NATIONAL BANK REAL ESTATE LOANS

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

EIGHTY-EIGHTH CONGRESS

SECOND SESSION

ON

S. 2576

A BILL TO AMEND SECTION 24 OF THE FEDERAL RESERVE ACT (12 U.S.C. 371) RELATING TO CERTAIN LIMITATIONS ON REAL ESTATE LOANS BY NATIONAL BANKS

MARCH 4 AND 10, 1964

Printed for the use of the Committee on Banking and Currency

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NATIONAL BANK REAL ESTATE LOANS

WEDNESDAY, MARCH 4, 1964

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:07 a.m., in room 5302, New Senate Office Building, Senator A. Willis Robertson (chairman of the subcommittee) presiding.

Present: Senators Robertson, Sparkman, Douglas, Muskie, Long, Bennett, Javits, and Simpson.

The CHAIRMAN. The subcommittee will please come to order.

We are working this morning under a rather serious time limitation. We set this hearing at a time when we did not know that the Senate would be meeting at 11 a.m., after which we will not be permitted to meet. So we have just 1 hour in which to hear the witnesses on four bills. Necessarily, the chance of completing the hearings on these bills in that time are rather slim.

In deference to the witnesses from out of town, we will hear first, of course, Members of the Senate who wish to make a statement, and after that we will hear the out-of-town witnesses, as many as we can.

(The subcommittee then proceeded to a consideration of other bills.)

The CHAIRMAN. We will now take up the Muskie bill to increase the percentage that national banks can lend on real estate, and we will insert the bill, S. 2576, at this point.

(The bill is reproduced as follows:)

88TH CONGRESS
2D SESSION

S. 2576

IN THE SENATE OF THE UNITED STATES

FEBRUARY 28 (legislative day, FEBRUARY 26), 1964

Mr. MUSKIE introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

---

A BILL

To amend section 24 of the Federal Reserve Act (12 U.S.C. 371) relating to certain limitations on real estate loans by national banks.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That clause (3) of the third sentence of the first paragraph of section 24 of the Federal Reserve Act (12 U.S.C. 371) is amended to read as follows: "(3) any such loan may be made in an amount not to exceed 80 per centum of the appraised value of the real estate offered as security and for a term not longer than thirty years if the loan is secured by an amortized mortgage, deed of trust, or other such instrument under the terms of which the installment payments are sufficient to amortize the entire principal of the loan within the period ending on the date of its maturity, and".

II

CHANGES IN EXISTING LAW

Changes in existing law made by the bill, S. 2576, as reported are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 24 OF THE FEDERAL RESERVE ACT

SEC. 24. Any national banking association may make real estate loans secured by first liens upon improved real estate, including improved farm land and improved business and residential properties. A loan secured by real estate within the meaning of this section shall be in the form of an obligation or obligations secured by a mortgage, trust deed, or other instrument upon real estate, which shall constitute a first lien on real estate in fee simple or, under such rules and regulations as may be prescribed by the Comptroller of the Currency, on a leasehold under a lease which does not expire for at least 10 years beyond the maturity date of the loan, and any national banking association may purchase any obligation so secured when the entire amount of such obligation is sold to the association. The amount of any such loan hereafter made shall not exceed 50 per centum of the appraised value of the real estate offered as security and no such loan shall be made for a longer term than five years; except that (1) any such loan may be made in an amount not to exceed 66⅔ per centum of the appraised value of the real estate offered as security and for a term not longer than ten years if the loan is secured by an amortized mortgage, deed of trust, or other such instrument under the terms of which the installment payments are sufficient to amortize 40 percentum or more of the principal of the loan within a period of not more than ten years, and (2) any such loan may be made in an an amount not to exceed 66⅔ per centum of the appraised value of the real estate offered as security and for a term not longer than twenty years if the loan is secured by an amortized mortgage, deed of trust, or ther such instrument under the terms of which the installment payments are sufficient to amortize the entire principal of the loan within a period of not more than twenty years, and (3) any such loan may be made in an amount not to exceed [75] *80* per centum of the appraised value of the real estate offered as security and for a term not longer than [20] *thirty* years if the loan is secured by an amortized mortgage, deed or trust, or other such instrument under the terms of which the installment payments are sufficient to amortize the entire principal of the loan within the period ending on the date of its maturity, and (4) the foregoing limitations and restrictions shall not prevent the renewal or extension of loans heretofore made and shall not apply to real estate loans which are insured under the provisions of title II, title VI, title VIII, section 8 of title I, or title IX of the National Housing Act or which are insured by the Secretary of Agriculture pursuant to title I of the Bankhead-Jones Farm Tenant Act, or the Act entitled "An Act to promote conservation in the arid and semiarid areas of the United States by aiding in the development of facilities for water storage and utilization, and for other purposes," approved August 28, 1937, as amended, or title V of the Housing Act of 1949, as amended, and shall not apply to real estate loans which are fully guaranteed or insured by a State, or by a State authority for the payment of the obligations of which the faith and credit of the State is pledged, if under the terms of the guaranty or insurance agreement the association will be assured of repayment in accordance with the terms of the loan. So such association shall make such loans in an aggregate sum in excess of the amount of the capital stock of such association paid in and unimpaired plus the amount of its unimpaired surplus fund, or in excess of 70 per centum of the amount of its time and savings deposits, whichever is the greater. Any such association may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such association may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such association is located.

Any national banking association may make real estate loans secured by first liens upon forest tracts which are properly managed in all respects. Such loans shall be in the form of an obligation or obligations secured by mortgage, trust deed, or other such instrument; and any national banking association may purchase any obligation so secured when the entire amount of such obligation is sold to the association. The amount of any such loan shall not exceed 60 per centum of the appraised fair market value of the growing timber, lands and improvements thereon, offered as security and the loan shall be made upon such terms and conditions as to assure that at no time shall the loan balance exceed 60 per centum of the original appraised total value of the property then remaining. No such loan shall be made for a longer term than three years: except that any such loan may be made for a term not longer than fifteen years if the loan is secured by an amortized mortgage, deed of trust, or other such instrument under the terms of which the installment payments are sufficient to amortize the principal of the loan within a period of not more than fifteen years and at a rate of at least 6⅔ per centum per annum. All such loans secured by first liens upon forest tracts shall be included in the permissible aggregate of all real estate loans prescribed in the preceding paragraph, but no national banking association shall make forest-tract loans in an aggregate sum in excess of 50 per centum of its capital stock paid in and unimpaired plus 50 per centum of its unimpaired surplus fund.

Loans made to finance construction of industrial or commercial buildings and having maturities of not to exceed eighteen months where there is a valid and binding agreement entered into by a financially responsible lender to advance the full amount of the bank's loan upon the completion of the buildings and loans made to finance the construction of residential or farm buildings and having maturities of not to exceed eighteen months, shall not be considered as loans secured by real estate within the meaning of this section but shall be classed as ordinary commercial loans whether or not secured by a mortgage or similar lien on the real estate upon which the building or buildings are being constructed: *Provided*, That no national banking association shall invest in, or be liable on, any such loans in an aggregate amount in excess of 100 per centum of its actually paid-in and unimpaired capital plus 100 per centum of its unimpaired surplus fund. Notes representing loans made under this section to finance the construction of residential or farm buildings and having maturities of not to exceed nine months shall be eligible for discount as commercial paper within the terms of the second paragraph of section 13 of this Act if accompanied by a valid and binding agreement to advance the full amount of the loan upon the completion of the building entered into by an individual, partnership, association, or corporation acceptable to the discounting bank.

Loans made to established industrial or commercial businesses (a) which are in whole or in part discounted or purchased or loaned against as security by a Federal Reserve bank under the provisions of section 13b of this Act, (b) for any part of which a commitment shall have been made by a Federal Reserve bank under the provisions of said section, (c) in the making of which a Federal Reserve bank participates under the provisions of said section, or (d) in which the Reconstruction Finance Corporation or the Housing and Home Finance Administration cooperates or purchases a participation under the provisions of the Reconstruction Finance Corporation Act, as amended, or of section 102 or 102a of the Housing Act of 1948, as amended, shall not be subject to the restrictions or limitations of this section upon loans secured by real estate. Loans in which the Small Business Administration cooperates through agreements to participate on an immediate or deferred basis under the Small Business Act shall not be subject to the restrictions or limitations of this section imposed upon loans secured by real estate. Home improvement loans which are insured under the provisions of section 203(k) or 220(h) of the National Housing Act may be made without regard to the first lien requirements of this section.

Loans made to manufacturing and industrial businesses where the association looks for repayment out of the operations of the borrower's business, relying primarily on the borrower's general credit standing and forecast of operations, with or without other security, but wishes to take a mortgage on the borrower's real estate as a precaution against contingencies, shall not be considered as real estate loans within the meaning of this section but shall be classed as ordinary commercial loans.

AGENCY REPORT

FEDERAL DEPOSIT INSURANCE CORPORATION,
OFFICE OF THE CHAIRMAN,
Washington, May 25, 1964.

Hon. A. WILLIS ROBERTSON,
Chairman, Committee on Banking and Currency,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: I would like to express the views of the Corporation on S. 2576, a bill which would amend section 24 of the Federal Reserve Act relating to certain limitations on real estate loans by national banks.

S. 2576 would authorize national banks to lend on real estate loans up to 80 percent of the appraised value of the real estate offered as a security for a term not in excess of 30 years. The present provisions of section 24 of the Federal Reserve Act permit national banks to lend up to 75 percent of the appraised value of the real estate offered as security, for a term not longer than 20 years.

The Corporation would not favor the relaxation, to the extent provided for in S. 2576, of the existing restrictions on loans which national banks may make on the security of real estate. If the Congress determines that national banks are operating under a competitive disadvantage in meeting a demonstrated need for longer maturities, we suggest that consideration be given to the enactment of statutory limitations applicable to all insured banks which would limit real estate loans up to 75 percent of appraised value of the real estate and a maximum maturity of 25 years. It should be noted that national banks may now meet such needs by FHA and GI loans with greater maturities and percentages of appraised value than provided by existing law.

We have been advised by the Bureau of the Budget that it has no objection from the standpoint of the administration's program to the submission of this letter.

Sincerely yours,

JOSEPH W. BARR, *Chairman.*

STATEMENT OF JAMES J. SAXON, COMPTROLLER OF THE CURRENCY

The CHAIRMAN. You may testify on that.

Mr. SAXON. This bill also, Mr. Chairman, originated in our Office, and it seeks to provide additional flexibility in this area for national banks in line with the much more liberal terms under most State laws. It provides additional competitive capability which would benefit the borrower and the economy. We feel there is great merit to this bill and would like to see it enacted.

(The prepared statement of Mr. Saxon follows:)

STATEMENT OF JAMES J. SAXON, COMPTROLLER OF THE CURRENCY, ON S. 2576 (H.R. 7878)

The law pertaining to the mortgage loan activity of national banks now specifies that such institutions may not make conventional loans in excess of 75 percent of the appraised value of improved real estate, and may not offer a conventional mortgage for longer than 20 years. H.R. 7878 would modify these constraints by permitting national banks to make conventional real estate loans for not more than 80 percent of the appraised value of the property and for a term of not more than 30 years.

In appraising the merits of this bill, I should like to explore briefly what statutory standards may be appropriate for such loans.

There is a natural constraint on mortgage terms even in the absence of restrictive controls, because of the conservatism, prudence, and caution of the typical bank loan officer. With minor exceptions, it is highly unlikely that banks would extend themselves beyond reasonable limits in setting mortgage terms. These exceptions, moreover, would not likely escape the criticism of our examining staffs.

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In determining the appropriate limitations for real estate loans, the principal question is: Should the ceiling on mortgage maturity and the loan-to-value ratio be set with the view of minimizing bank losses, or to encourage a maximum level of home ownership consistent with some bearable level of bank losses.

If Congress desired the former goal, the loan-to-value ratio would be set very low, and the maximum maturity of the mortgage would be fixed at a short-term level. I do not believe that this is good public policy in terms of our general goal of achieving a high rate of real income growth, which includes adding to our stock of housing and nonresidential productive capital in commercial and industrial buildings.

If commercial banks are to fulfill their functions, they must be allowed to take risks. Neither legislation nor administrative regulation should hamper them from doing so, within the bounds of ultimate safety of the deposit funds they have accepted. To assure the effective operation of banks, broad lending discretion is required.

Prospective mortgagors differ widely in their creditworthiness. They differ in terms of present income, prospective income, employment stability, ownership of liquid assets, insurability, and character. They live, furthermore, in widely varying economic environments, a fact which will color their credit capacity quite apart from the above-named characteristics. All of the factors enter into the calculation of the terms upon which mortgage loans can be made with reasonable prudence.

Because of these facts, there are some borrowers whose credit worthiness clearly indicates loan terms more restrictive than those set in the present law as maxima; and there are other borrowers who could make mortgage commitments on terms considerably more liberal than these proposed maxima, without subjecting the lending bank to unreasonable risk. The effect of present ceilings is thus to penalize in substantial degree both the prospestive borrower and the prospective lender. The prospective borrower may find liberal terms in his long-range interest, particularly where his normal income curve will rise in the future, and he expects later prepayments to offset the higher cost in the short run.

In recent years, the delinquency rates on conventional mortgages have tended to be lower than on FHA- and VA-insured loans. (See accompanying table 1.) This can be interpreted in three ways: (1) The legal limitations on the terms of conventional mortgages have made them less subject to delinquency; (2) the data reflect inherently more credit-worthy applicant borrowers in the conventional category; or (3) lenders screen uninsured risks more rigorously than those that are insured.

There is no reason to suppose that the stricter legal requirements for conventional mortgages are the bases for these differences. Since such borrowers are subject to generally higher amortization payments for any given loan size, a higher delinquency rate would be expected. Nor does there appear to be any reason why the more credit-worthy borrowers would seek convention loans in preference to insured loans. It would thus seem that lenders have in the past exercised greater care in screening conventional mortgage applicants than those for insured loans. On this basis, I would anticipate even more careful screening of applicants for liberalized terms, and a consequent reduction in their delinquency and default rates.

At this point I should like to call your attention again to table 1. As you can see, delinquency rates have fallen from 1961 to the latest quarter, June 1963. Conventional mortgage delinquencies show no trend since 1960. While FHA and VA delinquencies are higher now than in 1960, they have improved considerably in the more recent period.

A mortgage default is never due to the loan having too long a maturity. It is unlikely, therefore, that the passage of this amendment would alter the pattern of mortgage defaults, which tends to follow the course of the business cycle. We are therefore concerned solely with the impact that the extended maximum term would have on the safety and viability of our banking system and individual banks within that system.

The impact on a single bank of longer rather than shorter term mortgages is a reduction in the rate of cash payback from a given volume of outstanding loans. To the extent that those who hold mortgages from the banks are also its depositors, this slower payback from very long term mortgages simply means that both deposit liabilities and loan assets are extinguished at a lesser rate than would otherwise be the case. And if the borrowers are not depositors, but customers of other banks, then the lending bank under such circumstances will find its excess reserves augmented at a rate which is smaller than that which would obtain in the case of shorter term loans. In both cases, the practical effect of longer term loans is to reduce the cash inflow of the lending bank and thus to reduce its freedom to alter its asset structure in the very short run. I do not consider this a significant handicap, however, because the individual bank must provide for short-run liquidity needs largely through holdings of cash and secondary reserves, rather than through its prospective return flow of funds from amortized loans. In other words, the safety and viability of an individual bank does not turn primarily on the maturity of its amortized mortgage loans, but on the wisdom of its management of primary and secondary reserve assets as well.

Account must also be taken of equity considerations. The mortgage loan limitations on national banks are, in general, more restrictive than many State laws affecting State-chartered banks—and also more restrictive than Federal and State laws affecting savings and loan associations and other financial intermediaries. The accompanying tables provide appropriate comparisons between legislation affecting national banks and that governing banks in the several States.

I wish to make clear that I would support this bill even if all comparable Federal and State laws were either equally or more stringent than the existing Federal limitations.

I believe this bill can thus stand on its own positive merits. Congress, in passing this bill, will not only benefit the public, but remove the present discrimination against federally chartered commerical banks.

I strongly recommend the passage of H.R. 7878.

Table 1.—Mortgage delinquency rates, by selected States

(Percentages of number of loans delinquent to number outstanding)

End of period	All reporting States				Massachusetts				Connecticut				Maine				New Hampshire				Rhode Island			
	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.
1948	.33	.15	.45	.36	.20	.13	.40	.16	.49	.16	.57	.51	1.71	2.24	2.76	1.05	n.r.	n.r.	n.r.	n.r.	.24	.16	.26	.30
1949	.50	.33	.86	.44	.33	.21	.72	.24	.62	.34	1.09	.55	2.58	-	3.71	2.20	1.39	.39	2.48	1.20	.51	.65	.62	.36
1952	.25	.20	.32	.24	.24	.30	.34	.19	.32	.24	.40	.30	1.13	1.69	1.08	1.06	1.10	.75	2.09	.76	.50	.55	1.26	.27
1954	.22	.17	.26	.23	.24	.29	.28	.21	.34	.32	.36	.28	.91	.72	1.26	.74	.41	.26	1.09	.13	.59	.92	1.34	.34
1957	.25	.15	.32	.26	.31	.24	.44	.23	.34	.28	.50	.27	.79	.97	.90	.67	.81	.63	1.20	.62	.58	1.08	1.16	.39
1958	.34	.21	.43	.32	.38	.32	.54	.29	.63	.45	.90	.55	.87	.79	1.33	.61	.75	.44	1.17	.59	.59	1.10	1.07	.42
1959	.28	.21	.32	.29	.34	.44	.40	.29	.44	.38	.52	.42	.94	1.36	1.21	.53	.31	.16	.47	.27	.40	.41	.64	.34
1960	.50	.41	.53	.53	.69	.58	.88	.61	.50	.39	.50	.53	1.46	1.15	1.96	1.36	1.35	1.90	1.53	1.23	.78	.95	1.14	.69
1961	.63	.69	.66	.57	.75	.83	.96	.65	.52	.56	.59	.48	1.89	1.60	2.39	1.79	1.29	1.52	1.78	1.13	.98	1.07	1.57	.88
1962:																								
March	.61	.72	.63	.53	.62	.56	.73	.59	.54	.56	.66	.49	1.77	1.70	2.07	1.66	1.21	1.46	1.37	1.14	.88	1.12	1.35	.78
June	.59	.72	.58	.52	.63	.70	.74	.56	.56	.53	.68	.53	1.92	1.86	2.59	1.67	1.24	1.13	1.04	1.32	.83	1.06	1.31	.73
Sept.	.59	.72	.60	.50	.59	.65	.73	.53	.49	.51	.63	.45	1.88	2.43	2.47	1.40	1.16	1.35	1.12	1.15	.97	1.35	1.30	.88
Dec.	.60r	.73r	.60	.53	.67	.71	.77	.62	.44	.50	.55	.38	2.02	2.13	2.56	1.74	1.28	1.27	1.45	1.23	.87	1.22	1.41	.75
1963:																								
March	.60	.69	.61	.55	.66	.66	.77	.62	.42	.39	.46	.42	2.01	2.17	2.48	1.73	1.28	1.09	1.57	1.22	.71	1.09	1.11	.61
June	.55	.61	.56	.51	.64	.58	.70	.63	.44	.45	.51	.41	2.29	2.31	3.03	1.95	1.12	.92	1.13	1.14	.60	1.02	.81	.52

End of period	Vermont				New York City				New York Upstate				New Jersey[1]				Pennsylvania				Maryland			
	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.	Total	FHA	VA	Conv.
1948	1.27	1.24	3.85	.50	.35	.12	.25	.49	.33	.27	.37	.39	.22	-	.46	.20	.73	.22	1.46	.48	-	-	-	-
1949	1.85	.84	5.06	1.64	.37	.19	.51	.41	.39	.27	.36	.45	.18	.08	.06	.23	1.25	.82	2.90	.47	.05	-	.15	-
1952	1.25	1.50	2.07	.84	.23	.24	.20	.08	.30	.14	.20	.18	.35	.31	.18	.46	.40	.25	.58	.30	.02	.06	.03	-
1954	1.48	.48	1.50	1.54	.17	.14	.25	.07	.27	.20	.32	.26	.12	.08	.13	.12	.12	.04	.13	.17	.05	-	.12	-
1957	1.17	.22	1.47	.97	.27	.23	.37	.14	.36	.13	.35	.49	.31	.20	.34	.35	.11	.04	.17	.02	.07	.08	.13	.02
1958	.81	1.38	.61	.83	.35	.27	.51	.15	.52	.26	.61	.60	.36	.32	.49	.22	.18	.13	.25	.07	.04	.08	.03	.04
1959	1.15	.89	.67	1.49	.27	.31	.30	.19	.43	.28	.51	.46	.30	.31	.36	.20	.16	.18	.19	.03	.04	-	.12	-
1960	1.12	.77	1.20	1.13	.33	.40	.39	.21	.64	.44	.60	.74	.40	.51	.35	.38	.49	.63	.57	.24	.05	.06	.09	.03
1961	1.37	1.77	.83	1.57	.39	.52	.42	.26	.67	.51	.63	.76	.50	.63	.51	.41	.46	.65	.55	.16	.23	.22	.38	.10
1962:																								
March	1.51	1.68	1.59	1.44	.36	.50	.40	.24	.69	.70	.68	.70	.63	.86	.69	.40	.46	.61	.53	.23	.16	.09	.33	.03
June	1.21	.67	1.17	1.34	.33	.54	.33	.21	.60r	.50	.63	.62r	.49	.62	.30	.54	.43	.61	.46	.21	.19	.19	.23	.16
Sept.	1.35	1.79	1.15	1.35	.33	.49	.37	.20	.65	.51	.67	.69	.46	.59	.34	.47	.42	.61	.44	.20	.11	.16	.09	.10
Dec.	1.15	1.12	1.32	1.07	.36	.51	.37	.25	.65	.63	.68	.65	.49	.62	.52	.39	.48r	.80r	.41r	.22r	.15	.20	.22	.05
1963:																								
March	1.34	.92	1.24	1.49	.39	.56	.38	.30	.70	.61	.71	.72	.52	.64	.57	.38	.49	.78	.46	.20	.12	.13	.19	.04
June	1.26	1.39	1.45	1.15	.33	.45	.33	.26	.64	.50	.65	.68	.46	.64	.50	.31	.39	.63	.40	.12	.12	.12	.23	.02

