PROBLEMS ENCOUNTERED UNDER STATE USURY LAWS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-THIRD CONGRESS

SECOND SESSION

ON

S. 3817

TO AMEND THE NATIONAL BANK ACT, THE FEDERAL DEPOSIT INSURANCE ACT, THE NATIONAL HOUSING ACT, AND FOR OTHER PURPOSES

JULY 31, 1974

Printed for the use of the
Committee on Banking, Housing and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
38-252 O WASHINGTON : 1974

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PROBLEMS ENCOUNTERED UNDER STATE USURY LAWS

WEDNESDAY, JULY 31, 1974

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS,
Washington, D.C.

The subcommittee met at 10 a.m. in room 5302 of the Dirksen Senate Office Building; Senator John Sparkman, chairman of the full committee, presiding.

Present: Senators Sparkman and Brock.

Senator BROCK. The subcommittee will come to order.

I first would like to thank the chairman of the committee and the chairman of the subcommittee, Mr. McIntyre, for allowing us to bring this problem before the subcommittee.

This morning our subcommittee commences 1 day of hearings on the problems encountered by commercial borrowers under State usury laws to see if Federal remedial action is necessary and desirable.

Federal policy has brought the prime rate that banks charge their best customers to around 12 percent and banks now borrow from each other in the so-called Federal funds market at 13–14 percent. Under these conditions, corporations who need to borrow sizeable amounts in order to carry on their businesses, simply cannot get money in States like Tennessee and Arkansas, where the State constitutions impose ceilings of 10 percent. In Montana, statutory restrictions equally hard to change make it virtually impossible to get needed funds.

As an emergency measure designed to give these States sufficient time to act and to avoid unemployment and severe economic repercussions, on behalf of myself and the Senators from the affected States—Senators Baker, Fulbright, and Mansfield—I introduced S. 3817 which will be the focus of these hearings.

S. 3817 would authorize all federally-insured commercial and savings banks as well as savings and loan associations to charge up to 5 percent over the applicable Federal reserve discount rate to all corporate borrowers regardless of State usury rates. Consumer loans and home mortgages are not affected.

[Copy of the bill being considered follows:]

93d CONGRESS
2d Session

S. 3817

IN THE SENATE OF THE UNITED STATES

July 25, 1974

Mr. Brock (for himself, Mr. Baker, Mr. Fulbright, and Mr. Mansfield) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing and Urban Affairs

A BILL

To amend the National Bank Act, the Federal Deposit Insurance Act, the National Housing Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 5197 of the Revised Statutes, as amended (12 U.S.C. 85), is amended by inserting in the first and second sentences before the phrase "whichever may be the greater", the following: "or in the case of a loan to a corporate borrower, at a rate of 5 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the Bank is located,".

SEC. 2. The Federal Deposit Insurance Act is amended by adding at the end thereof the following:

"SEC. 24. (a) In order to prevent discrimination against State-chartered insured banks with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank would be permitted to charge in the absence of this subsection, a State bank may in the case of a loan to a corporate borrower, notwithstanding any State constitution or statute, which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 5 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the bank is located, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run.

"(b) If the rate prescribed in subsection (a) exceeds the rate such State bank would be permitted to charge in the absence of this paragraph, and such State fixed rate is thereby preempted by the rate described in subsection (a), the taking, receiving, reserving, or charging a greater rate of interest than is allowed by subsection (a), when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person who paid it may recover, in a civil action commenced in a court of appropriate jurisdiction not later than two years after the date of such payment, an amount equal to twice the amount of the interest paid from the State bank taking or receiving such interest.".

SEC. 3. Title IV of the National Housing Act is amended by adding at the end thereof the following:

"SEC. 412. (a) If the applicable rate prescribed in this section exceeds the rate an insured institution would be permitted to charge in the absence of this section, such institution may in the case of a loan to a corporate borrower, notwithstanding any State constitution or statute, which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 5 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the institution is located, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run.

"(b) If the rate prescribed in subsection (a) exceeds the rate such institution would be permitted to charge in the absence of this section, and such State fixed rate is thereby preempted by the rate described in subsection (a), the taking, receiving, reserving, or charging a greater rate of interest than that prescribed by subsection (a), when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person who paid it may recover, in a civil action commenced in a court of appropriate jurisdiction not later than two years after the date of such payment, an amount equal to twice the amount of the interest paid from the institution taking or receiving such interest.".

SEC. 4. If any provision of this Act or the application of such provision to any person or circumstance shall be held invalid, the remainder of the Act and the application of such provision to any person or circumstance other than that as to which it is held invalid shall not be affected thereby.

SEC. 5. The amendments made by this Act shall apply to loans made after the date of enactment of this Act, but prior to July 1, 1977.

Senator BROCK. We have several panels of witnesses. First, we will hear from the bank regulatory agencies. I am particularly delighted that we have with us the Honorable Hugh F. Sinclair, the commissioner of banking from Tennessee.

Next we will receive testimony from borrowers and lenders from the affected states.

Should we not be able to complete the testimony this morning, we will go over to 2 p.m. this afternoon. It will be appreciated if each witness will confine his opening statement to five minutes. We have your complete statements which will be made part of the record.

I would like to welcome Mr. James Smith, the Comptroller, Governor Bucher of the Federal Reserve, and Mr. Grady Perry of the Federal Home Loan Bank Board.

Gentlemen, I very much appreciate your being here and am looking forward to your testimony.

Mr. Smith, if you'll start, or whichever one you want to start.

Senator SPARKMAN. May I just say this: You say it might extend over to 2. I hope you find it possible to run through and finish. You and I have a housing conference at 1:30.

Senator BROCK. Well, yes, all right, we'll finish this morning, then, if we can.

Please proceed.

STATEMENT OF JAMES E. SMITH, COMPTROLLER OF THE CURRENCY; JEFFREY M. BUCHER, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE BOARD; AND GRADY PERRY, JR., MEMBER, FEDERAL HOME LOAN BANK BOARD

Mr. SMITH. Thank you, Mr. Chairman.

It is always a pleasure to appear before this committee and its respective subcommittees and it is especially a pleasure to appear today in support of S. 3817.

I will endeavor to summarize my statement which the committee has and ask that it be printed in full in the record [see p. 15]. I would also like to say at the outset, Mr. Chairman, that I have been advised by the Office of Management and Budget that the views which I am expressing this morning for the Comptroller of the Currency may also be regarded as the views of the administration in this matter.

Briefly described, S. 3817 proposes to amend the National Bank Act, specifically 12 U.S.C. 85, with respect to national banks and make corresponding changes in the Federal Deposit Insurance Act and the National Housing Act so as to permit all federally insured banks and savings and loan associations in lending and discounting to corporate borrowers to charge maximum rates of interest not to exceed 5 percent above the currently prevailing Federal reserve discount rate on 90-day commercial paper.

At present, as you know, the discount rate is at 8 percent, which would mean that this bill would permit a maximum rate of interest of 13 percent irrespective of the State law in which the lending institution has its principal offices and is extending the credit. We believe S. 3817 finds a very ample precedent for its provisions in a provision of the National Bank Act, namely 12 U.S.C. 85, which has been on the books for some 40 years, since 1933, and which today permits national banks alone to charge a rate of interest not to exceed one percent above the discount rate, irrespective of prevailing State law.

We are aware, and I know that the sponsor of the bill is aware, that historically the division of governmental authority as between the Federal Government and the State governments with respect to regulation of maximum contract rates of interest has left the regulation primarily with the States.

And we would not today be supporting this departure, if you will, from a rather well-established precedent if we did not think that there were clear and necessary circumstances which demanded Federal intervention.

