it is certainly possible that the proposed issue will, to some extent, compete directly for funds that might otherwise be placed in time or savings deposits at these institutions. Their net inflows have already fallen off substantially in recent months, and any significant additional diversion of funds is a matter for public concern.

It is not obvious, however, that the long-run public interest will be served by prohibiting or limiting innovative financing efforts of this type. The Board believes it would be best to observe the results of this innovation in its early stages before arriving at a

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conclusion on this matter. In the Board's view, this is particularly so since the proposed Citicorp offering has been revised to withhold the redemption option for about the first two years after issue.

If, nevertheless, legislation is deemed to be desirable, then several approaches come to mind. First, any serious damage to housing finance and thrift institutions might be offset by special assistance programs. Other public officials are better equipped to comment on specific measures that could be adopted, but one obvious approach would be to expand the present program of subsidized lending by the Federal Home Loan Banks. Also, since mutual savings banks may be especially vulnerable, such programs of assistance might be expanded to include them.

Second, Congress might wish to encourage thrift institutions to compete with such offerings by themselves offering a variable rate instrument of some type. For example, they could duplicate the Citicorp offering by selling notes through brokers. Or they could issue and market longer-term obligations with flexible rates. However, if the obligations were to be issued directly by thrift institutions, it would be important that investors be fully aware that such issues were not insured deposits. Even in the case of the Citicorp issue, the Board recommended to the Securities and Exchange Commission that the prospectus be amended to include in 10-point bold-face type a similar caution.

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Third, Congress might indicate its intent to give the Board authority to subject note issues of bank holding companies and their nonbank subsidiaries to regulation--regardless of the intended use of the proceeds. This would make it possible, for example, for the Board to limit the ability of the issuer to offer investors the option of periodic redemption. The Board believes that a redemption opportunity in the early life of the issue is the principal feature making such issues appear similar to a time deposit.

Fourth, another approach would be to expand the Board's regulatory authority with respect to the issuance of "cease-and-desist" orders. This could enable the Board, on a case-by-case basis, to determine if a proposed note issue by a bank holding company or its nonbank affiliates would have a sufficiently adverse impact on financial markets or depository institutions to justify imposition of appropriate restrictions by the Board. Such authority would be so extremely broad and flexible in character as to be difficult to administer.

None of these approaches would give the Board or any other agency authority to deal with any offerings outside the bank holding company area. If the Citicorp offering is marketed and has a good investor acceptance, offerings of this type will undoubtedly spread. In any event, issuers will not be limited to bank holding companies and their subsidiaries, but will likely include public utilities and national firms primarily engaged in non-financial business.

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With regard to H. R. 15869, a bill introduced only on Thursday by the distinguished Chairman on behalf of himself and four members of the Committee, the Board has not had time to reach any firm views. And, even if we had been able to come up with such views, we would not want to make them public until we had time to test our thinking. At the moment, then, we believe enactment of H. R. 15869 would be premature. I might add that in our preliminary review of the bill's provisions we have encountered a number of difficulties which have strengthened our determination to recommend against action of this kind.

For example, the bill would require referral by the Board of its determination on any application to a committee consisting of the Board of Governors, the Board of Directors of the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the Secretary of the Treasury. In view of existing responsibilities on each of the agencies named, including the Securities and Exchange Commission, whose views would also be solicited, we believe the proposed "committee referral" procedure to be unduly burdensome and, because of this fact, would not contribute significantly to the intended Congressional purpose. Preferable, it seems to me, would be a requirement that the agency having determination authority be required to elicit the views of the agencies comprising the committee, as well as of the SEC, before making a final determination. A similar

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solicitation of views and comments is followed under the Bank Merger Act and, in a more limited way, by the Board under the Bank Holding Company Act. Another concern with the Committee bill relates to its applicability to note issues having a redemption right within ten years or less. We believe that a shorter minimum redemption period should be made the subject of the proposed regulatory legislation. Finally, the Board is concerned that an unduly heavy "burden of proof" is placed on an applicant seeking approval under the bill's provisions. A more reasonable requirement might be a provision that would authorize agency approval only if the proposal were found not to be substantially at variance with the Act, nor to have a likely adverse impact on financial markets, and to be in the public interest.

A question has been raised as to whether the Board of Governors now has the requisite authority in sec. 19(a) of the Federal Reserve Act to regulate the Citicorp issue. Because this question is now being litigated in the U. S. District Court for the Southern District of New York, it would not be appropriate for me to comment in detail on this matter. Suffice it to say, that the Board believes its present statutory powers do not authorize us either to prevent a Citicorp-type of issue or to regulate its terms.

The Board also believes that there are no legal grounds for objecting to the issue under the terms of the Bank Holding Company Act. In fact, the financing will improve the financial position of

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Citicorp. Indeed the structure of our entire financial system would be strengthened if the maturity profile of liabilities of financial institutions, and depository institutions in particular, were more nearly matched with the maturity profile of their assets.

I should note that our view regarding our authority to effect regulation of the proposed Citicorp issue would be no different even with passage of the cease-and-desist amendment contained in the Senate-passed version of H. R. 11221, inasmuch as no aspects of the Citicorp proposal would appear to support findings of the nature contemplated by sec. 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)).

As a final note, I think it might be relevant for the recent correspondence with appropriate attachments involving the Chairman of the Board of Governors and myself and the Securities and Exchange Commission, the Chairman of this Committee, and the Chairman of Citicorp be included in the record of this hearing. To that end, I have copies of this correspondence which I shall be happy to make available to the Committee.

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