TABLE 1 (continued)

END OF PERIOD	FLORIDA				OTHER ATLANTIC STATES 2				GREAT LAKES STATES 3				ARKANSAS			
	TOTAL	FHA	VA	CONV.	TOTAL	FHA	VA	CONV.	TOTAL	FHA	VA	CONV.	TOTAL	FHA	VA	CONV.
1948	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	.20	.12	.29	.22	n.r.	n.r.	n.r.	n.r.
1949	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	.36	.40	.44	.30	n.r.	n.r.	n.r.	n.r.
1952	.11	.08	.13	.37	.13	.14	.16	-	.17	.09	.32	.18	.15	.11	.28	-
1954	.09	.09	.13	-	.14	.18	.06	.22	.20	.20	.29	.17	.22	.18	.39	-
1957	.09	.11	.07	-	.24	.41	.10	.12	.13	.05	.29	.11	.02	.02	a	a
1958	.17	.16	.22	-	.15	.09	.29	.02	.34	.17	.67	.22	.10	.09	.09	-
1959	.20	.19	.25	.03	.16	.15	.21	.31	.39	.27	.57	.27	.10	.07	.18	-
1960	.67	.68	.77	.14	.22	.27	.20	.13	.58	.30	.90	.57	.09	.12	-	-
1961	2.27	2.67	1.93	.29	.36	.39	.34	.33	.56	.45	.57	.59	.27	.34	-	-
1962:																
March	2.10	2.64	1.67	.15	.41	.48	.44	.21	.61	.41	.52	.70	.29	.34	.10	-
June	2.00	2.44	1.69	.23	.33	.39	.34	.20	.79	.89	.75	.72	.55	.68	-	-
Sept.	1.86	2.27	1.62	.07	.40	.52	.34	.25	.98	1.20	1.06	.65	.37	.45	-	-
Dec.	1.96	2.37	1.69	.31	.38	.41	.38	.32	.86	.98	.80	.80	.22	.27	-	-
1963:																
March	1.82	2.24	1.53	.15	.33	.33	.34	.31	.96	.94	1.07	.85	.22	.27	-	-
June	1.45	1.75	1.28	.08	.38	.42	.43	.20	.86	.87	.88	.84	.13	.14	.10	-

END OF PERIOD	TEXAS 4				OTHER SOUTHWEST STATES 5				CALIFORNIA				NORTHWEST STATES 6			
	TOTAL	FHA	VA	CONV.	TOTAL	FHA	VA	CONV.	TOTAL	FHA	VA	CONV.	TOTAL	FHA	VA	CONV.
1948	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.
1949	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.
1952	.11	.07	.17	.03	n.r.	n.r.	n.r.	n.r.	.40	.42	.45	.33	n.r.	n.r.	n.r.	n.r.
1954	.07	.04	.12	.07	.05	.05	.05	-	.42	.47	.37	.36	n.r.	n.r.	n.r.	n.r.
1957	.12	.07	.17	.13	.14	.19	.05	-	.20	.11	.25	.28	n.r.	n.r.	n.r.	n.r.
1958	.17	.15	.22	.08	.13	.18	.10	-	.22	.17	.25	.29	n.r.	n.r.	n.r.	n.r.
1959	.14	.10	.20	.17	.06	.08	.05	-	.20	.12	.25	.28	n.r.	n.r.	n.r.	n.r.
1960	.35	.36	.35	.31	.16	.17	.15	.12	.22	.18	.26	.24	.25	.26	.34	.18
1961	.81	.84	.74	.90	.35	.28	.42	.13	.24	.20	.34	.20	.19	.21	.16	.18
1962:					-											
March	.60	.71	.53	.38	.45	.44	.48	.13	.38	.30	.56	.33	.15	.14	.16	.15
June	.80	.98	.65	.52	.42	.40	.46	-	.30	.25	.42	.30	.23	.31	.23	.12
Sept.	.73	.88	.66	.27	.37	.45	.31	-	.37	.33	.48	.33	.26	.28	.31	.20
Dec.	.56	.65	.51	.32	.35	.24	.27	-	.36	.28	.36	.44	.20	.21	.22	.19
1963:																
March	.54	.56	.57	.28	.34	.44	.27	-	.36	.26	.44	.40	.20	.19	.36	.14
June	.42	.50	.38	.18	.30	.32	.30	.14	.40	.36	.55	.35	.23	.23	.31	.20

FOOTNOTES FOR REPORT

Note: Data reflect delinquencies on loans against 1-to 4-family properties located in the respective states or areas; mutual savings banks report on their own in-state loans, and selected mortgage servicing contractors report on loans which they service for savings banks and other institutional holders. Percentage ratios are computed by dividing the number of loans delinquent by the total number of loans held or serviced. Delinquent loans include those which are three or more payments overdue on a monthly program and one or more payments overdue on a quarterly program and, beginning in March 1956, all loans in the process of foreclosure on the date of the report. Data for years prior to 1960 are not strictly comparable with later data because of changes made in the survey, including a substantial increase in the number of savings bank reporters, the addition of several states to the survey, and the change in the classification of loans reported from total mortgages to 1- to 4-family mortgages.

n.r. No report

a. No loans of this type reported.

r. Revised

1/ Beginning with Dec. 1962 rates for New Jersey reflect a change in reporting procedure by one bank.

2/ Includes Georgia, North Carolina and District of Columbia from May 1951 and Delaware from March 1960.

3/ Includes Minnesota, Ohio, Indiana from December 1948, Michigan from May 1951, and Wisconsin from March 1960.

4/ Dec. 1961 rates for Texas reflect a basic change in collection policy by one major mortgage servicer.

5/ Includes Oklahoma from December 1954 and Arizona from March 1960.

6/ Includes Oregon, Washington and Alaska from March 1962.

TABLE 2.—*Tabulation of States with laws governing term of conventional mortgage loans relative to regulation governing national banks*

States with laws regarding term of conventional real estate loans that are—		
More restrictive	Less restrictive [1]	Same
Oklahoma	Alabama	California
South Carolina	Alaska	Colorado
Wyoming	Arizona	Georgia
Virginia	Arkansas	Idaho
(4)	Connecticut	Indiana
	Delaware	Iowa
	Florida	Massachusetts
	Hawaii	Michigan
	Illinois	Montana
	Kansas	New Jersey
	Kentucky	New Mexico
	Louisiana	North Dakota
	Maine	Ohio
	Maryland	Oregon
	Minnesota	Pennsylvania
	Mississippi	Texas
	Missouri	Vermont
	Nebraska	(17)
	Nevada	
	New Hampshire	
	New York	
	North Carolina	
	Rhode Island	
	South Dakota	
	Tennessee	
	Utah	
	Washington	
	West Virginia	
	Wisconsin	
	(30)	

[1] Includes States with no restrictions on term of conventional mortgage loan.

TABLE 3.—*Appraised value conventional mortgage loan limits of States compared with the limit applying to national banks*

States having appraised value conventional mortgage loan limits that are—		
More restrictive	Less restrictive [1]	Same
Minnesota	Alabama	California
Montana [2]	Alaska	Colorado
New Mexico	Arizona	Georgia
North Dakota	Arkansas	Hawaii
Oklahoma	Connecticut	Idaho
South Carolina	Delaware	Indiana
Texas	Florida	Iowa [2]
(7)	Illinois	Massachusetts
	Kansas	Michigan
	Kentucky	New Hampshire [3]
	Louisiana	Ohio
	Maine	Oregon
	Maryland	Pennsylvania
	Mississippi	South Dakota
	Missouri	Vermont [4]
	Nebraska	Virginia
	Nevada	Wyoming
	New Jersey	(17)
	New York	
	North Carolina	
	Rhode Island	
	Tennessee	
	Utah	
	Washington	
	West Virginia	
	Wisconsin	
	(26)	

[1] Includes States with no restrictions on term of conventional mortgage loan.
[2] Only 40 percent of the loan must be amortized in the 20-year period.
[3] New Hampshire law provides for maxima of 50 to 80 percent of appraised value, depending on the location of the property.
[4] 66⅔ to 80 percent, depending on type of property.

The CHAIRMAN. Senator Long.

Senator LONG. Do the national banks make many real estate loans of 80 percent of the value of real estate security for 30 years?

Mr. SAXON. They are not permitted to do so.

Senator LONG. They would under this.

Mr. SAXON. Yes; and it is a matter of competitive capability, really. In Maryland and other States in the Mid-Atlantic States it is 30 years and 80 percent, and in other States it is 100 percent, and I do not suggest at all that a great many banks will make a great many of these loans, but there ought to be the competitive capability to do so, and so long as that exists, I think we have approved a competitive climate condition that is of benefit to the borrower and salutary for the economy.

Senator LONG. I have had some experience, and I do not believe that banks loan anywhere near that high percentage for that length of time.

Mr. SAXON. Yes.

Senator LONG. I just wondered what your comment would be.

Mr. SAXON. It varies throughout the country. Some banks in some States would take advantage of this, others not, as their prudent banking judgment dictated. We do believe that the flexibility ought to be there to do so.

Senator JAVITS. I would like to ask, to what extent would this enlarge the availability of loanable bank funds from the national banks? In other words, there are certain ground rules for long-term mortgage investments. They can only invest a certain proportion, I assume, of their resources. You might tell us what that is. And then tell us to what extent this change would expand their loanable funds for long-term real estate loans.

Mr. SAXON. It is difficult to make any firm estimate, as you know. But there would be some sure, substantial reflection of this increased capacity in lending. However, this is a matter of the individual judgment of each institution. I think primarily it would be used only as a competitive device.

Senator JAVITS. The competition would be with savings banks and with State-chartered institutions and with savings and loan associations, too; would it not?

Mr. SAXON. Yes, sir; that is correct.

Senator JAVITS. Is this an essential competitive change, because they are not in competition now adequately?

Mr. SAXON. Yes, sir; it is essential.

Senator JAVITS. In your judgment.

Mr. SAXON. It is essential that this competitive capability be made available.

Senator JAVITS. It is true that large commercial banks, national banks, are looking more and more for savings in their savings departments, are they not?

Mr. SAXON. Yes.

Senator JAVITS. And is it a fact that the same regulation which applies to a national bank generally, applies not only to its commercial department but also to its savings department?

Mr. SAXON. Yes, sir; that is correct.

Senator JAVITS. So that that regulation would also apply to its savings deposits, and and this bill would largely apply to those long-term savings departments, would it not?

Mr. SAXON. Yes, sir.

Senator JAVITS. Are all these facts correct? I am aware of this from the New York banks, and this is why I am asking.

Mr. SAXON. It is true countrywide, speaking generally as to banks. Some banks, of course, as a matter of individual discretion, may not use it at all or may not be very active in this area. On the whole however, there has been much more intensive activity by the commercial banks in the mortgage area to the clear benefit of this economy. It has driven mortgage rates down now to 5.07 and 5.06 on first-rate real estate paper.

Senator JAVITS. It is now a fact that there is now also competition in the acquisition of mortgages by pension and welfare funds?

Mr. SAXON. Yes.

Senator JAVITS. For example, it is said that there is a hundred million dollars available currently from pension and welfare funds. Is that true?

Mr. SAXON. Yes, sir.

Senator JAVITS. And the bill would enable the banks to participate in this competition, too?

Mr. SAXON. That is correct.

Senator JAVITS. I have heard some criticism, Mr. Comptroller, of regulation Q which puts a certain ceiling on the interest-paying capability of the national banks.

Mr. SAXON. Yes.

Senator JAVITS. Would you have any comment on that—also within this same area of competition?

Mr. SAXON. Yes, sir, Senator, I believe it is an unfortunate regulation, that it is price fixing in its raw sense. It controls the rate which member banks, State and National, can pay for funds. I think it can easily be demonstrated that it has had the most damaging effect on the country domestically and internationally. It has been a large factor in the Euro dollar market, because it has prevented the major money center banks from competing for funds except by the devious device of having them deposited abroad where, of course, they are free of such restrictions.

It has been damaging domestically because it has put a halter on encouragement of the creation of additional savings. Today something must give on regulation Q, either the ceiling must be lifted or eliminated. We have an estimate of $10½ to $12 billion of CD's outstanding. Money rates are hardening very obviously. As these CD's run off, they will go to other instruments unless banks are in a position to compete to retain these funds by renewing these CD contracts.

In these circumstances—and this applies particularly to the non-money-center city banks which have to pay 25 to 40 basis points more for these funds because they don't have the names to carry the competitive rates in the Chicago, New York, and San Francisco markets—these funds would either float to New York or the other large money centers or into other channels of competing paper, commercial paper and other such channels. Something must give in this area.

Now, we are facing what appears to me to be a most serious threat to liquidity in the commercial banking system as a result of the ceiling on Q, at least at this level.

Senator JAVITS. Now, this is a Federal Reserve Board ceiling, is it not?

Mr. SAXON. Yes, sir.

Senator JAVITS. The Federal home loan banks—and I notice our good friend, Mr. McMurray is here—are similarly under the awning, as it were of the Federal Reserve Board Regulations, are they not?

Mr. SAXON. No, sir; they are not.

Senator JAVITS. They are not? It does not affect that?

Mr. SAXON. No, sir.

Senator JAVITS. But it would affect their system competitively, would it not?

Mr. SAXON. Yes, sir, certainly. They are able to compete more freely. This is a matter of fundamental principle, and as to whether an institution in our type of society—supposely we are dealing in a market society where supply and demand determine rates and supply—ought to be restricted by fixing the price or pegging the market.

Senator JAVITS. Is there any other system of banking under any other jurisdiction other than yours and the Federal Home Loan Bank Board which would be competively affected by regulations here?

Mr. SAXON. Well, there is no such restraint, as far as I know. Mr. Gannon is here, of the Bureau of Federal Credit Unions. This isn't a very substantial factor as yet. Mortgage funds, of course, are a very substantial factor. Insurance companies—others—today are practically in the banking business, in lending areas as well as the savings area.

Senator JAVITS. Except that they are not under any form of restriction.

Mr. SAXON. They are under no regulation. Banks have been freed, and quite wisely, it seems to me, in New York.

Talking about money, there ought to be a chance to compete for those funds, as banks may need them and put them to profitable use. They should not be restrained by an artificial inflexibility and price-fixing such as this, in our opinion.

Senator JAVITS. Mr. Chairman, as this is extremely important, may I make the following unanimous consent request: that the witness may review his testimony on this subject and in any way supplement it and revise it and submit any written document that he wishes to on this matter. And as Mr. McMurray has left the stand—it is may fault, I was not here——

Senator BENNETT. He has not been on yet.

Senator JAVITS. Oh, he has not been on yet. I was going to suggest that our staff request—and I will be happy to make the request—of the Federal Home Loan Bank Board and any other Government agency that would have a competitive interest, a similar comment so that the committee might have all together in one place a point of view from the Federal Government standpoint of this regulation Q, including the regulation itself.

30-698—64——3

The CHAIRMAN. It is quite apparent we cannot go into executive session on these bills today. We have only 15 minutes left. So I think it is quite pertinent that we get the information on the Federal Reserve Boards regulation Q and the comparable FDIC regulation, part 329, which are certainly of interest not only to New York, but outside. Is there objection? The Chair hears none.

Senator JAVITS. Thank you.

(Mr. Saxon subsequently submitted the requested statement which appears at p. 25.)

The CHAIRMAN. Now, Mr. Saxon, before you leave the stand, I want to call your attention to the fact that after 2 years of service in World War I, I got married and I rented a house, but I wanted to build one. Well, I had money enough to buy a lot and that was all, and I went looking around for some building funds, and there were no savings and loans in that area, and I found the commercial banks did not want to lend more than 50 percent of the fair value. When was the limit fixed at 75 percent?

Mr. SAXON. At 70 about 3 years ago, sir, I believe.

The CHAIRMAN. Fixed at 75 percent. Anyway, following World War I most of them loaned at 50 percent. In 1932 a lot of them went broke on 50 percent, is that not true? Well, they went broke for some reason. What broke them? What closed all the banks down, because so many of them either broke or were going broke?

Mr. SAXON. No, sir; we find, Mr. Chairman, the loss ratio in the conventional amortized mortgage area is almost negligible, almost nonexistent. We have learned since that time——

The CHAIRMAN. When? It was not negligible back there in 1934.

Mr. SAXON. You know, since these new techniques have been developed and loans are primarily on an amortized basis, which has been most——

The CHAIRMAN. I do not argue that the Home Loan Bank Board does not save them when they took in some of these homes, established a market, and we gradually pulled out of that real estate depression, and Mr. McMurray will tell you about that when he takes the stand. I was here, and I know how the homes were being foreclosed and how we made loans to the homeowner and carried the bank along until confidence could be restored and we would get better values for our property.

Now, the proposal pending here is to raise it from 75 to 80 percent, but we did not bring it up to 75 percent until when?

Senator BENNETT. Three years ago.

Mr. SAXON. 1959; 3 years ago.

The CHAIRMAN. All right; we have had the greatest boom in real estate in the last 3 years that the world ever saw. Now, how long that will last I do not know, but I am just calling attention to the fact that when I wanted to borrow money for my home the limit was 50 percent.

Mr. SAXON. Yes.

The CHAIRMAN. And a lot of them went broke on 50 percent. Now, this is proposed to raise it to 80 percent, and are you advocating that you insure them for $25,000 on top of that? Insure deposits?

Mr. SAXON. No, sir. No, indeed. I am not advocating an increase in the level of deposit insurance at all; no, sir.

(Mr. Saxon later submitted the following letter:)

COMPTROLLER OF THE CURRENCY,
U.S. TREASURY,
Washington, D.C., March 12, 1964.

Hon. A. WILLIS ROBERTSON,
Chairman, Senate Banking and Currency Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: At the hearing of the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency, on March 4, 1964, you asked whether we were advocating an increase in the coverage of Federal deposit insurance. I indicated that we were not advocating such an increase. and this letter outlines the basis for this opposition. We would appreciate it if this statement could be incorporated in the record.

Increased coverage of deposit insurance would not, in our view, serve any useful public purpose, and it would be likely to produce harmful effects. The chief reason advanced in support of such an increase is to avert disruptions in the economy resulting from the unavailability of deposit balances to commercial and industrial firms. Although there are sound reasons for insuring deposits to safeguard the smaller less knowledgeable depositors, commercial and industrial firms are better able to select the institutions in which their balances will be secure. An increase in insurance coverage is thus not required for those most in need of protection by this means.

The most harmful effect of increased deposit insurance coverage would be the danger of erosion of the prudency of bank management. The maturing risks under deposit insurance are not borne solely by the affected institutions, so that the incentive for prudent management is weakened as the coverage of risks is extended. Moreover, broadened insurance coverage would adversely affect the competitive position of banks with the highest quality of management performance, since it would tend to make depositors indifferent to such performance. This could have a severely harmful effect on the proper functioning of the banking system. Finally, since insurance assessments are based on total deposits, the costs of providing this competitive advantage to some banks would be inequitably borne by other banks.

In our view, the function of deposit insurance is to operate, not as a crutch, or as a barrier to initiative, but only as a limited safeguard in the case of occasional bank failure. Judged in these terms, we can see no necessity for an extension of the amount of deposit insurance coverage.

Sincerely,

JAMES J. SAXON,
Comptroller of the Currency.

Mr. SAXON. Now, the other point. We think the mortgage contract today is a wholly different instrument than that which existed in the past. Amortization of loans was the principal change, but there are others. Additionally, in the depression period it was the general decline in the economy that affected stock market collateral, everything, other collateral. The only thing that came out the best was unsecured paper where the banker relied on the borrower, his character, and his capacity.

The CHAIRMAN. I am just trying to emphasize the fact, based upon a service in the Congress for 31 years and much longer than that in State government, that you do not have perpetual prosperity.

Mr. SAXON. Yes.

The CHAIRMAN. And you know if you ever went to school in the country and they had the water pitcher on the outside of the room, and as you went out somebody threw water up and said, "What goes up must come down, and unless you get from under you are going to get water on you." I cannot think that we should, in the greatest real estate boom that I have ever known in this country, legislate on the assumption that it will never be any cheaper than it is now. That is the point I want to develop.