There are a number of States in which the contract ceiling rates of interest provided either by State constitution or State statute law are at levels which do not bear a realistic relationship to prevailing commercial lending rates in today's financial environment. Specifically, we have three States, Arkansas, Montana, and Tennessee, in which that contract ceiling rate is 10 percent, applicable not only to individual borrowers, but to corporate borrowers as well. In two of those three States, namely Arkansas and Tennessee, that contract ceiling rate is incorporated in the constitution of the State and could only be amended by going through the laborious and time-consuming process of constitutional amendment.

As we all know, a 10–percent rate of interest today in terms of corporate borrowing is clearly well below prevailing rates. We have a prime rate today which is at 12 percent and has been at that level for a considerable period of time. You pick up the Wall Street Journal any day and you see prime long-term corporate borrowing occurring in the range of 9 to 10 percent. Any other indices that you want indicate that 10 percent is clearly below the prevailing rate and so the result has been that, in these States, deserving corporate borrowers are today being denied essential credit.

I think it is clear that banks and other financial institutions in these States have endeavored to the best of their ability to continue to serve commercial borrowers, but it is unrealistic, it seems to me, to asume that can be done for any considerable period of time, both from the standpoint of the marginal costs of money which these institutions are having to pay to acquire funds today and also in terms of opportunity costs, if you will, for the application of their funds to alternative sources.

For example, I noticed today in the municipal bond market that the city of New York has isued a tax exempt bond in the range of 7.70 percent. In the Federal funds markets we have had daily prevailing rates in the range of anywhere from 11.5 to as high as 13 and 14 percent in recent weeks.

So on all of these bases it seems unrealistic to expect the financial institutions in these States to continue to extend credit at a level beneath the price of money to them and beneath levels which they could make alternative use of their funds. And it seems to me that the approach that you, Senator Brock, have taken in S. 3817, is a useful approach, a desirable approach. It cracks the precedent of 40 years of law and, speaking for the Comptroller's Office and for the administration, we would certainly hope that the Congress would see fit to enact this bill and to enact it promptly.

Senator BROCK. Thank you very much.

Mr. Chairman, if you don't mind, we'll let each one testify and then ask them questions.

Mr. BUCHER. It is a pleasure to be here and express our views with regard to Senate bill 3817.

I will summarize the formal statement and ask that the statement be submitted for the record [see p. 17].

The Board has been concerned for some time about the impact which usury ceilings have in the availability of funds in the local credit markets. When limits in specific markets are limited to artificially low levels, the continued availability of credit in these markets is threatened.

There is no question but that the potential for disruption of credit flows in States with relatively low usury ceiling has increased greatly in recent months due to the general increase in interest rates in competively determined markets.

Large commercial banks have been paying rates of 12 percent or more and since July the prime rate charged by money market banks to their best customers has been at 12 percent. It is reasonable to assume that many of the lending institutions in these States are finding it unattractive to lend at the low usury ceiling.

Our information does indicate a noticeable slowdown in business lending at some of the larger banks in Tennessee and Arkansas in the last couple of months and in the last few weeks. Federal funds have traded above a 12-percent range. Thus there are some temptations for banks in States like Tennessee, Arkansas, and Montana to sell Federal funds or to direct their money into more attractive investments rather than lend to local borrowers at the 10-percent ceiling rate. Because of distortions such as these, the Board of Governors strongly encourages efforts to reduce the restraints imposed on local credit markets by usury ceilings. We would prefer that remedial action to correct these inequities be undertaken at the State level.

I know you share that feeling. We understand, however, that in some States this is a constitutional problem which may require considerable time to resolve. In view of this and given the urgency of the problems developing in the credit markets currently, the Board supports the emergency measure you proposed by S. 3817. The Board, however, has reservation about two specific items in the pending bill.

First, we strongly urge that the maximum loan rate which institutions be allowed to charge not be tied to the Federal Reserve discount rate. As you are aware the discount rate is a policy rate administered by the Federal Reserve for monetary policy purposes. It is not a market determined rate and at times may not move in parallel with market rates.

Instead the Board would advise that the loan rate be tied to a market-determined interest rate, one which more clearly responds to the changes in credit market conditions. We suggest, for example, that the 90-day treasury bill rate might be appropriate.

The second concern which the Board has with the proposed bill is that the legislation would apply only on loans to corporations and would exclude noncorporate borrowers.

For equity reasons the Board believes that the bill should be expanded to cover all loans for business purposes. If lending institutions are allowed to charge higher rates on loans to corporations, we can foresee a large diminution in the availability of credit for unincorporated businesses. Available funds will be channeled into higher yielding corporate loans and credit which is already scarce for other borrowers could become virtually unattainable.

With the inclusion of these two modifications, tying the loan ceiling to a market rate and not the discount rate and expanding the coverage to all business loans, not just corporate loans, the Board favors proposed legislation as a productive and desirable emergency measure that should help to ease disproportionate credit constraints in certain local markets.

Senator Brock. Mr. Perry.

Mr. Perry. Thank you very much, Mr. Chairman.

The Board has been concerned about the impact of archaic State usury laws for sometime and with today's high interest rates the problem has become acute. These State laws set maximum interest rates that are unrealistic in view of prevailing market rates and thus seriously restrict the availability of credit in those States.

Many States with unrealistic usury ceiling either set a higher rate for corporate borrowers or completely exempt them from the usury ceilings. In such States individual mortgage borrowers are finding funds unavailable because of usury ceilings in many more States than are corporate borrowers. At the present time new commitments for home mortgages are being made at interest rates of 9 to 10 percent. Yet many State usury laws establish a rate at 9 percent or lower.

It is an economic fact of life that lending institutions will invest their money at the highest yields available and, where possible, will withdraw from mortgage lending if necessary to obtain higher yields. Such mortgage lending as they engage in will be concentrated in those jurisdictions in which they can obtain a fair interest rate. They will avoid or limit mortgage lending in a jurisdiction whose laws prevent the making of loans at the prevailing rate especially when it is costing them more than the usury limit to obtain funds from savers.

The charging of points and other service charges is a way to achieve a market return where a usury law sets a below market ceiling and the statute does not prohibit such charges. When such charges are inflated because of a usury ceiling, the result is discrimination against lower income borrowers because this practice increases the "front end" out-of-pocket cost of purchasing a home.

Most of the arguments against restrictive usury ceilings have centered on the negative impact on new home construction. This is, of course, a serious matter because of the need for new housing resulting from household formation. However, there is also an adverse impact on those who wish to buy and sell existing homes. A homeowner who has to sell his house because of a change in job or the needs of a growing family is strongly penalized. A seller is often forced to take back a second mortgage in conjunction with an assumable mortgage or to finance the first mortgage himself, but not all sellers can do this, nor are these practices always sound.

In the present market a homeowner forced to move often finds himself an unwilling landlord who must hold on to his own house and rent it in the hope that mortgage interest rates will eventually come down to the usury ceiling.

Ironically, it is the lower income home-purchaser who is hurt more than the upper income purchaser. This is because lending institutions will often make mortgage loans at a restrictive usury ceiling if the downpayment is sufficiently high and the life of the loan sufficiently low so as to make the mortgage a prime investment that can justify a low yield. However, the lower income buyer can typically only purchase a home with a low downpayment and a long maturity.

Restrictive usury ceilings not only have a perverse effect on the people that they are supposed to help but are completely unrealistic in an economy characterized by a high rate of inflation in which long term interest rates reflect an inflationary premium. If the expectation is for an inflation rate of 7 percent per annum, the real rate of return to a lender only represents that part of the interest rate in excess of 7 percent. From the point of view of a home buyer, a high interest rate mortgage is better than no mortgage if houses are expected to appreciate in price significantly because of inflation.

