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Statement of J. L. Robertson, Vice Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Banking and Currency

of the

House of Representatives

on

H. R. 15173

May 25, 1966

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At the Committee hearing yesterday, Representative Rees asked the Board to comment on H. R. 15173 at this morning's session. From our very brief study, it appears that the bill has three main provisions. It forbids insured banks (1) to issue interest-bearing negotiable certificates of deposit or other negotiable instruments, (2) to pay interest on time deposits held for less than one year, and (3) to pay higher interest rates on time deposits than on savings accounts.

The Board views such blanket prohibitions on competition for savings as detrimental to the public interest. They would erect legislative barriers to a free movement of funds that has great potential for increasing efficiency in financial markets. In their efforts to compete for savings of individuals, banks would be effectively limited to the acceptance of passbook savings, since few individuals would be willing to hold time deposits with a maturity of a year or more at interest rates no higher than those on savings accounts. The result of such legislation might be that the maximum rate on passbook savings would have to be raised to prevent banks from being barred from effective competition with nonbank intermediaries.

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The bill's prohibition of negotiable CD's is the same as that of H. R. 14026. Our objections to that bill thus apply to this bill also.

The other two provisions of H. R. 15173 seem unwarranted. As we noted yesterday, time certificates have been used in some sections of the country for many years as a medium for the investment of savings by individuals and other small investors. These certificates frequently have a maturity of less than one year. Maintenance of a solvent and liquid banking system does not require that all such certificates should have a maturity of one year or more. Time deposits of fixed maturity permit banks to tailor their asset structure to the maturities of their liabilities. With time deposit maturities of appropriate length, there is justification for permitting rates on time deposits to exceed those on savings accounts, which are in practice paid on demand.

In the past, Congress has taken the view that considerable latitude should be provided to the regulatory authorities for adjusting ceiling rates on time and savings deposits in the light of unfolding economic developments. As we noted yesterday, the Board welcomes consideration of measures

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directed at increased flexibility in administering interest rate ceilings. This bill, in our judgment, moves in the wrong direction, by providing a statutory prohibition and a statutory freezing of certain interest rate relationships on banks' time and savings deposits.

The changes in financial flows and in competitive relationships among financial institutions that seem likely to result from this bill are drastic. Such legislative action hardly seems appropriate to a competitive situation which, though it requires careful surveillance and possibly action to avoid excesses that might unduly harm particular sectors of the economy, at the same time offers promise of substantial gains in economic efficiency and in incentives for saving.

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