Senator BENNETT. Mr. Chairman, may I ask a question?

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Saxon, on January 20, 1964, you published on your letterhead what is called the "Copy of a Letter Addressed to Counsel for a National Bank," and in that letter the question was raised: May a bank under existing statutes rely on private mortgage guarantee insurance coverage to support a loan in excess of the legal limit which is 75 percent and 20 years?

Mr. SAXON. Yes.

Senator BENNETT. And you answer was, in effect: Yes, the bank may rely on such mortgage loan guarantees which in effect would then take the loan out of the real estate loan within the meaning of 12 U.S.C. 371, although as a matter of prudent banking practice it may also be secured by real estate.

Now you are raising the limit to 80, you are increasing the term to 30 years. Would your answer be the same to a similar inquiry today?

Mr. SAXON. Yes.

Senator BENNETT. Is not this a device to carry the national banks above their legal limit?

Mr. SAXON. No. The answer is "Yes," we would make the same answer to the inquiry today. We think that the bank can make, as indeed many do, loans for the purchase of real estate on a plain note. There is nothing to prevent a bank universally to lend to Saxon enough money to buy a house without taking it back as security.

Senator BENNETT. Like the Washington bank did to Bobby Baker, take no security, a $125,000 loan because he is a good man?

Mr. SAXON. Well, it's a nice day. [Laughter.]

And, indeed, we noted in our ruling that where the insurer is reliable, and the bank's records, information therein contained, demonstrates the reliability of the insurer, that we see no objection to this.

Senator BENNETT. The obvious followup question: The mortgage guarantee insurance company, which I think fills a need in our financial system as a private guarantor of mortgage insurance—and I am not bringing it up because of the relationship of some of its stockholders to a current problem—this would indicate that this company which has in the past been serving savings and loan associations largely, is encouraged to extend its activities to national banks if it can persuade the management of those banks to use its services, and you have no objection, I take it.

Mr. SAXON. It is if, as is brought out in our closing point in the last sentence, the records of the bank show that this is a reliable company. Now, it is clear today that other companies are moving into this area, and some very substantial insurance companies, some of the big-name companies.

Senator BENNETT. Yes.

Mr. SAXON. And what we are doing, what we did, is very similar to the present law on VA insured mortgages. If the VA insures 20 percent of the mortgage, it takes the whole thing out of the section 371 limit under the present law.

Senator BENNETT. Mr. Chairman, I would like to offer this letter for the record.

The CHAIRMAN. Without objection, it will be included in the record.

(The letter referred to is as follows:)

COMPTROLLER OF THE CURRENCY,
U.S. TREASURY,
Washington, D.C., January 20, 1964.

COPY OF A LETTER ADDRESSED TO COUNSEL FOR A NATIONAL BANK

In your letter of November 21, 1963, you requested a ruling for your client, the Citizens & Southern National Bank, Atlanta, Ga., as to whether, under existing statutes and regulations governing national banks, as interpreted by the Comptroller, private mortgage guarantee insurance coverage may be used to support a mortgage loan in excess of 75 percent of the appraised value of real estate and/or for an amortization term longer than 20 years. In other words, may private mortgage guarantee insurance, which is modeled after the FHA–VA type of coverage, be used to remove a mortgage loan from the classification of "real estate loan" within the meaning of 12 U.S.C. 371?

Paragraph 2000(b) of the "Comptroller's Manual" provides that a real estate loan within the meaning of 12 U.S.C. 371 is any loan secured by real estate where the bank relies upon such real estate as the primary security for the loan. However, where the bank in its judgment relies principally upon other factors, such as the general credit standing of the borrowers, guarantees, or security other than real estate, the loan does not constitute a real estate loan within the meaning of 12 U.S.C. 371, although as a matter of prudent banking practice it may also be secured by real estate.

It is your conclusion that where such mortgage insurance is the primary security relied upon, a national bank would be able to make those loans which would otherwise not qualify as conforming real estate loans, but which would in all other respects be real estate loans within the meaning of the applicable statutes. Your conclusion is based on the premise that mortgage insurance falls within the same classification as other types of guarantees, accommodation endorsements, and take out commitments, all of which have been held to remove loans from the definition of a real estate loan within the meaning of 12 U.S.C. 371.

We agree with your conclusion that private company mortgage insurance or guarantee may be used as a substitute for the insurance or guarantee of a Government agency and that where a national bank makes a loan in primary reliance upon such insurance or guarantee, the loan does not constitute a real estate loan within the meaning of 12 U.S.C. 371.

Where the bank relies on private insurance or guarantee as primary security for a loan, its files should contain evidence to demonstrate that the bank is justified in placing such primary reliance on the insurance contract.

Sincerely,

JAMES J. SAXON,
Comptroller of the Currency.

Senator MUSKIE. Mr. Chairman, Mr. Bergmann has submitted part of his statement, that dealing with S. 2259. He did not read the rest of it. I wonder if he wanted to submit the whole statement for the record, or whether he wanted to be called back to testify.

Mr. TIEMANN. Mr. Bergmann just left, and he would like to have his entire statement made a part of the record.

Senator SPARKMAN. Of course, Mr. Bergmann is here in town, but we will include in the record at the appropriate place the pertinent discussion under each of the two bills, S. 2259 and S. 2576.

(Mr. Bergmann's statement on S. 2576 follows:)

STATEMENT OF HARRY P. BERGMANN, SENIOR VICE PRESIDENT, RIGGS NATIONAL BANK, WASHINGTON, D.C., AND CHAIRMAN, MORTGAGE FINANCE COMMITTEE, AMERICAN BANKERS ASSOCIATION

S. 2576 would modernize present limitations on national bank real estate lending authority by providing additional flexibility for the banks. Existing limitations of real estate loans to 75 percent of appraised value and 20-year terms are unrealistic in some cases.

National banks hold approximately $14 billion in residential real estate loans and, in addition, originate a substantial volume of such loans for other permanent investors. Thus they are very significant participants in the residential mortgage market, yet they must operate at a serious disadvantage when compared with other mortgage lenders, including State-chartered commercial banks. For example, State-chartered banks in 20 States have no statutory limitations at all on loan-to-value ratios, while in 24 States there is no statutory limitation on the maximum maturities which can be given borrowers by State banks. Further, some of the States which do have limitations have less severe restrictions than are applicable to national banks.

The flexibility to be gained by national banks from a broadening of mortgage-lending authority is important for several reasons: First, it would enable them to serve those potential homeowners who, for various reasons, require a higher ratio of loan-to-value of property or a longer maturity or both. In communities where commercial banks are the principal mortgage lenders, modernized lending powers would be especially beneficial in permitting the servicing of those prospective borrowers who do not have the present ability to meet available terms and do not have ready access to other mortgage lenders. Second, since a significant activity which commercial banks perform in the housing finance field consists of loan origination for sale to other mortgage holders, they should have the more flexible powers to provide loan terms which would more nearly match the requirements of the prospective borrower and the standards established by the ultimate holder of the mortgage loan.

With respect to the latter point, it may be noted that the terms provided by S. 2576 would be especially advantageous in fast-growing areas where available mortgage credit facilities are inadequate to meet local mortgage-financing needs. In such areas, commercial banks often fill the gap by originating mortgage loans for sale in the secondary market.

It cannot be emphasized too strongly that modernization of real estate loan limitations for national banks does not mean that henceforth all residential real estate loans by national banks will be at 80 percent of appraised value and for 30-year terms. This is not the case with State banks today (in States permitting such loans) nor would it be for national banks. Indeed it is doubtful that adoption of this legislation would alter significantly the present lending policies of national banks. What it would do, however, is provide a degree of flexibility for national banks which would enable them, in appropriate circumstances, to make sound loans under somewhat more liberal terms than are presently possible.

For the foregoing reasons we respectfully request that your committee report favorably on S. 2576.

NATIONAL BANK REAL ESTATE LOANS

TUESDAY, MARCH 10, 1964

U.S. SENATE,
COMMITTEE ON BANKING AND CURRENCY,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room 5302, New Senate Office Building, Senator A. Willis Robertson (chairman of the subcommittee) presiding.

Present: Senators Robertson, Sparkman, Proxmire, Long, and Bennett.

(The subcommittee commenced the hearing with a consideration of other bills.)

The CHAIRMAN. Now we will return to the bill that we had under consideration. That is the bill that raises the limitations on loans by national banks on real estate, and we will ask our distinguished Comptroller of the Currency if he will return to the witness stand.

STATEMENT OF JAMES J. SAXON, COMPTROLLER OF THE CURRENCY

The CHAIRMAN. We welcome you, Mr. Saxon.

Mr. SAXON. Thank you, Mr. Chairman.

The CHAIRMAN. Do you wish at this time to add anything to your principal statement on this bill?

Mr. SAXON. Sir, if I may, I should like to have the privilege of putting into the record a statement on the proposal to modestly liberalize conventional amortized mortgage lending by national banks.

The CHAIRMAN. Just a minute, please. I see one or two commentators from our financial institutions with pencils poised, and they didn't catch just what you were going to recommend.

Mr. SAXON. I ask the privilege, Mr. Chairman, to have incorporated into the record a statement on the bill which would modestly liberalize the conventional amortized mortgage-lending authority of national banks.

The CHAIRMAN. Is there anything different in that statement from what you testified to heretofore?

Mr. SAXON. I didn't read any statement earlier, Mr. Chairman. I just made a few comments about a minute long, and I thought in view of the great importance of this issue to the national banks of the country, and it is of great significance, that the statement ought to be incorporated in the record and if the chairman should like, I would be glad to read this statement. This bill has very, very broad support throughout the national banking system and is urged by, I would say, 95 to 98 percent of the national banks of the country. It is a matter of considerable significance to us.

The CHAIRMAN. The distinguished Senator from New York, Mr. Javits, thought that regulation Q either was or was going to become a burning issue, and he asked you to have something to say on that subject. I believe you prepared a statement.

Mr. SAXON. Yes, sir.

The CHAIRMAN. Have you made that available to the press gallery?

Mr. SAXON. I believe it has been, Mr. Chairman.

The CHAIRMAN. I see it is rather long. You might summarize it briefly. Are you for it or against it?

Mr. SAXON. We would strongly urge the abolition of any ceiling or limitations on the payment of interest on time and savings accounts by member banks on the grounds set forth in this statement, because we think it is an artificial restraint which has very damaging effects on the economy, nationally and internationally, and it is price pegging in its worst form, pegs the market, deprives one type of institution of the opportunity to compete for funds, as the need therefor and the profitable use thereof may exist. It results in certain threats of serious illiquidity today because of such artificial limitations. We believe the question of rates should be left to the determination of the marketplace, not by the judgment of one or more men in a distant governmental capacity, but by the marketplace.

We would hope, therefore, that as we spell out here in considerable detail in this statement in response to Senator Javits' question, we would hope that the Federal Reserve Board would lift the present ceiling.

The CHAIRMAN. Who would conduct those hearings? Who do you have in mind?

Mr. SAXON. On regulation Q?

The CHAIRMAN. Yes.

Mr. SAXON. Part of the answer lies in existing authority of the Federal Reserve Board to lift, or as we think in reading the statute, to eliminate the ceiling altogether. Authority here congressionally lies within the Banking Committees of the Congress.

The CHAIRMAN. We have no bill on the subject.

Mr. SAXON. No, sir. There is no specific bill, to my knowledge, although S. 1799, among other things, provides for standby interest rate regulation.

The CHAIRMAN. We will ask the opinion of other agencies dealing with financial institutions for an expression of opinion, but as of now, we are not concerned immediately because we are limited to three bills, and in fact we have no bill on regulation Q.

Mr. SAXON. This statement was submitted and prepared in response to Senator Javits' request.

The CHAIRMAN. It will be put in the record for consideration. (See p. 25.)

The CHAIRMAN. The Senator from Missouri is recognized.

Senator LONG. Mr. Saxon, I appreciate your coming back this morning. I haven't had the opportunity to read your statement on regulation Q. I thought that I understood at least a reference in your remarks the other day about elimination of ceiling.

Now, so that I am sure we are talking about the same thing, you were referring to the ceiling of 4 percent on certificates?

Mr. SAXON. The various limitations imposed under regulation Q, on payment of interest on time and savings accounts.

Senator LONG. Now small banks, in Missouri, they pay 4 percent on certificates of deposits?

Mr. SAXON. Yes.

Senator LONG. It is your thought that the ceiling should be removed and you pay up to whatever the competitive figure might be?

Mr. SAXON. Yes.

Senator LONG. Five percent or ten percent?

Mr. SAXON. Yes.

Senator LONG. Even though we have in many States a statutory limit, I am not sure that would apply in this case.

But the thing I am particularly concerned about is small State banks. Was it not the experience of bank systems—especially State banking systems during the depression—that when they were in need of help, they needed money badly, they went out and paid excessive amounts for it when we didn't have this regulation?

Mr. SAXON. That is sometimes alleged, but we know of no substantial support for that allegation that is made, Senator.

No, as a matter of fact, the trouble that developed in that period hardly in our opinion can be attributed to mortgage loans held by the commercial banking system.

At that period, trouble was encountered with a substantial part of the total loan portfolio. The difficulties were incident to general deterioration of economic conditions throughout the country, indeed, throughout the world, and as a result of that, a lack of confidence in the banking system and capital markets generally, motivated primarily by the great deterioration in the stock market.

So, to me, we find little relevance in the allegation that the difficulties could be attributable to the price paid for money or to the investments in mortgages.

Senator LONG. Mr. Saxon, I fear that you are dealing on a worldwide or national basis, and we are losing sight of the problem we would have in our States with our smaller banks in the rural areas and so on.

There are situations, are there not, which do exist where a bank doesn't need money for lending purposes at a particular time. The banks 10 miles from there, may be in very difficult financial straits. They may jump the price 4 or 5 percent higher than the present 4-percent rate. As a result, there will be a considerable flow of money from the bank that doesn't pay the going rate, will there not?

Mr. SAXON. There could be, and I think the answer to that is "Yes," but this is part of a question of how our economy should operate, and particularly our commercial banking system and whether we should attempt to protect it here by a limitation such as this or depend on what, as we see it generally, is the good judgment and prudence of the banks.

We don't see excessive rates paid by the smaller banks. In fact, in cities like Columbus and Cleveland, and smaller areas, the rate is still 3 percent. There is no requirement to go to 4.

We see great prudence on the part of banks, and a number of banks, some larger as well as smaller, that went to the maximum limits, receded. But this was a matter left to the prudence and judgment of each individual institution.

Senator LONG. I wanted to be sure I understood your statement the other day. Frankly, I am very apprehensive of—and I am speaking only of the smaller banks, and I mean smaller banks, $4, $5, $10 million. I know of a number of banks in Missouri of that size that didn't pay any interest, anything at all and other banks would pay 3 percent. They had such an outflow of their funds, that they had to go to the 4 percent to meet competition.

Now, if there is another bank in the same town or the same community which goes to 6 percent, there will be such an outflow that they will have to go to that same price to meet competition.

And if the other bank raises its rate, it looks to me like it gets into a vicious circle. I think maybe we are speaking about different size banks.

Mr. SAXON. I am speaking to the same areas as you, the smaller banks, which we are as anxious about in our office since they are the great bulk of banks. We watch this very carefully, and we don't see excesses. We see smaller banks showing good growth, making better profit, very profitably and efficiently employing their funds and not at the risk of the accumulation of unhealthy assets. They are not reaching out.

When regulation Q was raised at the beginning of 1962, initially because of a demand for higher yielding securities, and the recourse to the municipal market, the curve went up sharply. But by September of that year, reflecting the good judgment of the banks in the country, it moved down just as sharply as they pulled away from a market which had pricewise gotten to such a point because of that demand, that it was yielding insufficient returns and raised a risk for them.

Senator LONG. That is not taking into consideration the banker who feels he could use a little more money, which is a typical attitude of bankers, and if he raises his rate higher there is bound to be a flow of funds into that bank.

Mr. SAXON. There could be, depending on distance and convenience. As you know, Senator, as a banker, there are a number of factors involved in accumulation of savings. One is the convenience factor to the depositor, another is the attitude of the institution, and the third is the rate differential, whether it is substantial enough to attract funds.

We are seeing the same thing where S. & L.'s are not subject to any ceiling, are able to and have been for many years attracting many funds out of the available pool at a given point in time, and the growth, even in these communities that you are speaking of, the small communities, the main competitor is usually an S. & L., not a bank. I don't think there should be a ceiling, as a matter of fact.

Senator LONG. That has been very detrimental to some of the banks. As far as the flow of funds is concerned, some have gone to the S. & L.'s, who could pay a higher rate of interest until it was amended to 4 percent, and then some of the S. & L.'s went up to 4¼ and 4½.

Mr. SAXON. At the 4¼ level and even 4½, the smaller banks in our analysis, continued to do very well indeed, and were able to compete very well.

We think the result looks good. Now, there are a lot of banks in this country still paying 1, and 1½ percent. This is their privilege, as we see it. I don't think we should be judging. And some are at 2, and some have various other restrictive provisions, as you well know, in their certificate-of-deposit contracts and in their savings contracts on the computation of interest, and have many other provisions which, while the rate looks like 3½ or 4, may be substantially below that figure.

This, again, so long as it is plainly understood by the public, to which appeal is made, as we would see it, is within the judgment of the bank. We don't see any of these banks imperiled.

The peril that is coming to banks is not from this source today.

Senator LONG. Thank you, Mr. Saxon.

The CHAIRMAN. Mr. Bennett.

Senator BENNETT. Mr. Saxon, when we were meeting last on these same bills, you and I had a little colloquy on private insurance.

Mr. SAXON. Yes.

Senator BENNETT. I hold in my hand the March 9 issue of the private publication called Washington Financial Reports, whose lead article says:

> Private insurance which covers the top 20 percent of the mortgages acceptable to the comptroller for purposes of his recent ruling that national banks may exceed normal real estate loan limits when they rely primarily on private mortgage insurance.

Have you seen this?

Mr. SAXON. I haven't seen the issue. I know the ruling we made in the form of a letter, of course.

Senator BENNETT. I would like either to give you this and let you comment on it, or ask you if you will comment in writing to the committee, saying that this is a reasonably accurate report?

Mr. SAXON. I will be glad to comment after reading it, Senator, if I may.

(Mr. Saxon later submitted the following statement.)

STATEMENT BY JAMES J. SAXON, COMPTROLLER OF THE CURRENCY

At a hearing before the Subcommittee on Financial Institutions of the Senate Banking and Currency Committee, on March 10, 1964, Senator Bennett requested that I supplement my remarks on the ruling of the Office of the Comptroller relating to the use by nationl banks of private mortgage insurance. This is submitted in response to that request.

The ruling represents a special application of a general principle evolved from a careful examination of congressional action and administrative interpretation with respect to real estate loans. Federal law (12 U.S.C. 371) requires that loans made by national banks on the security of real estate meet certain requirements with respect to the nature and value of the security, the term of the loan and the manner of its repayment. The law recognizes, however, that in certain circumstances loans secured by real estate are not made primarily on the security of real estate and are to be treated as ordinary commercial loans. From these provisions, there may be developed a general definition that a real estate loan within the meaning of the Federal law is any loan secured by real estate where the bank relies upon such real estate as the primary security for the loan. Where the bank in its judgment relies principally upon other factors, such as the general credit standing of the borrower, guarantees or security other than real estate, the loan does not constitute a real estate loan within the meaning of the Federal law, although as a matter of prudent banking practice it may also be secured by real estate. This definition was tested through application to a variety of transactions during the early part of 1963 and now appears as paragraph 2000(b) of the "Comptroller's Manual for National Banks." This manual was distributed to all national banks in June 1963.

It should be especially noted that the principle set forth in this definition is by law applied to loans insured under the National Housing Act and other Federal legislation and to loans fully insured or guaranteed where the insurance or guarantee is supported by the credit of a State (12 U.S.C. 371). It is also by law applied to any loan at least 20 percent of which is guaranteed by the Veterans' Administration (38 U.S.C. 1802(f)).

These provisions of law afford the immediate basis for paragraph 2150 of the "Comptroller's Manual" which provides that where a bank in its judgment relies principally on the insurance or guarantee of a governmental agency in making a loan, the loan does not constitute a real estate loan within the meaning of 12 U.S.C. 371 although, as a matter of prudent banking practice or because such security is required by the insurer or guarantor, the loan may also be secured by real estate. A cross-reference at the end of paragraph 2150 refers to paragraph 2000.

Counsel for a national bank, making the invited comparison, inquired whether private mortgage guarantee insurance could be used in the same manner as FHA and VA insurance and with the same result: that the loan would not constitute a real estate loan within the meaning of the Federal law. This Office replied that where a national bank makes a loan in primary reliance upon private mortgage insurance or guarantee the loan does not constitute a real estate loan within the meaning of section 371, title 12, United States Code. The admonition was added, however, that where the bank relies upon private insurance or guarantee as primary security for a loan, its files should contain evidence to demonstrate that the bank is justified in placing such primary reliance on the insurance contract. Accordingly, the terms and conditions in the insurance contract issued by a financially responsible company must afford adequate protection to the lending bank. The ruling does not represent an endorsement of any insurance company, policy, or form of coverage. It places in the lending bank the initial responsibility for evaluating the insurance company and policy on which it will primarily rely in making the loan. Our examiners will review, regularly and in detail, the manner in which each bank fulfills its responsibility in making these evaluations.