Given this situation, the Board supports enactment of S. 3817. The bill would benefit certain builders and other corporate borrowers who do business with FSLIC-insured savings and loan asosciations. The Board recommends that the bill be amended to extend its provisions to unincorporated builders. Such an amendment would not substantialy broaden the scope of the bill since loans to builders are business loans. The Board further recommends that you consider the problems that usury rates post for individual home buyers and sellers, although this may be beyond the scope of the present hearings. The bill would be primarily of benefit to banks, which have many corporate clients. Most borrowers from savings and loans, of course, are individuals. With respect to individuals, national bank already enjoy a competitive advantage insofar as they can override State usury rates when the discount rate plus 1 percent would be a higher rate.

Legislation establishing an alternative Federal usury ceiling on long term mortgage loans could provide for a rate an appropriate number of percentage points above a long term benchmark interest rate, such as an average interest rate on long-term U.S. Government securities. For mortgages, this would be preferable to the standard used in S. 3817 since short-term rates fluctuate far more sharply than long-term rates.

We realize that this bill and our proposed broadening of it concerns a matter ordinarily considered within the purview of State law. However, present law gives national banks some advantage over State banks, and we believe that it is appropriate that the bill supply to State chartered FDIC-insured banks and State chartered FSLIC-insured savings and loan associations so that the competitive relationships between Federal and State chartered banks and savings and loans will be preserved on a basis of substantial equality. We regard the problem created by usury ceilings as a matter of urgency which should not await the determination of the various State legislatures.

We understand that the administration favors the approach of this bill, but time did not permit us to obtain the advice of the Office of Management and Budget regarding this statement.

Thank you very much, Mr. Chairman.

Senator Brock. Gentlemen, as you may or may not know, I have no particular pride of ownership in this legislation, but I act out of a sense of almost desperation because of the condition in my home State, where we simply don't have any money anymore with the existing market rate and the constitutional ceiling of 10 percent.

We're going to run into really sizable economic problems if we don't get some change in the situation we presently have.

I may have some disagreemnt with the Federal policy that has gotten us to this point, but the fact is that we have to act to achieve some sort of remedy for Tennessee, Arkansas, Montana, for those States that are largely affected.

Now, Mr. Perry, you testified that you would like to see this extended to noncorporate borrowers.

Mr. Perry. Yes, sir.

Senator Brock. I'm sympathetic to that and the first time we drew up the proposed legislation we had, I think, $100,000 minimum and then it was across the board.

Would you suggest if we go across the board to any type of borrower, some particular dollar ceiling or limit rather?

Mr. Perry. Well, Senator, I don't have any magic figure. I would suggest that as a reasonable compromise that this be permitted for all federally insured financial institutions. I think that you can make that distinction which would be very helpful to us.

Senator Brock. Of course, you get into the problem there with some States which may not be federally guaranteed.

Mr. Perry. Yes, that's correct.

Senator Brock. But I don't believe we can pass legislation that would discriminate against a State institution. I personally do not support that. But I do think we have a problem with consumer loans. I think we're going to run into a hornet's nest in terms of a very small loan. I think we've got to have some kind of criteria. We switched to the corporate criteria, to try to deal with the problem of employment, business development so as to keep our economy viable. If you want to get away from the corporate definition, then you have to have some other criteria. I'm sort of reaching for that and I'm not sure what you would suggest.

Mr. Bucher. When the original bill, which contained the $100,000 limitation, was before us, our Board discussed it at great length. Again, no figure is magic, but we wanted to reduce it somewhat so we picked $50,000 as a better limit. But again these are matters of judgment and not matters based on any statistics that are comforting.

Our problem with the corporate limitation is the fact that there are a lot of businesses that are, by the judgment of their owners, better run as partnerships or as sole proprietorships. These judgments involve a great many different reasons including business reasons. In a lot of ways it seemed inequitable to us to exclude these from the category when their borrowings are for purposes very comparable to corporations. They're businessmen with sophisticated advice by attorneys and financial advisors. To us they more logically fall into the category with corporations as opposed to the category with home-owners and consumers.

Senator BROCK. I agree with that.

Mr. BUCHER. We mentioned in our statement also, and this is based on limited evidence, that we have some indication in Missouri there has been a trend towards the corporate form influenced by a similar distinction, that is, usury ceilings not applying to corporations.

Senator BROCK. Mr. Smith, do you have any particular problems with the $50,000 ceiling? Would you prefer that to the present language of the bill or do you have any alternative discussion?

Mr. SMITH. No, Senator, we certainly have no substantive objection at all. As Mr. Perry properly pointed out, the precedent setting provisions in the law today make no distinction as to the purpose of the loan or as to the borrower. I think this is clearly within the province of those who are managing this legislation.

I would say that the critical factor is what is needed to get some legislation adopted. Just from looking at State law in States other than Tennessee, Montana, and Arkansas, that do have ceiling rates in the range of 11 or 12 percent applicable to corporate borrowers, I noticed that the break is usually in dollar terms and it tends to be, as I recall, someplace in the $10,000 to $15,000 category, so I would think that the $50,000 figure would be a realistic one.

Senator BROCK. You know, as I said at the outset, I really am reaching for an answer and I don't know whether that is adequate; maybe something else is adequate.

But I would like to ask each of you, is there any other remedy that may or may not require legislative action? Is there anything else that you can suggest that we might do in this kind of circumstance?

Mr. SMITH. We are unaware of any other alternative, Senator.

Senator BROCK. How about the discount one

Mr. BUCHER. We of course have problems with using the discount window device for this type of situation. Our longstanding policy, and I think this is a proper policy, has been to administer the discount window in a uniform manner throughout the country. We have specific purposes for which the window may be used and those are quite well-defined, and we do have concern about breaking those rules, in effect, in particular local situations.

Where there are liquidity problems, or where there are specific seasonal needs, then there may be appropriate reasons for the use of the discount device. Where it is a matter of cost of funds, a matter of diminution of margins or spreads in rates for a particular institution, the Board has thought long and hard and has come to the conclusion that we don't feel this is an appropriate type of problem to be solved by discount lending.

Senator BROCK. You don't have any other suggestion for resolving this particular problem.

Mr. BUCHER. Well, I think the concept that you put forth is a very well thought-out one. Our only arguments were with very minor specifics.

I do come from a State where a different device has been used. I haven't thought this out, so I wouldn't like to be held to this, but in California the device is one of looking to who the lenders are and applying the usury ceilings to the unregulated lenders, the lenders who are not subject to scrutiny by one or another regulatory authority. In that case the banks and the savings and loans, certain finance companies and credit unions, are exempted.

Senator BROCK. Of course, that is not a remedy that is available to us. You can't amend the Constitution in Tennessee more than 1 in 6 years at best, and actually I think we've done it once every 50 years.

Mr. BUCHER. Perhaps this could be done on the Federal level by a preemptive statute relating to Federal insurance. In any event, we feel your approach makes a great deal of sense and we support it.

Senator BROCK. One last question:

We have some concern from only one group; it is a valid concern on the part of the State banking supervisors. They are concerned this is fringing on State prerogative and are concerned this not become a permanent part of the law.

I would like to ask if any of you desire to comment on whether or not this bill should be treated as a temporary device; if it is, what time frame should be dealt with, so that we can hopefully get the States to act in their own protection.

Mr. SMITH. Well, speaking for the Comptroller's Office, I think we would prefer to see it adopted as a permanent provision of the law.

As I say, it builds on 40 years of precedent. However, if in the judgment of those who are managing the legislation, a temporary provision seems more realistic, we certainly would not object. I think that the term should be one that would offer a realistic opportunity in those States that have constitutional provisions for lending to undertake a Constitutional amendment.

Senator BROCK. We discussed as much as 5 years. I think the States have an opportunity for change.

Mr. SMITH. I think it would be a mistake to adopt it for any period shorter than that.

