

FOR RELEASE ON DELIVERY
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STATEMENT BY

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BEFORE THE

SMALL BUSINESS OVERSIGHT SUBCOMMITTEE OF THE

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

SEPTEMBER 23, 1980

I AM PLEASED TO APPEAR BEFORE THE SMALL BUSINESS OVERSIGHT SUBCOMMITTEE TODAY TO PRESENT THE VIEWS OF THE FEDERAL RESERVE BOARD ON H.R. 7735. THIS BILL WOULD PREEMPT STATE LIMITS ON INTEREST RATES AND ON CERTAIN OTHER CHARGES FOR EXTENSIONS OF ALL TYPES OF CONSUMER CREDIT, BUT WOULD PERMIT ANY STATE TO REIMPOSE CEILINGS BY ENACTING OVERRIDING LEGISLATION. MOREOVER, FOR OPEN-END CREDIT PLANS, THE BILL WOULD REMOVE ALL STATE RESTRICTIONS ON TRANSACTION AND ACCESS FEES IMPOSED ON ACCOUNT HOLDERS. AS PRESENTLY DRAFTED, THIS LATTER PROVISION WOULD NOT PERMIT A STATE OVERRIDE. THESE PREEMPTIONS WOULD APPLY TO ALL CLASSES OF CREDITORS.

THE BOARD HAS LONG BEEN CONCERNED ABOUT THE ADVERSE IMPACT THAT USURY CEILINGS CAN HAVE ON THE AVAILABILITY OF FUNDS IN LOCAL CREDIT MARKETS. WHEN NOMINAL MARKET INTEREST RATES ARE HIGH, AS THEY HAVE BEEN RECENTLY, USURY CEILINGS TYPICALLY AFFECT CREDIT FLOWS BY ENCOURAGING LENDERS TO CHANNEL FUNDS INTO OTHER ASSETS OR TO GEOGRAPHIC AREAS PERMITTING A GREATER YIELD. CREDIT MAY THUS BECOME UNAVAILABLE TO ALL BUT THE MOST QUALIFIED BORROWERS, AS NONPRICE LENDING TERMS ARE TIGHTENED TO COMPENSATE FOR THE RELATIVELY LOW INTEREST RATES THAT ARE LEGALLY PERMISSIBLE. FOR THESE REASONS, THE BOARD SUPPORTS IN PRINCIPLE THE TERMINATION OF ANY SUCH ARTIFICIAL CONSTRAINTS.

AS YOU KNOW, CONGRESS HAS ACTED TO ALLEVIATE PRESSURES IN CERTAIN CRITICAL AREAS AFFECTED BY THE COMBINATION OF HIGH NOMINAL INTEREST RATES AND USURY CEILINGS. THE MOST RECENT MAJOR LAW IN THIS AREA, THE DEPOSITORY INSTITUTIONS DEREGULATION

AND MONETARY CONTROL ACT OF 1980, PREEMPTED STATE USURY CEILINGS ON CERTAIN RESIDENTIAL MORTGAGE LOANS FOR A BROAD SPECTRUM OF LENDERS. IT ALSO TEMPORARILY PREEMPTED LIMITS ON BUSINESS AND AGRICULTURAL LOANS OF \$25,000 OR MORE, AUTHORIZING LENDERS TO CHARGE A RATE UP TO 5% ABOVE THE FEDERAL RESERVE DISCOUNT RATE. THE ACT ALSO GRANTED TO OTHER FINANCIAL INSTITUTIONS THE AUTHORITY, PREVIOUSLY LIMITED TO NATIONAL BANKS, TO SET RATES FOR ALL TYPES OF LOANS UP TO ONE PERCENTAGE POINT ABOVE THE DISCOUNT RATE. INSTITUTIONS WILL BENEFIT FROM THIS PROVISION, OF COURSE, ONLY WHEN THE INDEXED RATE EXCEEDS THE STATE LIMIT THAT WOULD OTHERWISE APPLY.

IN THIS REGARD, THE BOARD CONTINUES TO HAVE STRONG RESERVATIONS ABOUT THE USE OF THE DISCOUNT RATE FOR INDEXING PERMISSIBLE LOAN RATES BECAUSE, AMONG OTHER REASONS, IT IMPOSES WHAT IS A SHORT-TERM RATE ON MARKETS THAT USUALLY INVOLVE LONG-TERM LENDING, AND MOVEMENTS AMONG SHORT-TERM AND LONG-TERM RATES OFTEN DIVERGE SUBSTANTIALLY. IN ADDITION, WE FEEL IT IS UNWISE TO SINGLE OUT A TOOL OF MONETARY POLICY FOR A PURPOSE -- SUCH AS INDEXING -- THAT IS NOT DIRECTLY POLICY RELATED. WE THEREFORE AGAIN URGE CONGRESS TO FIND A MORE APPROPRIATE FORMULATION.