There has been some misunderstanding about the scope of the insurance required. It is not necessary that such insurance eliminate all risk of loans. The amortization, maturity, and other restrictions imposed by Federal law (12 U.S.C. 371) on real estate loans made by national banks are designed to reduce the risk of loss in making such loans. They do not purport and are not intended to eliminate all risk of loss. Other financial institutions not subject to these restrictions have developed other methods of minimizing losses. One method, recognizing the usual salvage value of real estate security, is to insure not the whole risk but the most important part—the top 20 percent. Where a loan is made in primary reliance on insurance which adequately protects the bank against the major risk in the loan, i.e., that part of the loan in excess of what is recognized as the usual salvage value of the real estate security, the loan satisfies the requirements of both prudent banking practice and the principle contained in paragraphs 2000(b) and 2150 of the "Comptroller's Manual for National Banks."

The CHAIRMAN. Senator Proxmire?

Senator PROXMIRE. No.

The CHAIRMAN. He does not care to ask questions.

There being no more questions, Comptroller, we thank you.

Senator BENNETT. Thank you.

Senator SPARKMAN. May I ask this: Have you testified on both of the bank bills?

Mr. SAXON. Yes, Senator.

Senator SPARKMAN. One relating to the increased percentage of loans to value of ratio that might lend on real estate, and one relating to timber tracts?

Mr. SAXON. Yes.

Senator SPARKMAN. I read that you had both included the last time, but I wasn't sure that you covered both.

Mr. SAXON. Yes, I did, this morning, sir.

(The committee then proceeded to a consideration of other business.)

(The following material was later received for inclusion in the record:)

REGULATION Q

STATEMENT BY JAMES J. SAXON, COMPTROLLER OF THE CURRENCY

At a hearing before the Subcommittee on Financial Institutions of the Senate Banking and Currency Committee, on March 4, 1964, Senator Javits requested that I supplement my remarks on the effects of interest rate controls under regulation Q. This is submitted in response to that request.

A cardinal principle of our free enterprise system is that government should impose economic regulation only in those areas where free market forces lead to results that are clearly not in the public interest. When the Federal Government intervenes to fix prices administrative decisions are substituted for those of the marketplace: the decisions of one man or a very few men replace the judgments of thousands. Clearly there may be instances in which this is a desirable course. However, unless there is a clear-cut case for such intervention on social welfare grounds, it would be judicious to avoid the substitution of Government decisions for private decisions.

In my view, neither ceiling rates on deposits nor the standby authority to impose them are likely to bring improvements in the social welfare. On the contrary, they are likely to produce much damage.

Both the Commission on Money and Credit and the President's Committee on Financial Institutions recommended that interest-rate ceilings be placed on a standby basis, thus recognizing the fact that they are not normally desirable. Remarkably little discussion and debate was generated on this point when the Banking Act of 1933 was under consideration. What discussion there was rested on the assumption that the banking troubles of the 1930's were the result of imprudent banking practices. Such practices were forced upon the commercial banks, so the argument ran, by the severe competition for correspondent and other deposit balances. This competition, it was said, led to high interest rates on deposits, and impelled the banks to acquire very risky, high-yielding assets. In oher words, in order to justify the payment of high rates on deposits, the banks were forced to take risks that exposed them to the dangerous illiquidity that led to the banking crisis of 1933.

This argument appears to be as a gross oversimplification of the causes of the banking problems of 1919–33. I find it extremely difficult to believe that the troubles we experienced then could have been avoided by the prior existence of ceiling rates on time and savings deposits. The forces at work were varied, complex, and powerful. They suggest that the lack of interest-rate regulation could have been only tenuously connected with the general collapse of the banking system.

(1) For the most part, the crisis in the early 1930's was a liquidity crisis. It consisted of two forces that were mutually reinforcing. First, the stock market crash in 1929 destroyed public confidence in the workings of credit and capital markets. Coming at a time when the economy had already moved into the recession phase of the business cycle, the result was one of retrenchment, liquidation of debt, and a rapid decline in the supply of money. Currency drains on some banks put the latter in difficulty, and each failure generated new fears concerning the safety of bank deposits, which led in turn to fresh runs on other banks.

Because of existing central bank practices and authority, a second force intruded on the situation: the Federal Reserves' power to act as a lender of last resort was severely restrained, and partly bcause of this the member banks were kept under essentially tight money conditions throughout the period. With the exception of one episode in 1932, the System's powers were never fully utilized to meet the crisis.

(2) It should be recalled that, until 1932, the eligibility requirements for rediscounting at the Federal Reserve banks were extremely high. Only limited kinds of commercial paper could be rediscounted to enable a bank to meet its (fixed) reserve requirements in the face of deposit drains. Those banks that

were under severe strain found the discount window virtually closed. This led them to meet further drains by sale of assets in a declining market and at substantial losses. While an individual bank might meet deposit drains in this way, it is impossible for a major segment of the banking system to meet the problem in this manner. The result was a widespread liquidity crisis.

(3) Even more disastrous, however, was the tight-money policy pursued in 1931 by the Federal Reserve banks. This was motivated by a temporary loss of gold and rigid adherence to the rules of the gold standard game. This was surely a mistake, and the result of a misunderstanding of the central bank's responsibilities in that worldwide crisis. Temporarily revived confidence and a modest improvement in bank liquidity was struck down by the increase in the Federal Reserve discount rate and concurrent sale of Federal Reserve assets.

In summary, the banking crisis of the early 1930's was the product of a general loss of confidence in the banking system, declining business activity, the lack of a sound deposit insurance system, and the failure of the Federal Reserve as a lender of last resort.

With this as a background, I should like to review briefly the costs and benefits of interest rate ceilings on deposits.

A. The costs

1. *The imposition of ceiling rates on deposits distorts the market allocation of savings between various financial intermediaries.* By establishing prices and pegging the market in a discriminatory fashion—different rate ceilings being imposed on different classes of intermediaries—the regulatory authorities encourage the flow of savings into some kinds of institutions and discourage the flow to others. Savers, while apparently insensitive to general rate levels in determining how much to save out of a given level of income, are becoming increasingly sensitive to differential rates offered by various financial intermediaries. In other words, while total saving is not substantially influenced by the level of interest rates, individual savers allocate their funds to get the highest return for any given level of risk.

Since consumers and savers consider the risks of bank savings and shares in savings and loan associations, equal, or essentially so, the price control placed on the former dicriminates against commercial banks.

2. *The imposition of price control on a discriminatory basis distorts the flow of investment funds to particular uses.* If some intermediaries are allowed to pay higher rates on deposits than others, then it follows that investment funds will tend to be directed toward the specialized loan business of the favored institutions. In practical terms, this may mean that investment in some lines with a high rate of social return will go begging for funds, while other kinds of investment with lower rates of social return are assured ample supplies of the community's savings.

It can be shown that the maximum total return from a given level of investment expenditures is realized when the marginal returns of various kinds of investment are equal. I am suggesting that, where the monetary authorities distort the flow of savings by differential ceiling rates on deposits, the possibility exists that investment returns cannot be equalized; hence, the community suffers.

(A hypothetical example to illustrate this possibility may illuminate this further. Suppose we have two intermediaries X and Y. X specializes in making loans to the oil industry, while Y makes only mortgage loans. Suppose further that the rate of return on a marginal investment in oil-drilling machinery is 15 percent and the marginal return on housing investment is 10 percent. X is a commercial bank subject to a ceiling savings deposit interest rate of 4 percent, while Y, a savings and loan association, has no ceiling imposed and is offering 4¾ percent. Savers, being sensitive to deposit rate differentials, divert their funds from the commercial bank to the S. & L. Consequently, the savings of the community are used to build more houses at a 10 percent rate of return, and at the expense of investment in oil machinery at 15 percent.)

3. *A final cost of ceiling rates is that they tend to subsidize inefficient banks, while penalizing those that are well managed, vigorous, and efficient.*

Some banks, because of their high efficiency, are able to pay more than the existing ceiling rate without engaging in imprudent banking practices. Others, less well organized, less cost conscious, and perhaps in a sheltered competitive position, find the ceiling a convenient means of avoiding the rigors of competition for deposits with their more resourceful counterparts in the banking community.

It is essentially unwise for regulatory agencies to impose price controls that reward the slothful and discourage enterprise. Even if there were no other costs of this control—and there most certainly are—I would regard this cost a necessary and sufficient justification for its abolition.

B. Benefits

1. *It is sometimes alleged that ceiling rates on commercial bank deposits will prevent ruinous rate competition which leads to the acquisition by banks of risky and unsound loans.*

The restraints now imposed on such behavior through strict bank examination standards and the generally higher quality of risk assets today (in comparison with the period 1920–33) reduce the potency of this argument. Furthermore, the danger of any such development today is infinitely smaller than it was in the period that led to the Bank Act of 1933, because of our system of Federal deposit insurance.

2. *It is also argued that deposit rate ceilings improve domestic stabilization weapons in the hands of the Federal Reserve Board.*

I find this assertion difficult to understand, except in the context of deep and prolonged depression. Under such conditions it might be desirable to discourage saving in order to raise consumption, assuming that net private investment demand is very low. But this would require generally low ceilings on all liquid assets—otherwise, savings would simply be diverted from low-paying assets to higher. In any case, much more powerful tools exist to fight depression, including expenditure policy, and a vigorous policy of monetary ease.

The types of market distortions that result from the imposition of ceiling rates on deposits are well illustrated by the present situation with respect to certificates of deposit. A very large volume of such deposits are presently concentrated in money market centers. As yields on other market instruments have increased in recent months, large banks have moved to offer 6-month CD's at the maximum rate permitted by Federal Reserve regulation, 4 percent. If yields on competitive instruments continue to increase in the next 6 months, CD's will become increasingly unattractive, unless regulation Q is revised upward. If the present ceiling is maintained, we may look forward to a substantial churning in the location of deposits. This disruptive effect will result not from competitive market forces but rather from the price-fixing policy of the Federal Reserve.

FEDERAL HOME LOAN BANK BOARD,
Washington, D.C., March 27, 1964.

Hon. A. WILLIS ROBERTSON,
Chairman, Banking and Currency Committee,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR ROBERTSON: On March 4 the Subcommittee on Financial Institutions requested that the several agencies responsible for deposit-type institutions submit their views on the current status of regulation Q. The attached statement reflects our views on this issue at the present time. If we can be of further assistance, please do not hesitate to let us know.

Sincerely,

JOSEPH P. MCMURRAY, *Chairman.*

COMMENTS ON REGULATION Q

The Federal Home Loan Bank Board strongly opposes the elimination of the statutory authority for regulation Q. It is the Board's view that complete elimination of that authority at this time would lead to serious undesirable consequences. The resulting competition, under present conditions, for savings accounts might lead to an excessive level of interest or dividend rates in relation to that which can be earned on sound assets. It is the Board's view that credit quality is something less than desirable already. Nevertheless, we recognize that there are those who consider some changes may be advisable, and we have several points to offer in this connection.

Our first point involves the nature of the present control. Regulation Q, as presently required by law, provides continuous regulation. It could be argued that in periods when growth and earning opportunities for financial institutions are favorable that the regulation is not entirely necessary. The efforts to accelerate growth and strive for increased savings through interest or divident rate competition become intense only after growth has slowed. It is then that regulation may be advisable since interest and dividend rates may be escalated in successive rounds to preserve a growth position. The escalation in rates presses against the rate available on sound investments and thereby leads to a deterioration of credit quality as riskier investments are pursued. If the feeling that continuous regulation is not essential is valid, then we would favor the type of standby control offered by the administration in S. 1799 and endorsed by the President's Committee on Financial Institutions.

The second point involves competition among financial institutions. Obviously if one group is restricted and others are not, there is a competitive disadvanage. For this reason, too, we endorse the recommendation of the President's Committee on Financial Institutions for standby authority over all deposit-type institutions to be employed "either to prevent institutional practices in the payment of interest and extension of credit that were inconsistent with the safety and liquidity of a significant number of institutions or to supplement other governmental policies to promote the objectives of the Employment Act of 1946." We also endorse the recommendation for different rates for different accounts as provided for in the "Report of the President's Committee on Financial Institutions" on page 23. The essence of these recommendations is included in S. 1799.

Since we obviously favor some change, the question might be raised why we do not favor complete abandonment. Our reasons for this are stated, in part, in our final point. The ordinary market rules have not always worked well in this area. Senator Carter Glass, in recommending the amendment to section 19 of the Federal Reserve Act, stated that this step was being taken to assure sound banking. This was a clear recognition of a degree of market imperfection that cannot be ignored.

Secondly, complete removal of controls over interest rates would have a very disturbing effect on financial institutions by letting loose unrestrained competition for savings at a time when there is a variety of signs of deteriorating credit quality. We think such a step at this time would be ill advised.

Thirdly, allegations that regulation Q has prevented an adequate flow of savings and has contributed to the balance-of-payments problem is a clear misreading of recent history and current fact. Since 1961 the net increase in time and savings accounts has averaged over $25 billion a year or 167 percent of the 1960 level. In 1961 the flow was about $21 billion; in 1962, $28 billion; and last year, $29 billion. Relative to gross national product, the total flow into time savings accounts was 3 percent in 1960, 4 percent in 1961, and 5 percent in 1962 and 1963.

The effect of these flows was to create a downward pressure on mortgage interest rates which continued in 1962 and early 1963 when most other rates were rising. It also contributed to a decline in interest rates on municipal securities during 1962 and the latter part of 1963.

Insofar as the balance of payments is concerned even if regulation Q is too restrictive, why don't investors buy Treasury bills or high-grade private open market rather than send their funds abroad? When money has flowed out of the country because of rate differentials, regulation Q cannot be blamed. Open market rates have not been high enough, in these circumstances, to keep funds here. Consequently, we doubt the wisdom of arguing that elimination of regulation Q would have helped. Unless banks would have been ready to pay an uneconomically high rate in comparison with what they could have earned, the funds would have flowed abroad in any event.

Finally, we believe that the meaning of competition and markets need some clarification with reference to financial institutions.

The argument is frequently made that the control of interest rates on time deposits is a form of price control. The point is made that it interferes with the market and could cause serious misallocations in the flow of funds and in the use of resources. Generally, we would be disposed not to favor a price control mechanism. In most areas of our economic life, market forces, though imperfect to varying degrees, do yield more desirable results than could be achieved by administrative decisions about price.

It should be made clear, however, that competitively set prices in a free market require certain preconditions for success. A pure market, according to the conventional economic doctrine, is one in which there is perfect competition among buyers and sellers. Such a condition requires that each of the economic units be relatively small compared to the total market and thereby unable by its own decision to affect the supply of or the demand for a commodity. The market concept also requires a standard product, concentration on obtaining the largest short-run profit, and long-run conditions consistent with the short-run profit objective.

This type of market is almost conspicuous by its absence, but many markets contain enough similarities to this model to pass the test of satisfactory performance. When this is not the case, the Government usually intercedes. Rates for various utilities and other public services are subject to regulation and the Government intervenes in other markets too.

Financial institutions, by the very act of Government control over chartering, do not constitute a purely competitive structure. While there is a degree of competition among them, the numbers are restricted. In any one locale or even in broad areas, one or a few institutions can affect credit terms and interest or dividends on savings accounts. Action by a few induces others to follow even if the move is not justified.

Not only are financial institutions limited in number by legislative direction and administrative action pursuant thereto, but financial institutions do not deal in a standard product. Money is money, but not every loan is like every other loan, or every investment like all others. The terms, conditions, and interest rates can be varied greatly so that a real estate loan from one lender can vary greatly from that by another lender. Lenders can vary appraisals, downpayment ratios, maturities, type of security, and so on.

Financial institutions are keenly interested in their short-run profit position. It should be noted, however, that short-run and long-run profit considerations can be in conflict in a financial institution. A high yielding loan or investment improves the short-run profit position, but can damage the long-run position severely if the loan proves too risky and there is a default. Consequently, another keystone essential to complete reliance on markets may be absent under some circumstances in the case of financial institutions.

One reason for the intense competition for savings deposits among various types of financial institutions is a desire for growth. This is a long-run aim which may prove invalid if the funds cannot be safely invested at high enough yields to justify the rate on savings deposits that brings about the growth. Institutions seek this growth for reasons of market advantage over their competitors and because the prospect that their earnings will ultimately expand to justify their growth. The aim of growth for the sake of achieving size can be in serious conflict with soundness of institutions.

In our opinion, most of the arguments made against rate control, on the basis of market forces, have serious defects in the case at hand. In an industry where competition is imperfect, the argument that market forces will lead to rational results under all circumstances is misleading. All that happens, as we indicated earlier, is that in certain phases of an expansion the type of competition that exists drives interest and dividend rates up to a point where the only avenue open for earning is the acquisition of undue risk. This is a potential that Congress has seen fit to restrict in many ways in the course of legislating for financial institutions.

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, May 13, 1964.

HON. A. WILLIS ROBERTSON,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your letter of March 24, 1964, requesting the Board's views on the merits of regulation Q and on the general policy of regulating the maximum interest rates payable on savings deposits at commercial banks. It is assumed that your inquiry relates also to the interest rates paid on time deposits.

Under regulation Q of the Board of Governors, and parallel regulations of the Federal Deposit Insurance Corporation, all member and insured nonmember banks are restricted to a schedule of maximum rates that may be paid on time and savings deposits. Currently, the limits are set at 3½ percent for savings deposits of under 1 year, 4 percent for such balances that have been on the books 1 year or more, 1 percent for time deposits written to mature within 90 days, and 4 percent for such deposits carrying maturities of 90 days or more. Some States have lower interest rate limitations on time and/or savings deposits, and in these jurisdictions the lower limits apply to both National and State-chartered banks.

Enabling legislation for regulation Q, first enacted in 1933, is contained in section 19 of the Federal Reserve Act. The act (and the regulation) prohibits any payment of interest on demand deposits, and the act further states that the Board "shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts." The Board has interpreted the language of the statute as requiring that some schedule of maximum rates be specified at all times.

Maximum rates permissible under regulation Q have in fact been raised from time to time in recent years. Effective in January 1957, the limits were raised from 2½ to 3 percent on savings deposits and on time deposits written to mature in 6 months or longer, and from 2 to 2½ percent on time deposits payable in 90 days to 6 months. Effective in January 1962, the present 4-percent maximum was established for time deposits maturing a year or more after the date of deposit, and for savings deposit balances remaining for a year or longer; at the same time, the rate permitted on savings deposits remaining for less than a year was raised to 3½ percent, as well as the rates permitted as time deposits payable in 6 months to a year. In July 1963, the Board increased to 4 percent the rate limit on time deposits written for terms of less than a year but over 90 days, although it then made no change in the 3½-percent maximum applicable to savings deposit balances remaining for less than a year.

Many, but by no means all, commercial banks increased rates paid on some or all time and savings deposit categories to the new regulatory limits shortly after their establishment, and these higher rates doubtless have been a factor in the rapid buildup of time and savings deposit balances in recent years. In the 3 years, 1961 through 1963, such deposits at all commercial banks grew by $40 billion, an expansion of 54 percent. The share of the public's total liquid assets—deposits, share accounts, savings bonds, and U.S. Government securities maturing within 1 year—held in the form of commercial bank time and savings deposits, rose from 18.3 to 22.8 percent during the same period.

This faster rate of gain in commercial bank savings balances has had the effect of further stimulating the competition for funds among financial institutions generally. Other savings institutions have raised rates paid on savings too, and both the mutual savings banks and the savings and loan associations have been able to show record gains in savings balances despite accelerated commercial bank growth. The additional savings flow which made this possible came in part from an enlarged total of financial saving by the public, but also from a redirection of such saving to financial intermediaries in lieu of direct security investments. For example, a group of larger member banks now have more than $11 billion of negotiable time certificates of deposit outstanding in amounts of $100,000 or more; most such balances otherwise would have been invested directly by their holders in the short-term money market.

The expanded flow of funds to commercial banks and other financial institutions also has increased the competition among such lenders for suitable investment outlets carrying relatively high rates of return. This competition has been especially notable in the mortgage field, where the press of funds seeking investment has not only reduced interest rates but also has led to a competitive relaxation in lending terms and credit standards. Commercial banks also have promoted their consumer installment lending and have acquired record amounts of State and local securities, including intermediate and longer term issues. Reflecting the need to maintain investment yields in the face of higher interest expenses on savings, the tendency on the part of banks and others often has seemed to be toward giving up something in lending terms, credit standards, or asset liquidity in order to place a larger volume of lending at relatively favorable rates.

At this time, the abandonment of interest rate ceilings on commercial bank time and savings deposits might have unexpected effects. The competitive situation is unusually fluid and appears still to be in the process of change. In the absence of ceilings, some commercial banks might well elect to pay still higher rates on at least some types of savings, and this might lead other banks and nonbank savings institutions to respond in kind. The result could be a competitive escalation of interest rates in some savings markets, accompanied by substantial and potentially destabilizing shifts of funds. Given larger interest expenses, the pressures on institutions to obtain higher rates of return on investments would be intensified. This could lead to further relaxation in credit and investment standards, and any pervasive tendency toward lower quality assets and lessened liquidity would be an added burden upon the examination process.