Mr. BUCHER. Certainly it is the Board's preference to have State action solve this problem; however we also appreciate the practical problems involved, particularly with regard to the Constitutional aspect. We favor it as a temporary measure understanding many of the reasons for that need.

I personally think a longer period than the 3 years that has been proposed would be more realistic. That is my personal view. I know the problems. I have been involved with the problems of not only changing legislation in the States, but particularly changing Constitutional provisions, and my guess would be that a 3-year period would be on the short side.

Mr. PERRY. I don't have anything to add except I would like to echo Mr. Smith's remarks about the preference as to its term. We would have no problem with a 5-year temporary provision.

Senator BROCK. Mr. Chairman, do you have any questions?

Senator SPARKMAN. I have a lot of questions in my mind, but I don't know if they throw any light on this particular legislation.

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Of course, I like to try to seek an answer to the question when are we going to get some relief on interest rates. When are they coming down.

Senator BROCK. Now, we're back to basics.

[Laughter.]

Senator SPARKMAN. Well, frankly, I am greatly disturbed with the high interest rates we're paying today. I have spoken to Dr. Burns several times and with some of our outstanding economists in and out of government. I don't know what can be done, how it can be done, but I certainly wish some remedy could be found whereby we could start these interest rates down again to a normal level.

Mr. BUCHER. Well, Chairman Sparkman, first I'll say as a way to hedge a bit, I'm one of the two noneconomists on the Board.

Senator SPARKMAN. I recall that from your confirmation hearings.

Mr. BUCHER. So, my views may not be entirely in accordance with generally accepted economic principles. But I share your view and the Board shares your view as far as the concern about high interest rate levels and the problems that they cause, not only with the financial community but with the public in general.

High interest rates are caused by many things other than monetary policy. Monetary policy may have an immediate effect on rates, but inflation is the main cause for the rise of interest rates. So the shortest answer I can give you is if we can solve the inflation problem, we can solve the interest rate problem. We hope that the inflation problem is going to be solved, that is certainly our objective.

Senator SPARKMAN. Let me see if I understand this.

Now, this is a general law. Is this not restricted to the three States?

Senator BROCK. No, it is general.

Senator SPARKMAN. It is a general law.

Do you think this might be a psychological push upward on interest rates? Do you think it might have that tendency?

Mr. BUCHER. It is conceivable that some people might interpret it that way.

Senator SPARKMAN. I feel that they might.

Mr. BUCHER. I can understand such a perspective that some people might have, yes. I think that has to be weighed, however, with the dislocations and the very difficult problems that are being faced in the three States mentioned, and I think that it is a matter of weighing the importance of solving or alleviating those problems, and at the same time the risks involved on the other side of the equation—that is, the fear that this will build into the minds of individuals and into the financial system an acceptance of a higher level of interest rates.

I don't think that it is a serious basis for concern, although it should not be ignored.

Senator SPARKMAN. I don't intend to be throwing stones at the legislation, but I did just want to state those views.

Senator BROCK. I think it is a fair question and I really would be concerned if I thought that this would generate any further pressure on the States when they're already in my opinion unconscionable. I really don't think we can continue to pay what we're paying in this country for money any longer and not have any major economic consequences. I'm very much concerned and the chairman expressed that very well.

My basic approach to this thing was to provide an opportunity for at least three States to compete with the other 47 in terms of acquisition of capital, in terms of plant expansion, capacity expansion, job creation. If we're going to have an inflationary impact the bill would be counter-productive. I have no intention of having that happen, and gentlemen, if you think this bill might come under the pressure, I would like to know it.

Mr. BUCHER. My opinion would be it would be very marginal. My own evaluation would be that the effect would not be significant and would not offset the benefits that I see.

Senator BROCK. Why would this bill cause any change in banking approach or monetary rates in a nonaffected State?

Mr. BUCHER. I don't think it would. I was responding to Chairman Sparkman's question as to how people might perceive it, as another indication of a willingness to live with higher rates over the longer term. I can see some people perceiving it that way, but that is a matter of guesswork, and as far as the effect on the basic economy, and as far as inflation in general, I think the impact would be minimal, if not de minimis.

Senator BROCK. You don't believe it would generate further pressure?

Mr. BUCHER. No, I do not.

Chairman Sparkman's question was phrased in the way of perception by some individuals and I can see that one or two people or a hundred people might perceive it that way.

Senator BROCK. Yes, but I think the chairman's point is extremely valid and I don't believe any of us have any intention of making an awful situation worse.

It is my understanding of your testimony that you believe that would not take place.

Mr. BUCHER. Absolutely not.

Senator BROCK. I think we'd better move along.

I appreciate very much your testimony. Without objection I'm going to put in the record at this point a statement from Mr. Frank Wille of the Federal Deposit Insurance Corporation.

[The statements of the previous witnesses and of Mr. Wille follow:]

STATEMENT OF JAMES E. SMITH, COMPTROLLER OF THE CURRENCY

It is a pleasure to appear today in support of S. 3817, a bill to amend the National Bank Act and certain other acts to permit federally insured financial institutions to charge 5 percent above the Federal Reserve discount rate on loans to corporate borrows.

As the regulator of national banks, our Office is well aware of the reasons for this bill. In a number of states, usury laws limiting the amount of interest that national banks may charge on loans apply to corporate loans as well as to personel, consumer loans. In Tennessee, Arkansas and Montana, for example, the maximum loan contract rate for corporations is 10 percent, a figure below the prime rate and the Federal Fund rate. The inevitable result of this condition is the lack of funds available for the normal and productive conduct of the banking business as it relates to the corporate sector. Let me give you some examples.

A national bank in Tennessee has had a restrictive policy on loans for the past four months. Its senior loan officer has told us that $22,000,000 of creditworthy loans had to be refused. Although the stringent money market conditions have been partially responsible, the rate limit factor has been present in every case. The bank estimates that around 50 percent of these loan applications would have been approved if the bank had the ability to price the loan terms competitively.

Examining the situation on a case-by-case basis, another national bank in Tennessee had to turn down an otherwise creditworthy loan of about $1 million to a new company in the furniture manufacturing field. The new operation would have added new jobs to the Tennessee economy, but has not not been able to commence operations because of the lending restrictions in Tennessee.

The same bank had another application for a $400,000 loan from a coal company for the purchase of coal mining equipment. Despite the offer of personal endorsements on the loan and good equipment collateral, this loan was turned down because of the credit restrictions in Tennessee. Certainly this loss to the energy resources of the country is a very undesirable consequence of the special problems national banks face in states which extend usury laws to corporate borrowers.

In addition to these instances, I have seen copies of letters from businessmen in the affected states which reflect their deep concern about the restriction of available funds. A food company executive says: "Our business is hurt by this restriction." A small businessman cites the possibility that his company might "run short in relation to current payables, payroll, capital expenditures and expansion." Yet another letter, this one from a shopping center development company executive, states: "Because of the 10 percent usury law, we are being slowed up and find it very difficult to continue to develop in our state. Most of the other areas we are operating in are not handicapped by this law." In the vital area of health products, officials of a company supplying drug prescription products states: "Our ability to meet these needs is being seriously impaired due to the critical shortage of corporate money in Tennessee.

Of course, these examples illustrate the more fundamental question of usury laws and their social utility. Usury laws have always been presented by their proponents as offering protection against unreasonably high or unfair rates of interest. As long as the legal rate ceiling is above the going market rate, it is obvious that the law has no effect. During these periods, the existence of usury statutes is widely ignored.