THE DEREGULATION ACT PROVIDED LITTLE RELIEF FROM RATE CEILINGS FOR EXTENDERS OF CONSUMER CREDIT OTHER THAN FINANCIAL INSTITUTIONS. IN CONTRAST, THE PRESENT BILL WOULD COMPLETELY LIFT THE RATE CEILINGS ON CONSUMER CREDIT FOR ALL CLASSES OF CREDITORS, THEREBY FOSTERING COMPETITION IN THE MARKET PLACE. THE BOARD BELIEVES THAT SIMILARLY SITUATED CREDITORS SHOULD

OPERATE IN SIMILAR REGULATORY ENVIRONMENTS. IN THE BOARD'S VIEW, THEREFORE, EXTENDING RELIEF FROM USURY CEILINGS TO ALL CONSUMER CREDITORS IS APPROPRIATE.

THE BOARD HAS RESERVATIONS, HOWEVER, ABOUT ENDORSING THE PREEMPTION OF STATE USURY LAWS. WE BELIEVE THAT, WHENEVER POSSIBLE, THE SUBSTANTIVE REGULATION OF CONSUMER CREDIT MATTERS SHOULD BE LEFT TO THE STATES. CORRECTIVE ACTION AT THE STATE LEVEL, IT SEEMS TO US, WOULD BE THE MOST DESIRABLE WAY TO ADDRESS ANY COUNTER-PRODUCTIVE EFFECTS THAT STATE USURY LAWS MAY HAVE. H.R. 7735, AS NOTED EARLIER, WOULD ENABLE STATES TO OVERRIDE THE PREEMPTION OF USURY CEILINGS ON CONSUMER CREDIT THROUGH PASSAGE OF A NEW LAW OR BY REFERENDUM. IF CONGRESS CHOOSES TO ACT ON USURY LIMITS IN THE CONSUMER CREDIT FIELD, THE BOARD ENDORSES RETAINING THIS STATE PREROGATIVE.

THE OTHER MAJOR SECTION OF THE BILL WOULD DEREGULATE TRANSACTION AND ACCESS FEES ON OPEN-END ACCOUNTS. A NUMBER OF STATES HAVE LAWS LIMITING OR PROHIBITING ANY FEES, SUCH AS ANNUAL CREDIT CARD FEES, IMPOSED ON AN ACCOUNT HOLDER FOR THE PRIVILEGE OF HAVING AN ACCOUNT. IN THE ABSENCE OF ACCOUNT OR TRANSACTION FEES, CHARGES MAY NEVER ACCRUE TO THOSE CUSTOMERS WHO PAY IN FULL BY THE END OF EACH BILLING CYCLE. THIS MEANS, THEN, THAT THE COST OF OPERATING THE CREDIT SYSTEM MUST BE BORNE BY OTHERS, SUCH AS BY CUSTOMERS WHO EXTEND THEIR PAYMENTS OR BY USERS OF OTHER SERVICES OF THE INSTITUTION. PERMITTING TRANSACTION AND ACCESS FEES IN OPEN-END CREDIT PLANS MAKES ECONOMIC SENSE, BECAUSE THE FEE MECHANISMS ALLOW CREDITORS THE OPTION OF BETTER ALLOCATING COSTS AMONG ALL THOSE WHO USE SPECIFIC SERVICES.

AS DRAFTED, H.R. 7/35 DOES NOT ALLOW FOR A STATE OVER-
RIDE PROVISION ON TRANSACTION AND ACCESS FEES. IF CONGRESS SHOULD
DECIDE TO REGULATE THIS AREA, THE BOARD RECOMMENDS CONSIDERATION
OF A PROVISION PERMITTING ANY STATE TO REIMPOSE ITS RESTRICTIONS
ON TRANSACTION AND ACCESS FEES BY ENACTING OVERRIDING LEGISLATION.

IN SUMMARY, THE BOARD ENDORSES EFFORTS TO REMOVE THE
RESTRAINTS IMPOSED BY USURY CEILINGS IN CONSUMER CREDIT AND TO
PERMIT A MORE EQUITABLE DISTRIBUTION OF COSTS AMONG USERS OF OPEN-
END CREDIT ACCOUNTS. THE BOARD PREFERS, HOWEVER, THAT STATE
RATHER THAN FEDERAL LAW GOVERN CONSUMER CREDIT PRICING ISSUES SUCH
AS THESE WHENEVER POSSIBLE, AND WE URGE THE STATES TO ADDRESS
THESE MATTERS IN THE CONTEXT OF OTHER SUBSTANTIVE CONSUMER AND
CREDITOR RIGHTS AND RESPONSIBILITIES.