The Board fully recognizes the desirability of moving toward freer markets for savings. The very existence of interest rate regulation introduces rigidities into the competitive situation, and in one sense it is patently inequitable to restrict the commercial banks when other savings institutions, such as savings and loan associations, mutual savings banks, and credit unions, are largely free of rate regulation. But the Board also recognizes that unrestrained rate competition could, at times like the present, lead to undesirable consequences in terms of the financial soundness and liquidity needs of our credit and savings structure and to unwanted pressures on prevailing interest rate levels.

For these reasons, a majority of the Board would favor enactment of legislation which would permit the regulatory authorities to move to a standby basis on time and savings deposit interest rate limitations, without specifying the timing of such action. Furthermore, the Board strongly feels that such standby authority over maximum rates should extend also to other major depository-type savings institutions; the regulatory agencies in which this authority is vested should consult with one another in its administration but should not be bound by the others' views. The Board would urge that the prohibition of interest payments on demand deposits be continued, and that authority to establish different rate ceilings on different classes of savings deposits be retained.

Standby controls of the sort envisaged by the Board were proposed by the President's Committee on Financial Institutions in April 1963 and are contained in sections 4, 5, and 6 of S. 1799, introduced on June 26, 1963. Should this or similar legislation be enacted, the Board would anticipate moving toward a standby arrangement as soon as this seemed practicable.

Sincerely yours,

WM. McC. MARTIN, Jr.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

REGULATION Q

(12 CFR 217)

(As amended effective October 1, 1959, January 15, and October 15, 1962, and July 17, 1963)

CONTENTS

Payment of Interest on Deposits [1]

SECTION 217.0—SCOPE OF PART

(*a*) This regulation is issued under authority of provisions of section 19 of the Federal Reserve Act which, together with related provisions of law, are cited in the note [appendix] preceding this section:

(*b*) This part relates to the payment of deposits and interest thereon by member banks of the Federal Reserve System and not to the computation and maintenance of the reserves which member banks are required to maintain against deposits. The rules concerning reserves of member banks are contained in part 204 of this chapter.

(*c*) The provisions of this part do not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia.

SECTION 217.1—DEFINITIONS

(*a*) *Demand deposits.*—The term "any deposit which is payable on demand," hereinafter referred to as a "demand deposit," includes every deposit which is not a "time deposit" or "savings deposit," as defined in this section.

(*b*) *Time deposits.*—The term "time deposits" means "time certificates of deposit" and "time deposits, open account," as defined in this section.

(*c*) *Time certificates of deposit.*—The term "time certificate of deposit" means a deposit evidenced by a negotiable or nonnegotiable instrument which provides on its face that the amount of such deposit is payable to bearer or to any specified person or to his order;

(1) On a certain date, specified in the instrument, not less than 30 days after date of the deposit; or

(2) At the expiration of a certain specified time not less than 30 days after the date of the instrument; or

(3) Upon notice in writing which is actually required to be given not less than 30 days before the date of repayment; [2] and

(4) In all cases only upon presentation and surrender of the instrument.

(*d*) *Time deposits, open account.*—The term "time deposit, open account" means a deposit, other than a "time certificate of deposit" or a "savings deposit," with respect to which there is in force a written contract with the depositor that neither the whole nor any part of such deposit may be withdrawn, by check or otherwise, prior to the date of maturity, which shall be not less than 30 days after the date of the deposit,[3] or prior to the expiration of the period of notice which must be given by the depositor in writing not less than 30 days in advance of withdrawal.[4]

(*e*) *Savings deposits.*—(1) The term "savings deposit" means a deposit—

(i) Which consists of funds deposited to the credit of one or more individuals, or of a corporation, association, or other organization operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes and not operated for profit; [5] or in which the entire beneficial interest is held by one or more individuals or by such a corporation, association, or other organization; and

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[1] The text corresponds to the Code of Federal Regulations, title 12, ch. II, pt. 217; cited as 12 CFR 217.

[2] A deposit with respect to which the bank merely reserves the right to require notice of not less than 30 days before any withdrawal is made is not a "time certificate of deposit" within the meaning of the above definition.

[3] Deposits, such as Christmas club accounts and vacation club accounts, which are made under written contracts providing that no withdrawal shall be made until a certain number of periodic deposits have been made during a period of not less than 3 months constitute "time deposits, open account" even though some of the deposits are made within 30 days from the end of such period.

[4] A deposit with respect to which the bank merely reserves the right to require notice of not less than 30 days before any withdrawal is made is not a "time deposit, open account," within the meaning of the above definition.

[5] Deposits in joint accounts of two or more individuals may be classified as savings deposits if they meet the other requirements of the above definition but deposits of a partnership operated for profit may not be so classified. Deposits to the credit of an individual of funds in which any beneficial interest is held by a corporation, partnership, association, or other organization operated for profit or not operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes may not be classified as savings deposits.

(ii) With respect to which the depositor is required, or may at any time be required, by the bank to give notice in writing of an intended withdrawal not less than 30 days before such withdrawal is made.

(2) Subject to the provisions of subparagraph (3) of this paragraph, a member bank may permit withdrawals to be made from a savings deposit only through payment[6] to the depositor himself (but not to any other person whether or not acting for the depositor), except—

(i) Where the deposit is represented by a passbook, to any person presenting the passbook;[6]

(ii) To an executor, administrator, trustee, or other fiduciary holding the savings deposit as part of a fiduciary estate, or to a person, other than the bank of deposit, holding a general power of attorney granted by the depositor;

(iii) To any person, including the depository bank, that has extended credit to the depositor on the security of the savings deposit, where such payment is made in order to enable the creditor to realize upon such security;

(iv) Pursuant to the order of a court of competent jurisdiction;

(v) Upon the death of the depositor, to any person authorized by law to receive the deposit; or

(vi) With respect to interest paid to a third person pursuant to written instruction or assignment by the depositor accepted by the bank, and placed on file therein.

(3) Notwithstanding the provisions of subparagraph (2) of this paragraph, no withdrawal shall be permitted by a member bank to be made from a savings deposit after January 15, 1962, through payment to the bank itself or through transfer of credit to a demand or other deposit account of the same depositor (other than of interest on the savings deposit) if such payment or transfer is made pursuant to any advertised plan or any agreement, written or oral—

(i) Which authorizes such payments or transfers of credit to be made as a normal practice in order to cover checks or drafts drawn by the depositor upon the bank; or

(ii) Which provides that such payments or transfers of credit shall be made at daily, monthly, or other such periodic intervals, except where made to enable the bank, on the depositor's behalf and pursuant to his written instructions, to effect the payment of installments of principal, interest, or other charges (including taxes or insurance premiums) due on a real estate loan or mortgage.

(4) Where a savings deposit is evidenced by a passbook, every withdrawal made upon presentation of the passbook shall be entered in the passbook at the time of withdrawal, and every other withdrawal from such a deposit shall be entered in the passbook as soon as practicable after the withdrawal is made.

SECTION 217.2—DEMAND DEPOSITS

(*a*) *Interest prohibited.*—Except as provided in paragraph (b) of this section, no member bank of the Federal Reserve System shall, directly or indirectly, by any device whatsoever, pay any interest on any demand deposit.

Within this part, any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit shall be considered interest.

(*b*) *Exceptions.*—The prohibition stated in paragraph (*a*) of this section does not apply to—

(1) Payment of interest accruing before August 24, 1937, on any deposit made by a savings bank as defined in section 12B of the Federal Reserve Act, as amended (49 Stat. 706; 12 U.S.C. 264(c)(7)), or by a mutual savings bank;

(2) Payment of interest accruing before August 24, 1937, on any deposit of public funds[8] made by or on behalf of any State, county, school district, or other subdivision, or municipality, or on any deposit of trust funds, if the payment of interest with respect to such deposit of public funds or of trust funds is required by State law when such deposits are made in State banks.

[6] Payment from a savings deposit on presentation of a passbook may be made over the counter, through the mails, or otherwise.

[8] Deposits of moneys paid into State courts by private parties pending the outcome of litigation are not deposits of "public funds," within the meaning of the above provision.

(3) Payment of interest in accordance with the terms of any certificate of deposit or other contract which was lawfully entered into in good faith before June 16, 1933 (or, if the bank became a member of the Federal Reserve System thereafter, before the date upon which it became a member), which was in force on such date, and which may not legally be terminated or modified by such bank at its option or without liability; but no such certificate of deposit or other contract may be renewed or extended unless it be modified to eliminate any provision for the payment of interest on demand deposits, and every member bank shall take such action as may be necessary, as soon as possible consistently with its contractual obligations, to eliminate from any such certificate of deposit or other contract any provision for the payment of interest on demand deposits.

SECTION 217.3—MAXIMUM RATE OF INTEREST ON TIME AND SAVINGS DEPOSITS

(a) *Maximum rate prescribed from time to time.*—Except in accordance with the provisions of this part, no member bank shall pay interest on any time deposit or savings deposit in any manner, directly or indirectly, or by any method, practice, or device whatsoever. No member bank shall pay interest on any time deposit or savings deposit at a rate in excess of such applicable maximum rate as the Board of Governors of the Federal Reserve System shall prescribe from time to time; and any rate or rates which may be so prescribed by the Board will be set forth in supplements to this part, which will be issued in advance of the date upon which such rate or rates become effective. During the period commencing October 15, 1962, and ending upon the expiration of 3 years after such date, the provisions of this paragraph shall not apply to the rate of interest which may be paid by member banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such, or international financial institutions of which the United States is a member.

(b) *Modification of contracts to conform to regulation.*—No certificate of deposit or other contract shall be renewed or extended unless it be modified to conform to the provisions of this part, and every member bank shall take such action as may be necessary, as soon as possible consistently with its contractual obligations, to bring all of its outstanding certificates of deposits or other contracts into conformity with the provisions of this part.

(c) *Member banks limited to maximum rate for State banks.*—The rate of interest paid by a member bank upon a time deposit or savings deposit shall not in any case exceed (1) the applicable maximum rate prescribed pursuant to the provisions of paragraph (a) of this section or (2) the applicable maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such member bank is located, whichever may be less.

(d) *Grace periods in computing interest on savings deposits.*—A member bank may pay interest on a savings deposit received during the first 10 calendar days of any calendar month at the applicable maximum rate prescribed pursuant to paragraph (*a*) of this section calculated from the first day of such calendar month until such deposit is withdrawn or ceases to constitute a savings deposit under the provisions of this part, whichever shall first occur; and a member bank may pay interest on a savings deposit withdrawn during its last 3 business day of any calendar month ending a regular quarterly or semiannual interest period at the applicable maximum rate prescribed pursuant to paragraph (*a*) of this section calculated to the end of such calendar month.

(e) *Continuance of time deposit status.*—A deposit which was a time deposit at the date of deposit continues to be such until maturity although it has become payable within 30 days, and interest at a rate not exceeding that prescribed pursuant to the provisions of paragraph (*a*) of this section may be paid until maturity upon such deposit. A time deposit or a savings deposit with respect to which notice of withdrawal has been given continues to be such until the expiration of the period of such notice, and interest may be paid upon such deposit until the expiration of the period of such notice at a rate not exceeding that prescribed pursuant to the provisions of paragraph (*a*) of this section. Interest at a rate not exceeding that prescribed pursuant to the provisions of paragraph (*a*) of this section may be paid upon savings deposits with respect to which notice of intended withdrawal has not actually been required or given. No interest shall be paid by a member bank on any amount which, by the terms of any certificate or other contract or agreement or otherwise, the bank may be required to pay within 30 days from the date on which such amount is deposited in such bank.[9]

(*f*) *No interest after maturity or expiration of notice.*—After the date of maturity of any time deposit, such deposit is a demand deposit, and no interest may be paid on such deposit for any period subsequent to such date. After the expiration of the period of notice given with respect to the repayment of any time deposit or savings deposit, such deposit is a demand deposit and no interest may be paid on such deposit for any period subsequent to the expiration of such notice, except that, if the owner of such deposit advises the bank in writing that the deposit will not be withdrawn pursuant to such notice or that the deposit will thereafter again be subject to the contract or requirements applicable to such deposit, the deposit will again constitute a time deposit or savings deposit, as the case may be, after the date upon which such advice is received by the bank.

SECTION 217.4—PAYMENT OF TIME DEPOSITS BEFORE MATURITY

(*a*) *Time deposits payable on a specified date.*—No member bank shall pay any time deposit, which is payable on a specified date, before such specified date, except as provided in paragraph (*d*) of this section.

(*b*) *Time deposits payable after a specified period.*—No member bank shall pay any time deposit, which is payable at the expiration of a certain specified period, before such specified period has expired, except as provided in paragraph (d) of this section.

(*c*) *Time deposits payable after a specified notice.*—No member bank shall pay any time deposit, with respect to which notice is required to be given a certain specified period before any withdrawal is made, until such required notice has been given and the specified period thereafter has expired, except as provided in paragraph (*d*) of this section.

(*d*) *Payment in emergencies.*—In an emergency where it is necessary to prevent great hardship to the depositor, a member bank may pay before maturity a time deposit or the portion thereof necessary to meet such emergency: *Provided,* That before making such payment the depositor shall sign an application describing fully the circumstances constituting the emergency which is deemed to justify the payment of the deposit before maturity, which application shall be approved by an officer of the bank who shall certify that, to the best of his knowledge and belief, the statements in the application are true. Such application shall be retained in the bank's files and made available to the examiners authorized to examine the bank. Where a time deposit is paid before maturity the depositor shall forfeit accrued and unpaid interest for a period of not less than 3 months on the amount withdrawn if an amount equal to the amount withdrawn has been on deposit 3 months or longer, and shall forfeit all accrued and unpaid interest on the amount withdrawn if an amount equal to the amount withdrawn has been on deposit less than 3 months. When a portion of a time certificate of deposit is paid before maturity, the certificate shall be canceled and a new certificate shall be issued for the unpaid portion of the deposit with the same terms, rate, date, and maturity as the original deposit.

(*e*) *Loans upon security of time deposits.*—A member bank may make a loan to the depositor upon the security of his time deposit provided that the rate of interest on such loan shall be not less than 2 percent per annum in excess of the rate of interest on the time deposit.

SECTION 217.5—NOTICE OF WITHDRAWAL OF SAVINGS DEPOSITS

(*a*) *Requirements regarding notice.*—A member bank shall observe the requirements set forth below in requiring notice of intended withdrawal of any savings deposit, or in waiving such notice, or in repaying any savings deposit, or part thereof, without requiring such notice, whether such notice of intended withdrawal is required to be given in each case by the terms of the bank's

[9] Deposits, such as Christmas club accounts and vacation club accounts, which are made under written contracts providing that no withdrawal shall be made until a certain number of periodic deposits have been made during a period of not less than 3 months constitute "time deposits, open account" even though some of the deposits are made within 30 days from the end of such period.

contract with the depositor or may, under such contract, be required by the bank at any time at its option.

(1) If a member bank waive such notice of intended withdrawal as to any amount or percentage of the savings deposits of any depositor, it shall waive such notice as to the same amount or percentage of the savings deposits of every other depositor which are subject to the same requirement.

(2) If a member bank pay any amount or percentage of the savings deposits of any depositor, without requiring such notice, it shall, upon request and without requiring such notice, pay the same amount or percentage of the savings deposits of every other depositor which are subject to the same requirement.

(3) If a member bank require such notice before the payment of any amount or percentage of the savings deposits of any depositor, it shall require such notice before the payment of the same amount or percentage of the savings deposits of any other depositor which are subject to the same requirement.

A member bank is not prevented from paying during the next succeeding interest period, without requiring notice of withdrawal, interest on a savings deposit which has accrued during the preceding interest period: *Provided,* That it shall, upon request and without requiring such notice, pay in the same manner interest which has accrued during the preceding interest period on the savings deposits of every other depositor.

(*b*) *Requirements regarding change of practice.*—No member bank shall change its practice with respect to the requiring or waiving of notice of intended withdrawal of savings deposits except after duly recorded action of its board of directors or of its executive committee properly authorized, and no practice in this respect shall be adopted which does not conform to the requirements of paragraph (*a*) (1), (2), or (3) of this section.

(*c*) *Change of practice for purpose of discrimination.*—No change in the practice of a member bank with respect to the requiring or waiving of notice of intended withdrawal of savings deposits shall be made for the purpose of discriminating in favor of or against any particular depositor or depositors.

(*d*) *Requirements applicable although no interest paid.*—A member bank shall observe the requirements of this section with respect to savings deposits even though no interest be paid on such deposits.

(*e*) *Loans upon security of savings deposits.*—If it is not the practice of a member bank to require notice of intended withdrawal of savings deposits, no restrictions are imposed by this part upon loans by such bank to its depositors upon the security of such deposits. If it is the practice of a member bank to require notice of intended withdrawal of savings deposits or any amount or percentage thereof, such bank may make loans to its depositors upon the security of such deposits and, in each such case, the rate of interest on such loan shall be not less than 2 percent per annum in excess of the rate of interest on the savings deposit.

SUPPLEMENT TO REGULATION Q

SECTION 217.6

MAXIMUM RATES OF INTEREST PAYABLE ON TIME AND SAVINGS DEPOSITS BY MEMBER BANKS

Issued by the Board of Governors of the Federal Reserve System, Effective July 17, 1963

Pursuant to the provisions of section 19 of the Federal Reserve Act and section 217.3, the Board of Governors of the Federal Reserve System hereby prescribes the following maximum rates[1] of interest payable by member banks of the Federal Reserve System on time and savings deposits:

[1] The maximum rates of interest payable by member banks of the Federal Reserve System on time and savings deposits as prescribed herein are not applicable to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia.

(*a*) *Maximum rate of 4 percent.*—No member bank shall pay interest accruing at a rate in excess of 4 percent per annum, compounded quarterly,[2] regardless of the basis upon which such interest may be computed:

(1) On that portion of any savings deposit that has remained on deposit for not less than 12 months;

(2) On any time deposit having a maturity date 90 days or more after the date of deposit or payable upon written notice of 90 days or more;

(3) On that portion of any postal savings deposit which constitutes a time deposit that has remained on deposit for not less than 12 months.

(*b*) *Maximum rate of 3½ percent.*—No member bank shall pay interest accruing at a rate in excess of 3½ percent per annum, compounded quarterly,[2] regardless of the basis upon which such interest may be computed:

(1) On any savings deposit, except as otherwise provided in paragraph (a) (1), of this section;

(2) On any postal savings deposit which constitutes a time deposit, except as otherwise provided in paragraph (*a*) (3), of this section.

(*c*) *Maximum rate of 1 percent.*—No member bank shall pay interest accruing at a rate in excess of 1 percent per annum, compounded quarterly,[2] regardless of the basis upon which such interest may be computed:

(1) On any time deposit (except postal savings deposits which constitute time deposits) having a maturity date less than 90 days after the date of deposit or payable upon written notice of less than 90 days.

Appendix

STATUTORY PROVISIONS

Section 19 of the Federal Reserve Act (12 U.S.C., sec. 461), provides in part as follows:

SEC. 19. The Board of Governors of the Federal Reserve System is authorized, for the purposes of this section, to define the terms "demand deposits", "gross demand deposits", "deposits payable on demand", "time deposits", "savings deposits", and "trust funds", to determine what shall be deemed to be a payment of interest, and to prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section and prevent evasions thereof: * * *

* * * * *

(12 U.S.C., sec. 371a)

No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand: *Provided*, That nothing herein contained shall be construed as prohibiting the payment of interest in accordance with the terms of any certificate of deposit or other contract entered into in good faith which is in force on the date on which the bank becomes subject to the provisions of this paragraph; but no such certificate of deposit or other contract shall be renewed or extended unless it shall be modified to conform to this paragraph, and every member bank shall take such action as may be necessary to conform to this paragraph as soon as possible consistently with its contractual obligations: *Provided further*, That this paragraph shall not apply to any deposit of such bank which is payable only at an office thereof located outside of the States of the United States and the District of Columbia: *Provided further*, That until the expiration of two years after the date of enactment of the Banking Act of 1935 this paragraph shall not apply (1) to any deposit made by a savings bank as defined in section 12B of this Act, as amended, or by a mutual savings bank, or (2) to any deposit of public funds made by or on behalf of any State, county, school district, or other subdivision or municipality, or to any deposit of trust funds if the payment of interest with respect to such deposit of public funds or of trust funds is required by State law. So much of existing law as requires the payment of interest with respect to any funds deposited by the United States, by any Territory, District, or possession thereof (including the Philippine Islands), or by any public instrumentality, agency, or officer of the foregoing, as is inconsistent with the provisions of this section as amended, is hereby repealed.

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[2] This limitation is not to be interpreted as preventing the compounding of interest at other than quarterly intervals, provided that the aggregate amount of such interest so compounded does not exceed the aggregate of interest at the rate above prescribed when compounded quarterly.