When the level of interest rates moves upward, and the going market rates for particular types of loans would, in the absence of restrictions, exceed the funds funnelled by lending institutions to those types of loans dwindles over time and eventually disappears. While banks certainly attempt to meet the needs of their long-time customers, they are not charitable institutions. Therefore, they cannot indefinitely channel funds to uses yielding rates of return well below rates available on alternative uses or at rates below the bank's marginal cost for funds. It is cold comfort to a prospective borrower to be aware that he is "protected" from "usurious" rates of interest when no funds are available to him at these legal rates.

While the most desirable solution to this problem would be remedial action at the state level, we must confront the reality that in some affected states there is scant chance of such action—at least in the near term. In a state such as Tennessee, where the rate limit is a constitutional provision, the elaborate machinery simply cannot be cranked up in time to solve the very immediate dilemma. That, of course, mandates federal attention to an economic problem which is regional in scope and national in effect.

There is adequate precedent for federal action in this area. In 1933, the National Bank Act (12 U.S.C. 85) was amended to permit national banks to charge 1 percent above the discount rate in 90 day commercial paper in effect at the local Federal Reserve Bank. Senator Glass, who introduced the amendment, perceived that when such a rate exceeded the State interest rate ceilings, national banks had to be the instrumentalities to permit businesses to borrow money—or face possible collapse.

Although the Federal Reserve discount rate no longer reflects market rates and the 5 percent above discount rate provision is a necessary amendment, I think this precedent has some value in itself. It has been suggested that the Congress select an index, such as the 90 day Treasury bill rate, that would be more responsive to market conditions. As the need is for immediate remedial action, the most effective procedure would be a modification of the existing law, referring to the discount rate, in the manner of the bill introduced by Senator Brock. In this connection, the 5 percent leeway will give a sufficient margin of return to reopen the channels of credit to many deserving corporate borrowers in States such as Arkansas, Montana and Tennessee.

I am pleased to note that S. 3817 extends the coverage of the proposed amendment to all Federally-insured banks and savings and loan associations. This is in line with a recommendation transmitted to Senator Brock by our Office.

National banks in these states need the additional authority granted in S. 3817 in order to serve adequately the financial needs of businesses, on which payrolls and economic development depend. Swift passage of the bill would be a service to the public in those states.

Thank you.

Statement of Jeffrey M. Bucher, Member, Board of Governors of the Federal Reserve System

Mr. Chairman and members of the Subcommittee, I am pleased to have the opportunity to present the view of the Board of Governors on proposals to authorize national banks, Federally-insured banks and savings and loans associations to charge their corporate borrowers interest rates that reflect current market conditions.

The Board has been concerned for some time with the impact which usury ceiling have on the availability of funds in local credit markets. It goes without saying that no one wants to pay higher rate of interest for borrowed money than is absolutely necessary. But at the time, it is very important to insure the availability of credit and the flow of funds in all financial markets on an equitable basis. When interest rates in specific markets are limited to artificially low levels, the continued availability of credit in these markets will be severely threatened. Under such circumstances, lenders are likely to impose much stricter non-price lending terms in order to compensate for the relatively low nominal rates which can be charged. And borrowers, finding it increasingly difficult to obtain financing in local markets, may be forced to seek funds from out of State sources.

There is no question but that the potential for disruption of credit flows in States with relatively low usury ceilings has increased greatly in recent months due to the general increase of interest rates in competitively-determined markets. Large commercial banks have been paying rates of 12 per cent or more on large certificates of deposits in recent weeks in order to obtain loanable funds. These rates exceed by as much as 2 percentage points the maximum rates that banks are allowed to charge on loans to businesses in several States—including Tennessee, Arkansas and Montana. Since July, moreover, the prime rate charged by large money market banks to their *best* corporate customers has been at 12 per cent—also above the usury ceiling on business loans in the aforementioned States. It is reasonable to assume that many of the lending institutions in these States are finding it unattractive to lend at the relatively low usury rate, and since they cannot afford to compete effectively for money market funds, these institutions will find it increasingly difficult to continue to accommodate local credit needs of these conditions persist.

Our information—although limited—does indicate a noticeable slowdown in business lending at some o the larger banks in Tennessee and Arkansas in the last two months. In late April, the national prime rate rose above the 10 per cent usury ceiling that prevails in these two States, and in May and June commercial and industrial loans at 12 of the large Tennessee and Arkansas banks (the only regional banks for which we have current data) declined by approximately 5½ per cent. This decline contrasts with experience in the comparable months of previous years, when loans at these banks generally increased; and it contrasts especially with the continued substantial expansion this past spring in business loans at other large banks around the country. It might also be noted that in the last few weeks Federal funds—which are overnight loans sold by one bank to another—have traded at rates above 12 per cent. Thus, there is some temptation for banks in States like Tennessee, Arkansas, and Montana to sell Federal funds or to direct their money into other more attractive investment, rather than to lend to local borrowers at the 10 per cent ceiling rate.

Because of distortions such as these that result from artificially low rate limitations, the board strongly encourages efforts to reduce the restraints imposed on local credit markets by usury ceilings. We would prefer that remedial action to correct these inequities be taken at the State level, and in this regard we believe that States should promptly reevaluate their usury laws in light of recent experience. We understand, however that in some States this is a constitutional problem which may require considerable time to resolve. In view of this, and given the urgency of the problems developing in some markets currently, the board supports the emergency measure proposed by S. 3817 as a means of providing some relief to these markets.

The Board has reservations about two specific items in the pending bill. First, we strongly urge that the maximum loan rate which institutions will be allowed to charge *not* be tied to the Federal Reserve discount rate. As you are aware, the discount rate is a policy rate, administered by the Federal Reserve for monetary policy purposes. It is not a market-determined rate, and at times may not move in parallel with market rates.

Instead the Board would advise that the loan rate be tied to a market-determined interest rate, one which more clearly responds to changes in credit market conditions. We suggest for this purpose the rate paid on 90–day Treasury bills, and specifically the average rate paid over the preceding month or quarter on such bills. The bill rate is published weekly and is a familiar rate to lending institutions. If the loan rate were tied to such a market rate, then adjustments would be made automatically to changing market conditions, whereas this might not necessarily be the case if the base rate used were the discount rate.

The second concern which the Board has with the proposed bill is that the legislation would apply only on loans to corporations and would exclude all noncorporate borrowers. For equity reasons the Board believes that the bill should be expanded to cover all loans for business purposes. Indeed, if lending institutions are allowed to charge higher rates on loans to corporations, we can foresee sharp diminution in the availability of credit for unincorporated businesses. Available funds will be channeled into higher yielding corporate loans, and credit which is already scarce for other borrowers could become virtually unavailable. And, as a side effect, we would probably see many partnerships and proprietorships incorporating in order to obtain financing. This has reportedly occurred in Missouri, a state with a relatively low usury ceiling from which only corporate borrowers are exempted.

With the inclusion of the above two modifications—i.e., tying the loan ceiling to a market rate and not the discount rate, and expanding the coverage to all business loans, not just corporate loans—the Board favors the proposed legislation as a productive and desirable emergency measure that should help to ease disproportionate credit constraints in certain local markets.

Statement of Grady Perry, Jr., Member, Federal Home Loan Bank Board

It is a pleasure to appear before you today to discuss S. 3817 which would amend the National Bank Act, the Federal Deposit Insurance Act, and the National Housing Act to authorize Federally insured financial institutions to charge interest on loans to corporate borrowers at rates reflecting present market conditions. It is our understanding that Arkansas, Montana, Tennessee, and certain other States which have corporate usury rates would be affected by this bill.

The Board has been concerned about the impact of archaic State usury laws for some time, and with today's high interest rates the problem has become acute. These State laws set maximum interest rates that are unrealistic in view of the prevailing market rates and thus seriously restrict the availability of credit in those States. As you know, the prime rate for preferred corporate customers is now at about 12%. This means that in States like Arkansas and Tennessee, where the corporate usury limit is 10%, corporations, large and small, find it difficult to borrow funds. Local banks are unwilling to borrow from out-of-state banks at 13 or 14% to re-lend to their local customers at 10%. For individual borrowers the situation is much more difficult.