(12 U.S.C., sec. 371b)

The Board of Governors of the Federal Reserve System shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. No member bank shall pay any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the said Board, or waive any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement: *Provided*, That the provisions of this paragraph shall not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia.

Section 24 of the Federal Reserve Act (12 U.S.C., sec. 371), provides with respect to national banking associations in part as follows:

Any such association may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such association may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such association is located.

FEDERAL DEPOSIT INSURANCE CORPORATION,
OFFICE OF THE CHAIRMAN,
Washington, July 24, 1964.

Hon. A. WILLIS ROBERTSON,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR SENATOR ROBERTSON: I am responding further to your request of March 24, 1964, for my views on the merits of regulation Q and on general policy for regulating rates of interest paid on savings deposits.

The Banking Acts of 1933 and 1935 established statutory controls over the rates paid on time and savings deposits by member banks of the Federal Reserve System and by other banks participating in deposit insurance. These controls were part of the basic banking reform legislation aimed at remedying conditions that had brought on the financial debacle of the early 1930's.

From the early economic beginnings of the country, New York emerged as the dominant financial center and a focal point for the concentration of large liquid resources to which security market investors and speculators, through the call loan mechanism, gained easy access. Interior banks soon discovered that funds could serve as secondary reserves against deposits and notes equally well in New York as at home and simultaneously constitute an important source of income. High rates of interest paid by New York correspondents on deposits during stock market booms were said to have attracted funds away from local business and industry. But irrespective of whether that was true, businessmen certainly had to compete with speculators for the available supply of loanable funds. The system led to abnormal swings in the volume of bank credit, waves of excessive speculation, and periodic disruption of the whole financial structure. So in the reconstruction of the financial system in 1933 and 1935, restrictions on interest rates paid for time and savings deposits, as well as the prohibition of interest on demand deposits, were cornerstones of banking reform legislation.

Other important considerations also lead to the restrictions on interest rates paid to bank depositors. In the midst of the great depression of the 1930's, every effort was made to assist banks in any way possible to regain profitable operating status. The amount of interest paid to depositors was a substantial expense item, and the limitations imposed on rates tended to alleviate this burden to some extent.

Yet another major consideration in controlling interest rates was the desire to restrain banks from engaging in excessive competitive and undesirable practices which had been so dramatically exposed to public censure. In order to attract deposits, rates were often bid up to unrealistic levels. Funds so acquired were costly and to meet the related interest expense banks often found it necessary to resort to risky loans or investments. The intense competition for deposits was blamed for much of the speculative management of bank funds.

Many of these depression era considerations leading to the initial imposition of interest restrictions on time and saving deposits have disappeared. Fluctuations in the call loan market no longer predominate as a causal factor in the movement of funds to and from New York. For the most part, banks now adjust their reserves in the Government securities market rather than through the call loan mechanism. Nor are banks any longer burdened with interest costs of huge demand deposit balances. For these and other reasons, opinion is widespread that restrictions on time and savings deposits are no longer needed and should be lifted.

Since the controls were initiated, the growth of savings and loan associations has mushroomed. Complaints now are voiced that it is inequitable to impose ceilings upon savings accounts in commercial banks and not on thrift accounts in other institutions. Also, it is said that the controls aggravate our international balance-of-payments difficulties by preventing domestic banks from competing for foreign deposits.

Ordinarily, banks intent upon attracting the funds of savers are discouraged from raising interest rates on time and savings deposits so high as to result in shifts from demand deposits. Such shifts have two effects operating in opposite directions. In one direction, the lending capacity of the banks is increased in consequence of lower reserve requirements on time deposits. In the other, there are deposit costs in the form of interest payments not previously incurred. On balance, the prohibition of interest on demand deposits tends to discourage increases in the rate of interest on time deposits.

At present, however, there is intense competition for savings among all financial institutions. In the 5-year period 1958 through 1963, time and savings deposits in insured commercial banks increased from $66 to $112 billion, an expansion of 70 percent. There is some evidence that the efforts of commercial banks to keep these growing resources fully invested have resulted in a relaxation of credit terms and a deterioration in credit quality, particularly in the area of real estate loans. The situation is by no means critical, but there is always the possibility that competitive conditions of this nature can become more serious, with accompanying undesirable consequences for the banking system.

In general, I favor a minimum of interference with the free interplay of competitive forces in the economy, and interest rate restrictions on time and savings deposits are certainly one such interference. Furthermore, I think that under normal circumstances regulation Q. continuously invoked, has less validity now perhaps than in the past. Nevertheless, it is the overriding responsibility of all of us to do everything we can to maintain order in our monetary and banking processes. Nothing can be gained by permanently discarding any instrument that has proved useful and that is likely to become useful again, simply because its utility might seem inappropriate at some particular point in time. Conditions will certainly again arise where regulation Q seems more appropriate in influencing the flow of funds, for example, than an alternative. In addition it may assist in our balance-of-payments problems.

Accordingly, I recommend legislation which would continue the prohibition of interest on demand deposits and would authorize the Board of Governors of the Federal Reserve System and this Corporation, in their discretion, to place their regulations of interest on time and savings deposits on a standby basis. This would permit either agency to move to a standby basis when such action appeared appropriate. The legislation should provide similar authority for the Federal Home Loan Bank Board over shares of insured savings and loan association. I also think that in exercising this power, such authorities should be permitted discretion in establishing different rates for different accounts according to type, holder, maturity, or other characteristics. These changes should remove existing inequities and give the authorities added flexibility in dealing in a timely way with untractable monetary problems as they arise.

Sincerely yours,

JOSEPH W. BARR, *Chairman*.

(Part 329 of the rules and regulations of the FDIC follow:)

PART 329—PAYMENT OF DEPOSITS AND INTEREST THEREON BY INSURED NONMEMBER BANKS (12 CFR, PT. 329)

RULES AND REGULATIONS (REVISED JULY 17, 1963)

FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, D.C.

AUTHORITY: §§ 329.0 to 329.6 issued under sec. 9, 64 Stat. 881; 12 U.S.C. 1819. Interpret or apply sec. 18, 64 Stat. 891; 12 U.S.C. 1828.

SOURCE: §§ 329.0 to 329.6 appear at 15 F.R. 8640, Dec. 6, 1950, except as otherwise noted.

§ 329.0 *Scope.* The regulation contained in this part relates to the payment of deposits and interest thereon by insured nonmember banks. This part is not applicable to banks which are members of the Federal Reserve System. Regulation Q (Part 217 of this title), prescribed by the Board of Governors of the Federal Reserve System for banks which are members of that System, is not applicable to insured banks which are not members of the Federal Reserve System, except to the extent that the State law of a particular State provides otherwise. The provisions of this part do not apply to mutual savings banks, or to guaranty savings banks operating in the State of New Hampshire so long as said guaranty savings banks operate substantially under and pursuant to the laws of the State of New Hampshire pertaining to mutual savings banks and do not engage in commercial banking, or to any deposit in a bank located outside of, or payable only at a bank's office which is located outside of, the States of the United States and the District of Columbia.

[Last sentence amended, 20 F.R. 8949, Dec. 6, 1955]

§ 329.1 *Definitions*—(a) *Demand deposits.* The term "demand deposits" includes every deposit which is not a "time deposit" or "savings deposit", as defined below.

(b) *Time deposits.* The term "time deposits" means "time certificates of deposit" and "time deposits, open account," as defined below.

(c) *Time certificates of deposit.* The term "time certificate of deposit" means a deposit evidenced by a negotiable or nonnegotiable instrument which provides on its face that the amount of such deposit is payable:

(1) On a certain date, specified in the instrument, not less than thirty (30) days after the date of the deposit; or

(2) At the expiration of a specified period not less than thirty (30) days after the date of the instrument; or

(3) Upon written notice to be given not less than thirty (30) days before the date of repayment.[1]

(d) *Time deposits, open account.* The term "time deposit, open account" means a deposit, other than a "time certificate of deposit" or a "savings deposit," with respect to which there is in force a written contract with the depositor that neither the whole nor any part of such deposit may be withdrawn, by check or otherwise, prior to the date of maturity, which shall be not less than thirty (30) days after the date of the deposit,[2] or prior to the expiration of the period of notice

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[1] If the certificate of deposit provides merely that the bank reserves the right to require notice of not less than thirty (30) days before any withdrawal is made, the bank must require such notice before permitting withdrawal.

[2] Deposits, such as Christmas club accounts and vacation club accounts, which are made under written contracts providing that no withdrawal shall be made until a certain number of periodic deposits have been made during a period of not less than three (3) months, constitute "time deposits, open account", even though some of the deposits are made within thirty (30) days from the end of such period.

which must be given by the depositor in writing not less than thirty (30) days in advance of withdrawals.[3]

(e) *Savings deposits.* (1) The term "savings deposit" means a deposit:

(i) which consists of funds deposited to the credit of one or more individuals, or of a corporation, association, or other organization operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes and not operated for profit; [4] or in which the entire beneficial interest is held by one or more individuals or by such a corporation, association, or other organization; and

(ii) with respect to which the depositor is required, or may at any time be required, by the bank to give notice in writing of an intended withdrawal not less than 30 days before such withdrawal is made.

(2) Subject to the provisions of subparagraph (3) of this paragraph, an insured nonmember bank may permit withdrawals to be made from a savings deposit only through payment [5] to the depositor himself (but not to any other person whether or not acting for the depositor), except

(i) where the deposit is represented by a pass book, to any person presenting the pass book;[5]

(ii) to an executor, administrator, trustee, or other fiduciary holding the savings deposit as part of a fiduciary estate, or to a person, other than the bank of deposit, holding a general power of attorney granted by the depositor;

(iii) to any person, including the depository bank, that has extended credit to the depositor on the security of the savings deposit, where such payment is made in order to enable the creditor to realize upon such security;

(iv) pursuant to the order of a court of competent jurisdiction;

(v) upon the death of the depositor, to any person authorized by law to receive the deposit; or

(vi) with respect to interest paid to a third person pursuant to written instruction or assignment by the depositor, accepted by the bank, and placed on file therein.

(3) Notwithstanding the provisions of subparagraph (2) of this paragraph, no withdrawal shall be permitted by an insured nonmember bank to be made from a savings deposit after January 15, 1962 through payment to the bank itself or through transfer of credit to a demand or other deposit account of the same depositor (other than of interest on the savings deposit) if such payment or transfer is made pursuant to any advertised plan or any agreement, written or oral;

(i) which authorizes such payments or transfers of credit to be made as a normal practice in order to cover checks or drafts drawn by the depositor upon the bank; or

(ii) which provides that such payments or transfers of credit shall be made at daily, monthly, or other such periodic intervals, except where made to enable the bank, on the depositor's behalf and pursuant to his written instruction, to effect the payment of installments of principal, interest, or other charges (including taxes or insurance premiums) due on a real estate loan or mortgage.

(4) Where a savings deposit is evidenced by a pass book, every withdrawal made upon presentation of the pass book shall be entered in the pass book at the time of withdrawal, and every other withdrawal from such a deposit shall be entered in the pass book as soon as practicable after the withdrawal is made. [Paragraph (e) amended, 26 F.R. 12032, Dec. 15, 1961, effective Jan. 15, 1962]

PRIOR AMENDMENTS

1955: 20 F.R. 3328, May 14; 20 F.R. 8949, Dec. 6.

§ 329.2 *Demand deposits*—(a) *Interest prohibited.* Except as provided in this part, no insured nonmember bank shall directly or indirectly, by any device

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[3] If a deposit be made with respect to which the bank merely reserves the right to require notice of not less than thirty (30) days before withdrawal is made, the bank must require such notice to be given before permitting withdrawal.

[4] Deposits in joint accounts of two or more individuals may be classified as savings deposits if they meet the other requirements of the above definition, but deposits of a partnership operated for profit may not be so classified. Deposits to the credit of an individual of funds in which any beneficial interest is held by a corporation, partnership, association, or other organization operated for profit or not operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes may not be classified as savings deposits.

[5] Payment from a savings deposit or presentation of a pass book may be made over the counter, through the mails, or otherwise.

whatsoever, pay any interest on any demand deposit. Within this part any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit shall be considered interest.[6]

(b) *Exceptions.* The prohibition stated in paragraph (a) of this section does not apply to:

(1) Payment of interest accruing before August 24, 1937, on any deposit made by a "savings bank"[7] as defined in the Federal Deposit Insurance Act, or by a mutual savings bank;

(2) Payment of interest accruing before August 24, 1937, on any deposit of public funds[8] made by or on behalf of any State, county, school district, or other subdivision or municipality, or on any deposit of trust funds, if the payment of interest with respect to such deposit of public funds or of trust funds is required by State law when such deposits are made in State banks;

(3) Payment of interest in accordance with the terms of any certificate of deposit or other contract which was lawfully entered into in good faith before February 1, 1936 (or, if the bank became an insured nonmember bank thereafter, before the date upon which it became an insured nonmember bank), which was in force on such date, and which may not legally be terminated or modified by such bank at its option and without liability; but no such certificate of deposit or other contract may be renewed or extended unless it be modified to eliminate any provision for the payment of interest on demand deposits, and every insured nonmember bank shall take such action as may be necessary, as soon as possible consistently with its contractual obligations, to eliminate from any such certificate of deposit or other contract any provision for the payment of interest on demand deposits.

(c) *Deposits in saving banks.* Deposits in "savings banks"[9] in specifically designated deposit accounts with respect to which withdrawal by checking is permitted in accordance with section 3(g) of the Federal Deposit Insurance Act, shall for the purposes of this part be classed as demand deposits.

§ 329.3 *Maximum rate of interest on time and savings deposits*—(a) *Maximum rate prescribed from time to time.* Except in accordance with the provisions of this part, no insured nonmember bank shall pay interest on any time deposit or savings deposit in any manner, directly or indirectly, or by any method, practice, or device whatsoever. No insured nonmember bank shall pay interest on any time deposit or savings deposit at a rate in excess of such applicable maximum rate as the Board of Directors of the Federal Deposit Insurance Corporation shall prescribe from time to time; and any rate or rates which may be so prescribed by the Board will be set forth in supplements to this part (see § 329.6), which will be issued in advance of the date upon which such rate or rates become effective. During the period commencing October 15, 1962, and ending upon the expiration of three years after such date, the provisions of this subsection shall not apply to the rate of interest which may be paid by insured nonmember banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such or international financial institutions of which the United States is a member.

(b) *Modification of contracts to conform to regulation.* No certificate of deposit or other contract shall be renewed or extended unless it be modified to conform to the provisions of this part, and every insured nonmember bank shall take such action as may be necessary, as soon as possible consistently with its contractual obligations, to bring all of its outstanding certificates of deposit or other contracts into conformity with the provisions of this part.

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[6] The absorption of normal or customary exchange charges by an insured nonmember bank, in connection with the routine collection for its depositors of checks drawn on other banks, does not constitute the payment of interest within the provisions of this part.

[7] Section 3(g) of the Federal Deposit Insurance Act provides: "The term 'savings bank' means a bank (other than a mutual savings bank) which transacts its ordinary banking business strictly as a savings bank under State laws imposing special requirements on such banks governing the manner of investing their funds and of conducting their business: *Provided*, That the bank maintains, until maturity date or until withdrawn, all deposits made with it (other than funds held by it in a fiduciary capacity) as time savings deposits of the specific term type or of the type where the right is reserved to the bank to require written notice before permitting withdrawal: *Provided further,* That such bank to be considered a savings bank must elect to become subject to regulations of the Corporation with respect to the redeposit of maturing deposits and prohibiting withdrawal of deposits by checking except in cases where such withdrawal was permitted by law on August 23, 1935, from specifically designated deposit accounts totaling not more than 15 per centum of the bank's total deposits."

[8] Deposits of moneys paid into State courts by private parties pending the outcome of litigation are not deposits of "public funds", within the meaning of the above provision.

[9] See footnote 7.

(c) *Grace periods in computing interest on savings deposits.* An insured nonmember bank may pay interest on a savings deposit received during the first ten (10) calendar days of any calendar month at the applicable maximum rate prescribed pursuant to paragraph (a) of this section calculated from the first day of such calendar month until such deposit is withdrawn or ceases to constitute a savings deposit under the provisions of this part, whichever shall first occur; and an insured nonmember bank may pay interest on a savings deposit withdrawn during its last three (3) business days of any calendar month ending a regular quarterly or semiannual interest period at the applicable maximum rate prescribed pursuant to paragraph (a) of this section calculated to the end of such calendar month.

[Paragraph (c) amended, 17 F.R. 5187, June 7, 1952; 17 F.R. 5315, June 11, 1952; 24 F.R. 7062, October 1, 1959]

(d) *Continuance of time deposit status.* A deposit which was a time deposit at the date of deposit continues to be such until maturity, although it has become payable within thirty (30) days, and interest at a rate not exceeding that prescribed pursuant to the provisions of paragraph (a) of this section may be paid until maturity upon such deposit. A time deposit or a savings deposit, with respect to which notice of withdrawal has been given, continues to be such until the expiration of the period of such notice, and interest may be paid upon such deposit until the expiration of the period of such notice at a rate not exceeding that prescribed pursuant to the provisions of paragraph (a) of this section. Interest at a rate not exceeding that prescribed pursuant to the provisions of paragraph (a) of this section may be paid upon savings deposits with respect to which notice of intended withdrawal has not actually been required or given. No interest shall be paid by an insured nonmember bank on any amount which by the terms of any certificate or other contract or agreement, or otherwise, the bank may be required to pay within thirty (30) days from the date on which such amount is deposited in such bank,[10] except as to savings deposits with respect to which the bank consistently continues to adhere to a practice existing prior to January 23, 1936, of requiring notice of at least fifteen (15) days before permitting withdrawal.

(e) *No interest after maturity or expiration of notice; exception.* No interest shall be paid on any time or savings deposit for any period subsequent to maturity, whether such deposit matures by its terms on a specific date or at the expiration of a notice period pursuant to written notice actually given, except if a time certificate is renewed within ten (10) days after maturity, the renewal certificate[11] may draw interest from the maturity date of the matured certificate.

§ 329.4 *Payment of time deposits before maturity*—(a) *Time deposits payable on a specified date.* No insured nonmember bank shall pay any time deposit, which is payable on a specified date, before such specified date, except as provided in paragraph (d) of this section.

(b) *Time deposits payable after a specified period.* No insured nonmember bank shall pay any time deposit, which is payable at the expiration of a specified period, before such period has expired, except as provided in paragraph (d) of this section.

(c) *Time deposits payable after a specified notice.* No insured nonmember bank shall pay any time deposit, with respect to which notice is required to be given a specified period before any withdrawal is made, until such required notice has been given and the specified period thereafter has expired, except as provided in paragraph (d) of this section.

(d) *Loans upon security of time deposits.* An inured nonmember bank may make a loan to the depositor upon the security of his time deposit, provided that the rate of interest on such loan shall be not less than 2 percent per annum in excess of the rate of interest on the time deposit.

Where a loan to the depositor upon the security of his time deposit upon terms satisfactory to the insured nonmember bank and the depositor cannot be arranged, and where the depositor signs a written statement to be kept in the files of the bank that he is in need of money represented by the time deposit before the maturity thereof, stating the definite amount needed, the time deposit may be

[10] Deposits, such as Christmas club accounts and vacation club accounts, which are made under written contracts providing that no withdrawal shall be made until a certain number of periodic deposits have been made during a period of not less than three (3) months, constitute "time deposits, open account" even though some of the deposits are made within thirty (30) days from the end of such period.

[11] Where a time certificate is renewed within ten (10) days after maturity, the renewal certificate may be dated back to the maturity date of the matured certificate.

paid before maturity to the extent required to meet such need, but the depositor shall forfeit accrued and unpaid interest for a period of not less than three months on the amount withdrawn. When a portion of a time certificate of deposit is paid before maturity, the certificate shall be canceled and a new certificate shall be issued for the unpaid portion of the deposit, with the same terms, rate, date, and maturity as the original deposit.

§ 329.5 *Notice of withdrawal of savings deposits*—(a) *Requirements regarding notice.* An insured nonmember bank shall observe the requirements set forth as follows in requiring notice of intended withdrawal of any savings deposit or part thereof or in permitting withdrawal without requiring such notice:

(1) If an insured nonmember bank pay any amount or percentage of the savings deposits of any depositor without requiring such notice, it shall, upon request, and without requiring such notice, pay the same amount or percentage of the savings deposits of every other depositor, subject to the same notice requirement, except if the bank changes its practice in accordance with paragraph (b) of this section.

(2) If an insured nonmember bank requires such notice before the payment of any amount or percentage of the savings deposits of any depositor, it shall require such notice before the payment of the same amount or percentage of the savings deposits of any other depositor, subject to the same notice requirement, except if the bank changes its practice in accordance with paragraph (b) of this section. Even though the bank's practice is to require notice, an insured nonmember bank is not prevented by this part from paying during the next succeeding interest period without requiring notice of withdrawal interest on a savings deposit which has accrued during the preceding interest period.

(b) *Requirements regarding change of practice.* No insured nonmember bank shall change its practice with respect to the requiring or not requiring of notice of intended withdrawal of savings deposits, except after duly recorded action of its board of directors or of its executive committee properly authorized, and no practice in this respect shall be adopted which does not conform to the requirements of paragraphs (a) (1) and (a) (2) of this section.

(c) *Change of practice for purpose of discrimination.* No change in the practice of an insured nonmember bank with respect to the requiring or not requiring of notice of intended withdrawal of savings deposits shall be made for the purpose of discriminating in favor of or against any particular depositor or depositors.

(d) *Requirements applicable although no interest paid.* An insured nonmember bank shall observe the requirements of this section with respect to savings deposits even though no interest be paid on such deposits.

(e) *Loans upon security of savings deposits.* An insured nonmember bank may make a loan to any of its depositors upon the security of his savings deposits, provided that if the bank's practice is to require notice before permitting withdrawal of any amount or percentage of the savings deposits of any depositor, the rate of interest on such loan shall not be less than 2 percent per annum in excess of the rate of interest on the savings deposit.

§ 329.6 *Maximum rates*[12] *of interest payable on time and savings deposits by insured nonmember banks*—(a) *Maximum rate of 4 percent.* No insured nonmember bank shall pay interest accruing at a rate in excess of 4 percent per annum, compounded quarterly,[13] regardless of the basis upon which such interest may be computed:

(1) On that portion of any savings deposit that has remained on deposit for not less than 12 months,

(2) On any time deposit having a maturity date 90 days or more after the date of deposit or payable upon written notice of 90 days or more,

(3) On that portion of any postal savings deposit which constitutes a time deposit that has remained on deposit for not less than 12 months.

(b) *Maximum rate of 3½ percent.* No insured nonmember bank shall pay interest accruing at a rate in excess of 3½ percent per annum, compounded quarterly,[13] regardless of the basis upon which such interest may be computed:

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[12] The maximum rates of interest payable by insured nonmember banks on time and savings deposits as prescribed herein are not applicable to any deposit which is payable only at an office of an insured nonmember bank located outside of the States of the United States and the District of Columbia.

[13] This limitation is not to be interpreted as preventing the compounding of interest at other than quarterly intervals: *Provided,* That the aggregate amount of such interest so compounded does not exceed the aggregate amount of interest at the rate above prescribed when compounded quarterly.

(1) On any savings deposit, except as otherwise provided in paragraph (a) (1) of this section.

(2) On any postal savings deposit which constitutes a time deposit, except as otherwise provided in paragraph (a) (3) of this section.

(c) *Maximum rate of 1 percent.* No insured nonmember bank shall *pay* interest accruing at a rate in excess of 1 percent per annum, compounded quarterly,[13] regardless of the basis upon which such interest may be computed, on any time deposit (except postal savings deposits which constitute time deposits) having a maturity date less than 90 days after the date of deposit or payable upon written notice of less than 90 days. [28 F.R. 7423, July 20, 1963, effective July 17, 1963.]

THE SECRETARY OF THE TREASURY,
Washington, D.C., April 1, 1964.

HON. A. WILLIS ROBERTSON,
Chairman, Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Your letter to Secretary Dillon of March 24 requests his views and those of the Treasury Department on the regulation of interest rates on time and savings deposits. This general matter has been considered within the administration upon a number of occasions in recent years, most extensively by the Interagency Committee on Financial Institutions that reported to President Kennedy on April 9, 1963. The relevant conclusion of that Committee, in which Secretary Dillon participated, remains the view of this Department and the administration generally, and was also incorporated in one section of S. 1799 which you introduced in the Senate on June 26, 1963, at the Secretary's request.

Essentially, we believe that it is no longer necessary to have continuous regulation of interest rates on savings and time deposits. Under the Banking Act of 1935, the Federal Reserve's regulation Q and related FDIC regulations have been required to establish maximum interest rates for the purpose of assuring sound banking practices. Other supervision of banking performance has now been sufficiently developed, however, to make it possible in ordinary circumstances to leave the determination of these rates to the free play of market forces. This would be in accord with a basic presumption that freedom from regulation will ordinarily facilitate the allocation of scarce loanable funds to their most rewarding use, encourage effective competition between savings institutions, and achieve an equitable distribution of the returns between the ultimate saver and the savings institution.

However, past experience has suggested that, in some circumstances, unbridled competition for deposits through payment of successively higher rates of interest on savings and time deposits—which rates in turn become deeply imbedded in the whole structure of interest rates and, in many given market circumstances, cannot be quickly and flexibly reduced as credit demands slacken—can contribute to unsound banking practices. In particular, in the search for high-yielding assets providing a return sufficient to justify payment to savers of rates ratcheted upward by unusual competitive pressures, some institutions may be tempted to sacrifice unduly the quality and marketability of their investments. While these dangers are mitigated by effective supervision and examination, and both the Federal Reserve and Federal deposit insurance provide protection against a liquidity crisis, total abandonment of all possibility of interest rate regulation would not be justified. Instead the possibility of reestablishing such regulation, at least for periods of particular pressure, might appropriately be retained on a standby basis. Knowledge that such authority remained available for use if required would, in itself, help to prevent excesses in banking practices that could become dangerous.

Moreover, there are occasions in which flexible use of interest rate ceilings—perhaps applied only to certain types of deposits—can assist the implementation of general economic policies, including the reconciliation of domestic aims with balance-of-payments considerations. For instance, certain other countries have recently found it helpful, in the interests of international monetary stability, to limit interest rates paid foreign depositors, and the United States should retain a similar authority for use if needed. In other circumstances, use of standby authority to impose maximums on other limited types of deposits could exert a useful marginal influence on the flow of funds through savings institutions, without making necessary implementation of a full range of regulations.

Consequently, the position of the Department and the administration is that, while continuous regulation of interest rates on time and savings deposits is no longer necessary, standby authority to impose maximum rates should be retained, and the supervisory authorities should be provided discretionary authority to invoke this authority in a flexible manner, as among classes of deposits, when required to assure the continued safety of the banking system and to promote the stability of the economy. Moreover, the Committee on Financial Institutions also concluded that standby authority to impose maximum rates should be extended to nonbank financial institutions, such as savings and loan associations, that accept deposits or shares.

Sincerely yours,

ROBERT V. ROOSA, *Acting Secretary.*

Compilation of State Laws Concerning Real Estate Loans by Banks

(By the Office of the Comptroller of the Currency)

PART 1. REAL ESTATE LOANS

NOTE.—The laws summarized in part 1 hereof cover "conventional" mortgage loans and deal with real estate lending limits, maximum permissible terms of loans, and restrictions on the kinds of real property which may be taken as security. Such laws may also, in some instances, specify various kinds of real estate loans authorized (residential, industrial, etc.) as well as certain technical or administrative requirements in connection with such loans and geographical limitations on lending areas. Statutes authorizing leasehold loans are summarized in appendage E. Laws relative to total or aggregate limits on all real estate loans, taken together, are tabulated in part 2 hereof. Laws permitting VA or FHA loans or other Government-guaranteed loans or loans in connection with activities of small business investment companies are not summarized. Many States exempt such loans from limitations applicable to "conventional" mortgage loans. In some States, there are no express statutory limits or restrictions on real estate loans except as given in laws restricting loans to one borrower. Certain State laws relating to construction loans or to commercial loans where a mortgage constitutes additional security are summarized here.

Alabama.—No statutory restrictions.

Alaska.—No statutory restrictions except that loans to finance out-of-State enterprises are prohibited (sec. 34–1–134 Alaska Comp. Laws, Ann.).

Arizona.—Requires written application, financial statement, appraisal of property, abstract of title together with attorney's opinion and either title insurance or an unlimited certificate of title. Buildings shall be insured. First mortgage required and loans on real estate outside United States prohibited (secs. 6–251 E and F and 6–256A).

Arkansas.—No statutory restrictions.

California.—Requires first lien. Limitations include (*a*) 10-year term not over 60 percent market value; (*b*) 20-year term not over 75 percent market value, repayable in equal monthly installments; (*c*) 20-year term on productive agricultural lands not over 75 percent market value, repayable in equal monthly installments; (*d*) 6-month term not over 85 percent market value; and (*e*) 18-month term on construction loan (under plan for repayment or takeout commitment) not over 85 percent market value. Market values shall be determined by appraisal. Above limitations inapplicable to loan to facilitate sale of real property owned by banks (Financial Code, sec. 1227).

Colorado.—Requires first lien on improved real estate, including improved farmland and business or residential property. Permits banks to purchase authorized loans. Limitations include 5-year term not over 50 percent appraised value, or 10-year term not over 60 percent appraised value, repayable in installments sufficient to amortize 40 percent or more of principal within such term. Such loans may be renewed or extended. Improvement loans are permitted. Provision is made for loans on forest tracts. In addition, a bank may make any real estate loan authorized to be made by national banks. Exceptions are given from above loan limitations for loans to provide working capital to industrial or business enterprise and 18-month construction loans (secs. 14–16–3 and 14–16–4).

Connecticut.—State banks may make mortgage loans on real estate in State. Limitations include (*a*) not over 50 percent of appraised value or (*b*) 25-year term not over 66⅔ percent of appraised value and not over $20,000, or 1 percent of capital and surplus, whichever is greater, if repayable in installments sufficient to amortize in full. In connection with latter class of loans, real estate shall be unencumbered, certificate of title or title insurance policy shall be obtained, appraisal is required, and financial statement shall be obtained; 18-month construction loans not over 66⅔ percent of the "then" value are permitted. A bank may also service mortgages. Above limitations inapplicable to loans to established industrial or commercial business where repayment out of operations is contemplated but where mortgage is taken. Savings banks and savings departments of State banks may make additional mortgage loans, including 25-year installment loans or residential property in State or certain areas of adjoining States, not over 80 percent of appraised value and not over $20,000, in amount, and certain home improvement loans (secs. 36–65, 36–70, 36–73, 36–99, and 36–100).

Delaware.—No statutory restrictions.

Florida.—No statutory restrictions but 1st mortgage required, with certain exceptions (sec. 659.17 (5)).

Georgia.—With certain exceptions, loans shall not exceed 50 percent of appraised value or, if provision is made for regular amortization, 75 percent of appraised value. Limitation inapplicable to temporary loans or commercial transactions secured in whole or in part by real estate, or to real estate loan of $3,500 or less repayable in 3 years or less (sec. 13–2015).

Hawaii.—Requires first lien and loan shall not exceed 75 percent of appraised value. Supervisory authorities may require appraisal, evidence of merchantable title, and insurance. Loans of savings department funds shall not exceed 75 percent appraised value (secs. 178–66 and 178–86 (e)).

Idaho.—Requires first lien on improved real estate, including improved farmland and business or residential property. Bank may purchase mortgages. Limitations include (*a*) 5-year term not over 50 percent appraised value, (*b*) 10-year term not over 66⅔ percent appraised value, repayable in installments sufficient to amortize 40 percent or more of principal within such term, (*c*) 20-year term not over 75 percent appraised value, repayable in installments sufficient to amortize in full. Such loans may be renewed or extended. Above limitations inapplicable to 6-month construction loans. Section 26.601.

Illinois.—Real estate loans meeting following conditions are execpt from limits on loan to one borrower: where there is first lien on productive real estate after valuation by two independent appraisers. Loan not to exceed 50 percent of appraised value, and first lien shall be evidenced by title insurance policy registrar's certificate of title or attorney's opinion. Certain charges on title, including leases, do not negative first lien. There is no express prohibition of real estate loans not meeting cbove conditions. Chapter 16½ section 132(3).

Indiana.—Requires first lien on real estate in State or within 50 miles of lending bank. Limitation is 20-year term and not over 75 percent of appraised value. Certain periodic principal payments are required if loan is not over 10-year term and exceeds 50 percent appraised value. If loan is over 10-year term and exceeds 50 percent appraised value, repayment in periodic installments sufficient to amortize in full over term of loan is required. Otherwise, loan may not exceed 5-year term or 50 percent of appraised value. Appraisal required. Bank may buy and sell loans. Section 18–1307.

Iowa.—Permits loans on unencumbered farmlands in State not over 50 percent of value. Permits loans on unencumbered real estate in State or certain areas of adjoining States. Loans may not exceed 50 percent of value or may not exceed 75 percent of appraised value and not over 20-year term, repayable in installments sufficient to amortize 40 percent or more of principal within such period. Renewal is permitted. Sections 526.25(5), 526.28, and 528.14.

Kansas.—No statutory restrictions except that first lien is required and mortgage may be open end permitting subsequent advances up to original amount. Section 9–1101(4).

Kentucky.—No statutory restrictions. Mortgage may be open and permitting additional loans to the extent authorized by the mortgage. Section 382.520.

Louisiana.—No statutory restrictions.

Maine.—No statutory restrictions applicable to mortgage loans by a trust company except that mortgaged real estate shall be insured. Separate and rather detailed laws govern mortgage loans by savings banks. Chapter 59, sections 18, 19–H(I).

Maryland.—No statutory restrictions.

Massachusetts.—Trust company may make, acquire by purchase, participate in or service first mortgage loans (*a*) on improved farmland in State or within 50 miles of bank's main office for not over 3 years on 50 percent appraised value, or not over 5 years if certain periodic principal repayments are required, (*b*) on improved real estate in United States for not over 5 years or 50 percent of appraised value, (*c*) on improved real estate in State or within 50 miles of bank's main office for not over 3 years or 60 percent of appraised value, or not over 5 years if certain periodic principal repayments are required, (*d*) on improved real estate in United States for not over 10 years on 75 percent of appraised value, if repayable in installments sufficient to amortize 40 percent or more of principal within such period, or not over 20 years if repayable in installments sufficient to amortize in full. Application and appraisal are required. Commissioner has power to regulate loans on certain out-of-State real property and participation loans and servicing arrangements. Certain loans permitted by savings banks are also permitted by trust companies, including certain 25-year installment loans at 80 percent of appraised value, residential development loans, construction loans, improvement loans, and housing projects. Real estate loan limitations do not apply to 18-month construction loans for industrial or commercial buildings where there is takeout commitment. Chapter 172, sections 55 and 57. See also, chapter 168, sections 34–36 for savings bank loans which may be made by trust companies.

Michigan.—Requires first lien on improved real estate, including improved farmland and business or residential property. Requires appraisal in form prescribed by Commissioner. Bank may purchase mortgages. Limitations include (*a*) 5-year term not over 50 percent appraised value, (*b*) 10-year term not over 66⅔ percent appraised value, if repayable in installments sufficient to amortize 40 percent or more of principal within such period, or (*c*) 20-year term not over 75 percent appraised value if repayable in installments sufficient to amortize in full. Renewal and extension permitted. Appraisal is required in accordance with regulations of Commissioner. Above limits do not apply to 18-month construction loans or to loans to a business which include a real estate mortgage but where repayment out of operations is contemplated. Participation loans permitted. Section 23.823.

Minnesota.—Requires first lien and appraisal. Permits loan on improved real estate in State or within 20 miles of bank. Conventional loans limited to 40 percent cash value of security covered by mortgage. Sections 48.19 and 48.24 (subdivision 2).

Mississippi.—No statutory restrictions.

Missouri.—No statutory restrictions except that a trust company not receiving demand deposits may lend on first mortgage not in excess of capital and surplus, or 66⅔ percent appraised value. Section 363.260(11).

Montana.—Requires first lien on improved real estate, including improved farmland and business or residential property. Limitations include (*a*) 5-year term not over 50 percent appraised value, (*b*) 20-year term not over 60 percent appraised value, repayable in installments sufficient to amortize 40 percent within term of loan, (*c*) 6-month construction loans. Loans may be renewed or extended. Bank may purchase loans. Section 5–506.

Nebraska.—No statutory restrictions.

Nevada.—Mortgage loan limits governed by laws relating to such loans by savings and loan associations. Purchase of loans is permitted. Lending area restricted to State or 100-mile radius of lending office but certain loans outside lending area are permitted. Loans on improved real estate are permitted not over 30-year maximum term and repayable in installments sufficient to amortize in full in such term. Certain loans not over 25-year maximum term and not over 80 percent appraised value on residential or combined residential and business property or not over 75 percent appraised value on other improved property are also permitted. Short-term loans on unimproved real estate also permitted. One-year construction loans and certain $5,000 limit improvement loans permitted. Appraisal is required. Sections 662.270, 673.028, 673.279, 673.317, and 673.323–673.329.

New Hampshire.—Trust company may lend on first mortgage on New England real estate not over 70 percent of value. Separate laws govern mortgage loans of funds of savings bank and savings department of trust company. Savings funds loans on real estate in State or contiguous State may not exceed 70 percent of value. Savings funds loans on one- to four-family dwellings in State may not exceed 20-year term and 80 percent value and scheduled installment repayments shall include estimated taxes. Application and appraisal are required and property shall be revalued every 5 years. Provision is made for other savings funds mortgage loans, including loans on property anywhere in United States, participation loans and purchase, and sale and servicing of loans. Sections 387:4, 387:21–a, 390:9, and 392:33.

New Jersey.—A bank may avail itself of any lending activities authorized by Federal legislation if authorized by general order of commissioner. Bank may lend on property in State or within 50 miles of border of State, may participate in loans, and may purchase loans. Loans shall be on improved real estate or farmlands unless made to finance improvements. First lien certified by qualified attorney or approved by title insurance company is required. Appraisal is also required. Loan may not exceed (*a*) 66⅔ percent appraised value, (*b*) 20-year term and not over 80 percent appraised value and $25,000 on single family dwelling, (c) 80 percent of first $30,000 appraised value and 50 percent of excess on two- to four-family dwelling. Provision is made for installment repayments at rates depending on ratio of loan to appraised value. Certain loans may be repaid in equal periodic installments sufficient to amortize loan in full within certain time. Eighteen-month construction loans permitted. Certain 9-month construction loans and loans based on borrower's financial condition and/or other security are exempted from real estate limitations. Sections 17:9A–25(12), 17:9A–64 through 17:9A–67, 17:9A–69D, and 17:9A–70B.

New Mexico.—Bank may make or purchase first mortgage loans on improved real estate for not over 5-year term or over 50 percent of appraised value, or not over 20-year term or over 66⅔ percent of appraised value if provision is made for full amortization within such term. Appraisal required. Section 48–3–7.

New York.—Limitations are (a) on unimproved real estate 66⅔ percent appraised value, (b) on real estate improved (or to be improved) by building or buildings used for residential, business, manufacturing or agricultural purposes, 75 percent appraised value, or (c) on real estate improved by one or two family residence, 80 percent appraised value. Appraisal required. Mortgage shall be recorded. Bank may service mortgages. Limitations inapplicable where real estate security is less than 15 percent of amount of loan, where loan is for improvement purposes and not over $5,000 or 61-month term, or where there is takeout commitment. Real estate security shall not include assignments of rents under a lease, leasehold loans, loans secured by assignments of rents, or royalties from oil, gas, minerals, lumber, or other products, certain commercial loan where a real estate mortgage is taken as additional security, or other loans involving liens on property exempted by banking board regulation. Banking law sections 96–a and 103(4).

North Carolina.—No statutory restrictions.

North Dakota.—First mortgage and appraisal required. Loan may not exceed 5 years and 50 percent cash value or 10 years and 66⅔ percent of cash value, if repayable in installments sufficient to amortize 40 percent within such period or 20 years and 66⅔ percent cash value, if repayable in installments sufficient to amortize in full within such term. Mortgage may include open-end terms permitting additional advances to original amount not over $2,500 for improvement purposes. Bank may sell loans. Sections 6–03–05, 6–03–05.1 and 6–03–06.

Ohio.—Requires first lien on improved real estate in State or in contiguous State. Appraisal is required. Advance on construction loans may not exceed expenses incurred. Improvements (unless of fireproof construction) shall be insured if over 10 percent of security. Loan may not exceed 5-year term and 50 percent appraised value, 20-year term and 66⅔ percent appraised value, if repayable in installments sufficient to amortize 5 percent a year or sufficient to amortize in full at maturity, or 20-year term and 75 percent appraised value, if repayable in equal installments sufficient to amortize in full at maturity. Certain loans or unimproved farm lands at 40 percent appraised value are also permitted. Real estate loan limitations do not apply to certain 9-month construction loans for residential or farm buildings or to 18-month construction loans for residential or farm buildings or to 18-month construction loans for industrial or commercial buildings or certain apartment houses, where there is takeout commitment. Other real estate loans where there is takeout commitment are also not within limitations. Other exceptions to limitations include loans to established industrial or commercial businesses where repayment out of operations is contemplated and loan secured by assignment of rents. Section 1105.19.

Oklahoma.—Requires first lien on unimproved real estate, including improved farmland or residential or business property, in State or within 50 miles of lending bank. Purchase of loan permitted and participation with other banks permitted. Loan may not exceed 3-year term and 50 percent appraised value, or 10-years term and 70 percent appraised value, if amortized by installment payments sufficient to amortize 40 percent of principal within that period. Loans may be renewed or extended. Real estate loan limitations do not apply to certain 9-month construction loans or to 18-month construction loans for industrial or commercial buildings where there is takeout commitment. Title 6, section 108b.