Many States with unrealistic usury ceilings either set a higher rate for corporate borrowers or completely exempt them from the usury ceiling. In such States, only loans to individuals are subject to the ceilings. Thus, individual mortgage borrowers are finding funds unavailable because of usury ceilings in many more States than are corporate borrowers. At the present time new commitments for home mortgages are being made at interest rates in the 9 to 10 per cent range. Yet many State usury laws establish a maximum rate at 8% or lower.

It is an economic fact of life that lending institutions will invest their money at the highest yields available and, where possible, will withdraw from mortgage lending if necessary to obtain higher yields. Such mortgage lending as they engage in will be concentrated in those jurisdictions in which they can obtain a fair interest rate. They will avoid or limit mortgage lending in a jurisdiction whose laws prevent the making of loans at the prevailing rate especially when it is costing them more than the usury limit to obtain funds from savers.

The charging of points and other service charges is a way to achieve a market return where a usury law sets a below market ceiling and the statute does not prohibit such charges. When such charges are inflated because of a usury ceiling, the result is discrimination against lower income borrowers because this practice increases the "front end" out-of-pocket cost of purchasing a home.

Most of the arguments against restrictive usury ceiling have centered on the negative impact on new home construction. This is, of course, a serious matter because of the need for new housing resulting from household formation. However, there is also an adverse impact on those who wish to buy and sell existing homes. A homeowner who has to sell his house because of a change in job or the needs of a growing family is strongly penalized. A seller is often force to take back a second mortgage in conjunction with an assumable mortgage or to finance the first mortgage himself, but not all sellers can do this, nor are these practices always sound. In the present market a homeowner forced to move often finds himself an unwilling landlord who must hold on to his own house and rent it in the hope that mortgage interest rates will eventually come down to the usury ceiling.

Ironically, it is the lower income home-purchaser who is hurt more than the upper income purchaser. This is because lending institutions will often make mortgage loans at a restrictive usury ceiling if the down-payment is sufficiently high and the life of the loan sufficiently low so as to make the mortgage a prime investment that can justify a low yield. However, the lower income buyer can typically only purchase a home with a low downpayment and a long maturity.

Restrictive usury ceilings not only have a perverse affect on the people that they are supposed to help but are completely unrealistic in an economy characterized by a high rate of inflation in which long term interest rates reflect an inflationary premium. If the expectation is for an inflation rate of 7 percent per annum, the real rate of return to a lender only represents that part of the interest rate in excess of 7 percent. From the point of view of a home buyer, a high interest rate mortgage is better than no mortgage if houses are expected to appreciate in price significantly because of inflation.

Given this situation, the Board supports enactment of S. 3817. The bill would benefit certain builders and other corporate borowers who do business with FSLIC-insured savings and loan associations. The Board recommends that the bill be amended to extend its provisions to unincorporated builders. Such an amendment would not substantially broaden the scope of the bill since loans to builders are business loans. The Board further recommends that you consider the problems that usury rates pose for individual home buyers and sellers, although this may be beyond the scope of the present hearings. The bill would be primarily of benefit to banks, which have many corporate clients. Most borrowers from s-&-ls, of course, are individuals. With respect to individuals, national banks already enjoy a competitive advantage insofar as they can override State usury rates when the discount rate plus one percent would be a higher rate.

Legislation establishing an alternative Federal usury ceiling on long term mortgage loans could provide for a rate an appropriate number of percentage points above a long term benchmark interest rate, such as an average interest rate on long-term U.S. Government securities. For mortgages, this would be preferable to the standard used in S. 3817 since short-term rates fluctuate far more sharply than long-term rates.

We realize that this bill and our proposed broadening of it concerns a matter ordinarily considered within the purview of State law. However, present law gives national banks some advantage over state banks, and we believe that it is appropriate that the bill apply to State chartered FDIC-insured banks and State chartered FSLIC-insured savings and loan associations so that the competitive relationships between Federal and State chartered banks and savings and loans will be preserved on a basis of substantial equality. We regard the problem created by usury ceilings as a matter of urgency which should not await the determination of the various State legislatures.

We understand that the Administration favors the approach of this bill, but time did not permit us to obtain the advice of the Office of Management and Budget regarding this statement.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, D.C., July 29, 1974.

Hon. WILLIAM E. BROCK,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BROCK: Enclosed herewith is the statement which I have filed with the Subcommittee on Financial Institutions on behalf of the Federal Deposit Insurance Corporation in respect of S. 3817, a bill which you introduced on July 24, 1974.

FDIC fully supports S. 3817 as an effective but temporary means of providing relief from certain State usury ceilings that currently inhibit the flow of credit to corporate borrowers because much higher yields are presently available in the market on alternative investments to lending institutions affected by such ceilings. The Corporation prefers S. 3817 to your earlier draft proposal which also extended similar Federal provisions to loans of $100,000 or more to noncorporate borrowers. You might, however, wish to consider, as my statement mentions, tying the alternative Federal ceiling to a market-determined rate such as some appropriate average of prime commercial paper rates or Treasury bill rates. The Federal Reserve discount rate, as you know, is an administered rate. Changes in that rate depend on a number of factors and frequently lag behind rate movements in the capital and money markets.

Sincerely,

FRANK WILLE,
Chairman.

STATEMENT OF FRANK WILLE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

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

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

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

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

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

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

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

Senator Brock. Mr. Sinclair, I appreciate your coming and ask you to proceed at your own pace. If you can sum it up I'll appreciate it.

STATEMENT OF HUGH F. SINCLAIR, COMMISSIONER OF BANKS, STATE OF TENNESSEE

Mr. Sinclair. Thank you, sir. It is a pleasure to be here, Mr. Chairman.

I am Hugh Sinclair. I am Commissioner of Banks of the State of Tennessee. This is my testimony statement. Some background information is necessary to an understanding of the proposed amendments to the National Banking Act and Federal Deposit Insurance Act.

These amendments would allow national and insured State banks, respectively, to charge interest of up to 5 percent in excess of the prevailing discount rate on corporate loans, any State usury law to the contrary notwithstanding.

For over a century, Tennessee has had a Constitutional 10 percent limit on interest. This restriction applies to both corporate and individual borrowers and to both commercial and noncommercial loans.

Prior to the current inflationary upsurge, this usury ceiling had little apparent effect either on the soundness of financial institutions in Tennessee or on economic development there. However, under present conditions, Tennessee's usury law actually mandates a negative true rate of interest, when the inflationary depreciation in the value of the dollar over the term of a loan is taken into account.

The effects of the squeeze between the law and inflation are twofold: On the one hand, loans are becoming increasingly unavailable; on the other, the liquidity of Tennessee banks is adversely affected.

On the first point, the unavailability of loans, banks in Tennessee are now turning away borrowers in droves. To the extent that corporations cannot obtain funds for expansion, Tennessee's economic development will be crippled. The ultimate result will be increased unemployment in Tennessee, which will have a depressing effect in other States as well, particularly border States.

Furthermore, small borrowers are also affected adversely. The larger corporate borrowers may be able to obtain loans from out-of-state banks. However, in so doing, they may well have to maintain compensating balances with such banks. Since these deposits will in most cases be taken from Tennessee banks, a reduction in loanable funds for small as well as large borrowers will result.

As I mentioned earlier, the current squeeze also represents a potential threat to the liquidity of Tennessee banks. This threat stems both from an abnormal curtailment of banks' profits and from an outflow of deposits. To the extent that this, in combination with other factors, adversely affects the financial soundness of Tennessee banks, a remedial amendment to the Federal Deposit Insurance Act is most appropriate, both to protect the banks themselves and to reduce the threat of claims against the Federal Deposit Insurance Corporation's insurance fund by curtailing the possibility of bank failures.

Normally, it is the responsibility of the particular State concerned to remedy a problem occasioned by its own laws. However, the problem in this instance consists of Tennessee's usury law combined with inflation. While the former might normally be solely a State responsibility, inflation is a national problem, and curbing it is a national responsibility.

In addition, as a practical matter it is impossible for Tennessee to lift its usury ceiling in the near future. Since it is fixed in the State Constitution, an act of the legislature would probably be ineffective. At best, the Constitution could not be amended prior to the latter part of 1977, even assuming that such an amendment was unopposed. Passage of the proposed amendments to the National Banking Act and Federal Deposit Insurance Act offer by far the best chance of relief, and would serve the best interests of both Tennessee and the Nation.

In conclusion, in my 50 years of banking, I have not experienced such a disturbing condition in financial institutions as it exists today, particularly in Tennessee, with the possible exception of the Depression of the late twenties and early thirties, of course.

As Commissioner of Banks for the State of Tennessee, I urge you to continue to work for the immediate passage of this amendment in the Senate and just as soon as possible in the House.

I thank you.

Senator BROCK. Thank you, very much. You're short and to the point and I appreciate it very much.

Mr. SINCLAIR. Thank you.

Senator BROCK. I was particularly interested in your comment that at best we could effect some remedy in the State of Tennessee by 1977.

Mr. Sinclair, if we don't do something about this problem before then, nobody is going to be asking for any money.

Mr. SINCLAIR. I agree. We can't wait 3 years, 4 or 5, no.

Senator BROCK. I do believe this is beyond legislative remedy. I don't see any particular legislation that can be passed other than a Constitutional amendment. In order to do an honest job, we might be able to run around the barn with that with you; I'm not sure that would stand up.

You know, back in the good old days, Mr. Chairman, when I was in the candy business, we used to have to borrow an awful lot of money in the spring and summer to build our inventories for fall shipment. And if you're going to sell any, you've got to borrow a ton to fill those inventories. It isn't a matter of spending money on frill to put in a corporate jet. It is a matter of survival.

I assume the companies still have the same borrowing needs. I know an awful lot of companies in Tennessee do. It isn't a question of trying to do something to allow, even in some instances of allowing them to have enough working capital to stay in business at all, and they can't get those funds because they're simply not available. You cannot have a bank paying 12, 13, 14 percent and loaning it back at 10. That is a very short road.

Is it not true that our larger corporations already have gone out of State with their funds? They don't have any choice. As a matter of fact, I would wager that some of them are down in Birmingham borrowing in competition with your money.

Senator SPARKMAN. Don't you think some are up in Nashville?

Senator BROCK. They can't get any money. A Tennessee bank cannot loan even to an out-of-State corporation in excess of 10 percent; that's correct, isn't it?

Mr. SINCLAIR. That's right.

Senator BROCK. I would ask really just one question, Mr. Sinclair, and that is on the testimony we had previously both the Federal Reserve and the Home Loan Bank Board suggested we apply this to any borrower, incorporated or unincorporated, given the fact that an awful lot of builders for example are partnerships or unincorporated firms.

First, would you agree with that, and secondly, I believe you have some understanding—as I mentioned I had $100,000 minimum in an early bill. One of the previous witnesses suggested a $50,000 minimum. I'd like your comments on these two.

Mr. SINCLAIR. Well, we don't have the magic figure either. But I recall that your original bill did state a hundred thousand to an individual. I would agree with that if it could be incorporated into the bill, but, if not, we would like the bill anyway.

Senator BROCK. Mr. Chairman, do you have anything?

Senator SPARKMAN. Not at this time, thank you.

Mr. SINCLAIR. I would like to say one more word.

I believe, Senator, and you mentioned, that the crunch in Tennessee, particularly will come this fall when the crops begin to come in and the demands for business come in. And it will permeate down to the smallest banks because the small banks usually go to the medium banks and the medium-sized banks go to the largest banks. And that is where the buck stops. We just don't have the money.

Senator BROCK. Not only for crop harvesting but you go right around the circle on the horns in the spring when you've got to plant. The same problems will exist then that exist now.

Mr. SINCLAIR. That is true.

Senator BROCK. There is one area we would like to ask you to comment on.

I think, well, I'm not sure which one of our previous witnesses suggested that this problem was not only a problem for the consumer, the business or individual who wants to borrow money and simply cannot get it at any price, but it also is a problem for the banks as institutions, in terms of liquidity and perhaps maybe even solvency.

I wonder if you would comment on the effect the current situation is having on Tennessee banks as lending institutions and their ability to survive in this kind of climate?

Mr. SINCLAIR. Well, the larger banks have already stopped lending so to speak. They're not making any new loans. They're calling many of the loans they have outstanding.

The medium-sized banks are beginning to do that.

It is my hope that the smallest banks will also cut down to that extent as much as possible. There are some banks who are probably overloaned at this time. We are making every effort to insist that they cut down their loans.

Senator BROCK. In some words, Mr. Commissioner, you—I don't want to put words in your mouth, so I will ask you to specify: Are there institutions which may be jeopardized if some action isn't taken if the present market rates prevail for any extended period of time, or are they capable of just cutting back on their loans, which may be an enormous hazard for their customers?

I don't want to throw square words. I'm being very careful with my terminology.

Mr. SINCLAIR. Yes, sir. If they will cut back. I'm particularly speaking of the smaller banks now.

Senator BROCK. If they will cut back, they're going to be all right.

Mr. SINCLAIR. Right.

Senator BROCK. But that, of course, is their ultimate responsibility and ours.

Mr. SINCLAIR. All we can do is instruct the Board of Directors to instruct their officers to carry out the orders. If they don't do it, that is too bad.

Senator BROCK. If they do cut back, it is quite possible that the lack of funds may jeopardize the existence of some business ability.

Mr. SINCLAIR. Yes, sir.

Senator BROCK. You would be more concerned about them in terms of their ability to stay in business than you would the banks themselves, which can survive?

Mr. SINCLAIR. That is true. It would cause unemployment.

Senator BROCK. Thank you very much.

Mr. SINCLAIR. It is a pleasure to be with you.

Senator BROCK. Mr. Chairman, I would ask consent to include at this point in the record a letter from the Governor of the State of Tennessee.

Senator SPARKMAN. Without objection.

Senator BROCK. And a letter to the chairman of the subcommittee, Senator McIntyre from Lawrence E. Kreider of the Conference of State Bank Supervisors.

[The documents follow:]

STATE OF TENNESSEE, *July 29, 1974.*

Hon. WILLIAM E. BROCK, III,
U.S. Senator,
Old Senate Office Building,
Washington, D.C.

DEAR BILL: It has come to my attention that you are planning to introduce a bill designed to affect the level of interest which banks can charge to large corporate borrowers. I am writing to advise you of my views on interest levels as they currently apply to Tennessee.

As you are aware, the Federal Reserve Board, in attempting to halt our inflationary spiral, has been stringently exercising its control over interest rates through its use of discount policies. As interest rates rise across the nation, money flows are restricted, loan funds become scarce and expansion is reduced. I agree with these policies on a national scale, as I realize that this inflationary period must be limited.

But when the Board applies its pressure on rate structures, it does so with the expectation that activity will be restricted uniformly. I feel that each state should bear an equal burden of reduced economic activity; yet in the present circumstances those states with constitutional usury ceilings such as Tennessee are forced to share an inequitably high portion of the results. In Tennessee, borrowers cannot pay above ten percent rate for money. So long as discount rates force prime and secondary lending rates well above this limit, activity will be stymied. Large corporate borrowers will be compelled to close loans out of state, resulting in an outflow of capital as well as compromised business relations with Tennessee lenders. Small businessmen, unable to borrow in other states, will continue to forgo expansions and in some cases will face serious financial constraints on their current operations.