Oregon.—Requires first lien on improved real property. Loan may not exceed (a) 5-year term and 50 percent appraised value, (b) 10-year term and 66⅔ percent appraised value, if repayable in installments sufficient to amortize 40 percent within such term, or (c) 20-year term and 75 percent appraised value, if repayable in installments sufficient to amortize in full within such term. A purchase of a contract of sale is a real estate loan subject to above limits. Restrictions do not apply to mortgage taken to facilitate sale of real estate owned by bank. Certain loans on forest tracts permitted. Bank shall have such evidence of title and insurance as required by superintendent. Eighteen-month construction loans not over 70 percent market value of real estate and planned improvements are permitted but limit on amount is inapplicable if there is takeout commitment. Restrictions do not apply to commercial loans secured by real estate where repayment from borrower's operations is contemplated. Sections 708.030 and 708.032.

Pennsylvania.—Requires first lien on improved real property including improved farmland in State or within 50 miles of border. Loan may not exceed 10-year term and 66⅔ percent actual value, or 20-year term and 75 percent actual value, if repayable in installments sufficient to amortize in full within term. Appraisal required. All expenses of making loan shall be paid by borrower. Buildings shall be insured for fire in company authorized to do business in State. Loans or judgments which are first liens are also permitted. Entry of judgment on installment loan note before default where bank looks to repayment from borrower but where lien is also secured on real estate is not within real estate limitations. Certain investments in mortgages in foreign countries or in dependency or insular possession of United States also permitted. Title 7, sections 819–1001A(4) (e) and 819–1012A, B and D.

Rhode Island.—The following statutory restrictions are applicable only to real estate loans of savings banks and savings departments of banks: Requires first mortgage and appraisal. Reappraisal required if mortgage loan continues for 5 years without being reduced in amount. Loan may not exceed 60 percent of value (40 percent of value on unimproved real estate). Loans on improved residential real estate may not exceed 70 percent of value for 21-year maximum term, repayable in installments. Loans on improved real estate used for one- to four-family dwellings, within 50 miles of principal office of bank, repayable in installments, may not exceed 25-year term and 80 percent of first $25,000 value plus 70 percent of value exceeding $25,000. Such one- to four-family residential loans may not be made unless a certificate is submitted that borrower is able to make required repayments. U.S.-guaranteed portion of loans are excluded in computing maximum amounts which may be loaned. Above restrictions inapplicable to loans to enable purchase of real estate from lending bank. Other real estate loans permitted include participation in loans on real estate in State, open end mortgages, and loans for residential development. Sections 19–9–1, 19–9–8, 19–9–9, and 19–9–10.

South Carolina.—Requires first lien on improved real estate for 10-year term not over 60 percent appraised value with required amortization of at least 5 percent of principal a year. Section 8–222.

South Dakota.—No statutory restrictions.

Tennessee.—No statutory restrictions.

Texas.—Requires first lien. Limitations include: (*a*) loan may not exceed 50 percent appraised value, (*b*) loan may not exceed 60 percent appraised value, if repayable in installments sufficient to amortize 40 percent of principal in 5 years, or (*c*) loan on one- to four-family dwelling may not exceed 66⅔ percent appraised value, if repayable in monthly installments sufficient to pay loan in full in not over 240 months, such payments to include insurance premiums and taxes. Mortgage loans require attorney's opinion or title insurance, evidence of payment of all but current year's taxes, written appraisal, and adequate insurance if improvements constitute a substantial portion of security. Above restrictions do not apply to 18-month construction loans with takeout commitments, or to 9-month loans for construction of residential or farm buildings. Certain mortgage loans to manufacturing or industrial businesses where repayment from business operations is expected and certain 36-month loans for construction of buildings to be occupied by U.S. agencies are not governed by above restrictions. Another law permits any loan or investment which may be made by a national bank. Articles 342–504 and 342–511.

Utah.—No statutory restrictions.

Vermont.—Requires first lien on timberland in State or on improved real estate in U.S. loans are permitted on timberland, mines, quarries, or industrial plants for 5-year term not over 40 percent appraised value. Other real estate loans are permitted for 1-year term or on a demand basis not over 60 percent appraised value. Still other such loans are permitted for 20-year term not over 66⅔ percent appraised value, payable in installments sufficient to amortize in full in such term. Certain loans on 1- or 2-family dwellings are permitted, subject to above limitations, except that they may not exceed 80 percent appraised value. All loans require evidence of marketable title or title insurance (except for loans under $1,000), evidence of payment of all but current year's taxes, written appraisal, and certain certifications. Dwelling loans not over 80 percent appraised value require additional certification including a financial statement, information as to borrower's earning capacity, and certain information as to the character of the neighborhood, etc. Such loans may be renewed or extended if based upon reexamination of facts and reappraisal within 3-year period. Certain open-end provisions are authorized and banks may service mortgages (title 8, secs. 754, 756, and 757).

Virginia.—Permits real estate loans not over 50 percent appraised value. Loans are permitted not over 75 percent appraised value, if repayable in installments sufficient to amortize 4 percent of principal a year for 10-year term, or sufficient to amortize 5 percent of principal a year for 20-year term. Appraisal is required if loan over $1,000, and appraisal by two appraisers if required if loan is over $5,000. Above limits do not apply to 18-month construction loans with takeout commitments, construction loans with takeout agreements of insurance companies authorized to do business in State. Above limits also do not apply to loans to a business which include a real estate mortgage but where repayment out of operations is contemplated (secs. 6–78 and 6–79.1.)

Washington.—No statutory restrictions.

West Virginia.—No statutory restrictions.

Wisconsin.—No statutory restrictions except that loans are limited to mortgages on real estate in State and adjoining States (secs. 221.32 and 223.03(11)).

Wyoming.—Requires first lien on improved real estate, including improved farmland and business or residential property. Bank may purchase mortgages. Loan may not exceed 5-year term and 50 percent appraised value or 10-year term and 75 percent appraised value, if repayable in installments sufficient to amortize 40 percent within such term. Loans may be renewed or extended. Certain 6-month construction loans are not subject to above restrictions. Another law permits trust company loans on unencumbered real estate worth double the amount loaned.

TABLE 1.—*Conventional real estate loans*

State	Loan-to-value ratio	Term	Geographical limits
Alabama [1]			
Alaska [1]			Out of State prohibited.
Arizona			Out of United States prohibited.
Arkansas [1]			
California	A. 60 percent B. 75 percent C. 75 percent productive farmlands. D. 85 percent E. 85 percent construction loan.	A. 10 years B. 20 years, equal monthly installments. C. 20 years, equal monthly installments. D. 6 months E. 18 months	
Colorado [2]	A. 50 percent B. 60 percent	A. 5 years B. 10 years, 40 percent to be amortized within such period.	
Connecticut	A. 50 percent B. 66⅔ percent, not over $20,000 or 1 percent of capital and surplus, whichever greater. C. 66⅔ percent, construction loan. D. 80 percent, not over $20,000 (savings departments of State banks).	A. B. 25 years, fully amortized. C. 18 months D. 25 years, installments	In State and certain areas of adjoining States.
Delaware [1]			
Florida [1]			
Georgia	A. 50 percent B. 75 percent	A. B. Regular amortization	
Hawaii	75 percent		
Idaho	A. 50 percent B. 66⅔ percent C. 75 percent	A. 5 years B. 10 years, 40 percent to be amortized within such period. C. 20 years, fully amortized.	
Illinois [2]	50 percent		

See footnotes at end of table, p. 54

TABLE 1.—*Conventional real estate loans*—Continued

State	Loan-to-value ratio	Term	Geographical limits
Indiana	A. 75 percent	A. 20 years, fully amortized.	In State or 50 miles of lending bank.
	B. 50 percent or more	B. 10 years or less, amortized at not less than 2 percent per year.	
	C. 50 percent or more	C. Over 10 years but not over 20 years, fully amortized.	
	D. 50 percent	D. 5 years, or amortization.	
Iowa	A. 50 percent	A.	In State or certain areas of adjoining States.
	B. 75 percent	B. 20 years, 40 percent to be amortized within such period.	
Kansas [1]			
Kentucky [1]			
Louisiana [1]			
Maine [1]			
Maryland [1]			
Massachusetts	A. 50 percent, farmland	A. 5 years, amortized at not less than 2 percent per year.	A. In State or within 50 miles of main office.
	B. 50 percent	B. 5 years	B. Improved real estate in United States.
	C. 60 percent	C. 5 years, amortized at not less than 2 percent per year.	C. Improved real estate in State or within 50 miles of main office.
	D. 75 percent	D. 10 years, 40 percent amortized within such period.	D. Improved real estate in United States.
	E. 75 percent	E. 20 years, fully amortized.	E. Improved real estate in United States.
	F. 80 percent	F. 25 years, installments	
Michigan	A. 50 percent	A. 5 years	
	B. 66⅔ percent	B. 10 years, 40 percent amortized within such period.	
	C. 75 percent	C. 20 years, fully amortized.	
Minnesota	40 percent		In State or within 20 miles of bank.
Mississippi [1]			
Missouri [4]	66⅔ percent		
Montana	A. 50 percent	A. 5 years	
	B. 60 percent	B. 20 years, 40 percent amortized within such period.	
Nebraska [1]			
Nevada	A.	A. 30 years, full amortized.	In State or 100 miles of bank.
	B. 80 percent, residential or combined residential and business property.	B. 25 years, fully amortized.	
	C. 75 percent other improved property.	C. 25 years; fully amortized.	
New Hampshire	A. 70 percent [5]	A.	A. New England real estate.
	B. 70 percent [6]	B.	B. In State or contiguous State.
	C. 80 percent,[6] 1 to 4 family dwellings.	C. 20 years, fully amortized.	C. In State.
	D. 50 percent [6]		D. Anywhere in United States.
New Jersey [3]	A. 66⅔ percent	A.	In State or within 50 miles of State border.
	B. 80 percent, not over $25,000, on 1 family dwelling.	B. 20 years	
	C. 80 percent of first $30,000 and 50 percent of excess, 2 to 4 family dwelling.		
New Mexico	A. 50 percent	A. 5 years	
	B. 66⅔ percent.	B. 20 years—fully amortized.	
New York	A. 66⅔ percent, unimproved real estate.	Statute silent	Statute silent (by implication, in or out of State).
	B. 75 percent, improved real estate.		
	C. 80 percent, 1- or 2-family dwelling.		
North Carolina [1]			

See footnotes at end of table, p. 54

TABLE 1.—*Conventional real estate loans*—Continued

State	Loan-to-value ratio	Term	Geographical limits
North Dakota	A. 50 percent	A. 5 years	
	B. 66⅔ percent.	B. 10 years, 40 percent amortized within such period.	
	C. 66⅔ percent.	C. 20 years, fully amortized.	
Ohio	A. 50 percent	A. 5 years	In State or in contiguous State.
	B. 66⅔ percent.	B. 20 years, 5 percent amortization per year.	
	C. 75 percent.	C. 20 years equal installments, fully amortized.	
	D. 40 percent, unimproved farmlands.		
Oklahoma	A. 50 percent	A. 3 years	In State or within 50 miles of bank.
	B. 70 percent.	B. 10 years, 40 percent amortized within such period.	
Oregon	A. 50 percent	A. 5 years	
	B. 66⅔ percent	B. 10 years, 40 percent amortized within such period.	
	C. 75 percent	C. 20 years, fully amortized.	
	D. 70 percent, construction loans.		
Pennsylvania	A. 66⅔ percent	A. 10 years	In State or within 50 miles of State border.
	B. 75 percent	B. 20 years, fully amortized.	
Rhode Island [7]	A. 40 percent, unimproved real estate.[5]		
	B. 60 percent, improved real estate.		
	C. 70 percent, improved residential real estate.	C. 21 years, installments	
	D. 80 percent of 1st $25,000 plus 70 percent of excess, on 1- to 4-family dwellings.	D. 25 years	D. Within 50 miles of principal office.
South Carolina	60 percent	10 years at least 5 percent amortization per year.	
South Dakota [1]			
Tennessee [1]			
Texas [2]	A. 50 percent		
	B. 60 percent	B. 5 years, 40 percent amortized within such period.	
	C. 66⅔ percent, 1- to 4-family dwelling.	C. 20 years, fully amortized.	
Utah [1]			
Vermont	A. 40 percent, on timberland, mines, quarries, or industrial plants.	A. 5 years	Timberland in State, or improved real estate anywhere in the United States.
	B. 60 percent	B. 1 year	
	C. 66⅔ percent	C. 20 years, fully amortized.	
	D. 80 percent, 1- or 2-family dwellings.	D. 20 years, fully amortized.	
Virginia	A. 50 percent		
	B. 75 percent	B. 10 years, amortized 4 percent per year.	
	C. 75 percent	C. 20 years, amortized 5 percent per year.	
Washington [1]			
West Virginia [1]			
Wisconsin [1]			In State and all joining States.
Wyoming	A. 50 percent	A. 5 years	
	B. 75 percent	B. 10 years, 40 percent within such period.	

[1] No statutory restrictions.
[2] May also make loans authorized to national banks.
[3] Exempt from limits on loans to 1 borrower; not other statutory restrictions.
[4] Restrictions applicable to trust company not receiving demand deposits.
[5] Trust company.
[6] Savings departments of trust company.
[7] Restrictions applicable only to savings departments of banks.

PART 2. REAL ESTATE LOANS—OTHER LIMITATIONS

NOTE.—Part 1 of this statutory summary deals with State laws limiting amounts of individual real estate loans on the basis of the kind of real estate taken as security, the appraised value of such real estate, or the nature of the loan transaction. Laws summarized herein deal with limitations of the aggregate amounts which a bank may lend on real estate or on certain kinds of real estate. Such aggregate limitations are often based on factors such as the capital and surplus of the lending bank or the amount of deposits or savings deposits of the bank. This summary also includes laws limiting the aggregate amount of construction loans or other special kinds of loans. In addition, the summary includes laws of some States which expressly limit the amount which may be loaned to one borrower or real estate loans or on secured or collateral loans. Such limitations are based on a factor, such as capital and surplus, other than the appraised value of the real estate security. Where no limitation on real estate or collateral loans to one borrower is given herein it is possible that the general limitation of loans to one borrower (see table 5, appendage J) would apply in the particular State. The summary herein does not, except in a few instances, refer to laws concerning Government-guaranteed real estate loans (such as VA and FHA loans). In many instances, the guaranteed portions of such loans are exempt from general or aggregate real estate limitations. For convenience, this summary has been set up in the form of a table, referred to as table 2.

TABLE 2.—*Appendage D*

State and statute	Aggregate real estate loan limits	Limits on real estate or secured loans to 1 borrower (if different from general limit)	Other provisions of State law relating to real estate loans
Alabama (title 5, sec. 82)		20 percent capital, surplus, and undivided profits where loan is secured.	
Alaska	No provision		
Arizona (sec. 6-251E)	25 percent demand deposits, other than public deposits. Applies to loans on and investments in real property.		
California Financial Code (secs. 1221 (b) and 1230).	35 percent total assets	15 percent capital and surplus	
Colorado (sec. 14-16-8 (b) and (d))	100 percent capital and surplus, 60 percent time deposits or 25 percent interest-bearing securities, whichever is greater (including real estate other than office premises owned by bank).		Aggregate limit on certain construction loans, 100 percent capital and surplus.
Connecticut (secs. 36-70 and 36-99)	Commercial department: 10 percent capital and surplus or 10 percent commercial deposits, whichever is greater. Savings banks and savings departments of banks: 70 per ent assets of savings department (including real estate other than office premises owned or under contract of purchase).		Certain classes of savings department real estate loans are also limited, both in the aggregate and as respects 1 borrower.
Delaware (title 5, sec. 909(a)(3)		25 percent capital and surplus and undivided profits where loan is secured.	
Florida (sec. 659.17(2)(a))		25 percent capital and surplus where loan is secured.	
Georgia (secs. 13-2013 and 13-2015)	100 percent capital and surplus, or 100 percent savings or time deposits, whichever is greater.	20 percent capital and surplus where loan is secured.	
Hawaii (secs. 178-66 and 178-86)	Commercial department: 25 percent capital, surplus, and commercial deposits. Savings department: 75 percent savings deposit in real estate loans, together with certain other classes of loans and investments.		
Idaho (sec. 26-601)	100 percent capital and surplus, or 60 percent time and savings deposits, whichever is greater.		Aggregate limit on certain construction loans, 50 percent capital.
Illinois (ch. 16½, sec. 132)		Certain real estate loans exempted from general limit of loans to 1 borrower.	
Indiana (secs. 18-103(p) and 18-1307)	100 percent total sound capital. 35 percent total deposits, or 60 percent time deposits, whichever is greater.		
Iowa (sec. 528.14)		Certain farmland loans: 50 percent capital and surplus.	
Kentucky (sec, 287.280)		30 percent capital and surplus	
Louisiana (sec. 6:259)		50 percent capital and surplus where loan is secured.	
Maine (ch. 59, sec. 112)		20 percent capital and surplus where loan is secured.	

Massachusetts (ch. 172, sec. 56)	Commercial departments: 15 percent deposits other than savings deposits. Savings departments of trust companies: 70 percent savings deposits.		Certain classes of real estate loans are also limited in the aggregate.
Michigan (sec. 23.823)	100 percent capital and surplus, or 60 percent time and savings deposits, whichever is greater.		Aggregate limit on certain construction loans, 50 percent capital. Aggregate limit on certain leasehold loans, 100 percent capital plus 50 percent surplus.
Minnesota (sec. 48.22 (Subd. 2))		25 percent capital and surplus	
Missouri (secs. 362.170(1)(b) and 363. 260(1)(b)).		25 percent capital and surplus where loan is secured.	
Montana (sec. 5-506)	100 percent capital and surplus, or 60 percent time and savings deposits, whichever is greater.		Aggregate limit on certain construction loans, 50 percent capital.
New Hampshire (secs. 387:3(IV) and 390:9).	Applies to loans by savings banks and savings departments of trust companies: 75 percent savings deposits on "conventional" mortgage loans.		Aggregate limit on "conventional" mortgage loans on real estate outside New England, 10 percent savings deposits.
New Jersey (sec. 17:9A-69)	100 percent capital and surplus, or 60 percent time deposits, whichever is greater (including real estate other than office premises owned by banks).		Aggregate limit on certain construction loans, 50 percent capital and surplus.
New Mexico (sec. 48-3-7)	On mortgages not over 5-year term, 30 percent total deposits, or 75 percent savings deposits (banks), or 75 percent deposits of trust funds (trust companies). No aggregate limit on mortgages of longer term than 5 years.		
New York banking law (sec. 103(4))	15, 25, or 40 percent of total assets (depending on place of location of bank's principal office), or 60 percent time and savings deposits, whichever is greater.	10 percent capital, surplus, and undivided profits (specified for real estate loans with other limits governing other kinds of secured loans).	
North Dakota (sec. 6-03-05)	100 percent capital and surplus, or 66⅔ percent time and savings deposits, whichever is greater.		
Ohio (secs. 1105.19 and 1105.21(C)(6))	100 percent capital and surplus, or 60 percent time and savings deposits, whichever is greater (or 70 percent of such deposits if they total ⅔ or more of total deposits and banking board authorizes increase in aggregate limits).	Loans on improved farm property exempted from limit of loans to 1 borrower.	Aggregate limits on certain classes of construction loans, 100 percent capital and surplus.
Oklahoma (title 6, sec. 108(b))	100 percent capital and surplus, or 60 percent time and savings deposits, whichever is greater.		Aggregate limit on certain construction loans, 100 percent capital and surplus.
Oregon (secs. 708.030 and 708.365)	25 percent capital, surplus, and demand deposits plus 75 percent savings deposits.	10 percent capital and surplus (specified for real estate loans).	
Pennsylvania (title 7, secs. 819-1006B and 819-1012C).	100 percent capital and surplus or 60 percent time deposits, at bank's option.	25 percent capital and surplus where loan is secured.	
Rhode Island (secs. 19-9-1 and 19-9-8)	Appliesto loans by savings banks and savings departments of banks: 80 percent savings deposits with certain exceptions.		Not over half of permitted aggregate "conventional" loans may be on out-of-State real estate. Also limits aggregate of certain other real estate loans.
South Carolina (sec. 8-234)	50 percent capital plus 50 percent deposits		

TABLE 2.—*Appendage D*—Continued

State and statute	Aggregate real estate loan limits	Limits on real estate or secured loans to 1 borrower (if different from general limit)	Other provisions of State law relating to real estate loans
Texas (art. 342-504)	Aggregate of loans on residential real estate: 100 percent capital and surplus. Commissioner may authorize higher aggregate limit.		Aggregate limit on certain construction loans, 100 percent capital and surplus.
Virginia (sec. 6-78)	100 percent capital and surplus or 70 percent time and savings deposits, at election of bank.		Do.
Washington (sec. 30.04.110)		Secured loans exempted from limits of loans to 1 borrower.	
Wisconsin (sec. 221.32)	50 percent capital, surplus, and deposits, but loans exceeding aggregate limits may be authorized by directors of bank under certain conditions.		
Wyoming (secs. 13-21 and 13-98 (13th)).	100 percent capital and surplus or 60 percent deposits, whichever is greater but uninsured loans may not exceed aggregate of 20 percent capital, surplus, and deposits.		Aggregate limit on certain construction loans, 50 percent capital. Aggregate of mortgage loans, together with certain other loans and investment trust companies. Banks may not exceed 80 percent deposits.

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