As a Governor, I believe that our problems should be solved at the state level. However, in this instance, remedial action on our part involves a constitutional revision process which is too lengthly to overcome this problem which has recently arisen. Any attempt to amend our constitution in Tennessee cannot be culminated for several years. I therefore support your effort to amend the National Bank and Federal Deposit Insurance acts as a three-year interim measure. This legislation will solve our problem temporarily, as we attempt to find more permanent answers within our boundaries.

With respect to the specifics of the bill, I recommend further insurance that residential mortgage and consumer loan rate ceilings will not be affected by its provisions. I suggest that your proposal be modified to set a minimum eligible loan size or corporate as well as noncorporate borrowers, thus preventing forced incorporation in order to attain borrower status.

With this modification, I strongly favor the proposed temporary legislation as an interim means of alleviating the pressing restrictions within our state's financial markets. I would appreciate your bringing these thoughts to the attention of the committee during its hearings.

Sincerely,

WINFIELD DUNN,
Governor.

OFFICE OF THE ATTORNEY GENERAL,
Nashville, Tenn., August 5, 1974.

Commissioner HUGH F. SINCLAIR,
Department of Banking,
Capitol Hill Building,
Nashville, Tenn.

DEAR COMMISSIONER SINCLAIR: In reply to your request of this office for an opinion as to the earliest possible time the state constitution can be amended by the convention route, Article 11, Section 3 of the Tennessee Constitution provides that the Legislation must submit first to the people at any *general* election the question of calling a convention. If, at such general election, the voters favor the call of the convention, the delegates must be chosen at the next general election. After the delegates to the convention have acted, if they vote favorably on a change such, then, is submitted back to the people for ratification or rejection "at an election to be held in such manner and on such date as may be fixed by the convention."

The last sentence of such constitutional section prohibits a convention from being held more often than once in six years. Therefore, since the last convention was held in August of 1971, no convention could be held prior to August of 1977. It would depend then on how long the convention lasted as to when the ratification of the convention's action could be effected—the time of such ratification vote to be set by the convention itself following its adjournment. The earliest such convention could be held would appear, therefore, to be the Fall of 1977.

Paragraph one of the above article and section of the Constitution, which would permit an amendment without holding a convention by appropriate legislative action and ratification of the people, would require an even longer period of time since it is geared to the next gubernatorial election.

Very truly yours,

ROBERT H. ROBERTS,
Advocate General.

CONFERENCE OF STATE BANK SUPERVISORS,
Washington, D.C., July 31, 1974.

Hon. THOMAS J. MCINTYRE,
U.S. Senate,
Old Senate Office Building,
Washington, D.C.

DEAR SENATOR MCINTYRE: The Conference of State Bank Supervisors desires to express its pleasure at having the opportunity to present its views on S. 3817 which was introduced on July 24, 1974 by Senator William E. Brock.

As the primary regulatory authority for the country's approximately 9,800 state-chartered commercial and mutual savings banks our state banking commissioners are vitally interested in the objectives and implications of S. 3817.

The bill, in part, would amend the National Bank Act (12 U.S.C. 85) to permit national banks in connection with corporate loans to charge at a rate of up to 5% in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank in the district where the national bank is located. The Federal Deposit Insurance Act would also be amended in order to permit federally insured nonmember banks to charge interest on corporate loans up to 5% in excess of the discount rate on ninety-day commercial paper, notwithstanding any provision in a State's constitution or statutes to the contrary. A similar amendment is made to Title IV of the National Housing Act. To give expression to Senator Brock's intent that S. 3817 be considered as emergency legislation, the bill provides that the amendments cited above would apply to loans made after enactment of the bill "but prior to July 1, 1977." This termination date of July 1, 1977, is intended to give those states desiring to do so, the opportunity to express the will of their residents with respect to whether or not they desire, in view of the current experience reflecting money market pressures, to alter their existing usury ceilings.

It is the understanding of the Conference that the bill under consideration by the Subcommittee was designed to assist residents principally in the states of Tennessee, Arkansas and Montana, where constitutional or statutory provisions in effect have established maximum interest rates of 10% on corporate loans; that because these ceilings are substantially below today's market rates, Senator Brock felt this situation could ultimately cause unemployment and severe economic repercussions in those geographic areas.

Information secured from the Federal Reserve Banks of Minneapolis and St. Louis would indicate that the 10% usury law provisions in the states of Tennessee, Arkansas and Montana have resulted in contractions of commercial and industrial loans by commercial banks in varying degrees in those states in the period from late April, 1974, to late June, 1974. Late April to June 1974 was selected as a base because that was about the time Fed funds and large denomination C.D. rates exceeded 10% and began to make it more difficult for banks with 10% interest ceiling limitations to justify additional borrowings to support lending at a 10% maximum rate. Weekly reporting member banks in West Tennessee had a 9.5% decline in commercial and industrial loans (C & I loans) during the April to June 1974 period compared with a 1.0% decline for the same period in 1973 when money market conditions were more normal. In Arkansas weekly reporting member banks experienced a 7.4% decline during the 1974 two-month period compared with a 3.1% rise a year earlier. Montana's reporting member banks experienced a 0.2% loan decline during the April to June 1974 period compared with a 2.3% rise in these C & I loans during the same 1973 period.

By way of contrast, weekly reporting member banks nationally were able to maintain about the same rate of growth in C & I loans in the April to June period of 1974 (2.8%) as in 1973.

While commercial banks in both Tennessee and Arkansas show rather significant declines in commercial and industrial loans during the period April to June, 1974, compared to the same period a year earlier, the extent of actual borrowings by corporations in those states is not known. Nor is the Conference in possession of information at this time to indicate the extent to which corporate facilities in those states with parent firms headquartered out-of-state can secure financing through their parent organizations.

As indicated below, it appears as though the usury law loan constraint problem is significant at the present time in Tennessee, a little less severe in Arkansas, and even less so in Montana. The problem in Tennessee may be more acute because of the greater concentration of industry than in Arkansas and Montana.

Percentage changes in commercial and industrial loans, weekly reporting member banks, selected areas, last Wednesday of April to last Wednesday of June, selected years

Area and year	*Percent change April to June*
Tennessee:	
1973	−1.0
1974	−9.5
Arkansas:	
1973	3.1
1974	−7.4
Tennessee + Arkansas:	
1973	−.6
1974	−9.3
Montana:	
1973	2.3
1974	−.2
United States:	
1973	2.7
1974	2.8

The Conference of State Bank Supervisors is sensitive to the fact that artificial constraints connected with usury limitations can distort credit flows when rates determined by competition in the marketplace exceed unrealistic usury ceilings. However, state authorities in most instances have taken, or have pursued appropriate corrective measures to achieve greater flexibility in the interest rate structure of their respective states as one means of facilitating efforts of lending institutions to meet credit needs in their communities. For example, some 32 states today have no usury limitations on corporate contract loans,[1] and nearly all other states have modified usury ceilings to ease the pressures of present money market conditions. Only three states, Arkansas, Montana and Tennessee have a 10% usury limitation on corporate loans, with North Carolina having a 10% limitation on such loans in the $50,000 to $100,000 range.

I believe the foregoing illustrates the fact that state and local officials are capable of dealing with problems of this type which are reflective primarily of the fiscal and monetary policy excesses of this country that have extended over the past decade, and have resulted in today's virulent inflation and concomitant high interest rates that adversely affect savers, borrowers and lenders alike in all sections of our country and in virtually every walk of life.

Because almost without exception the States have acted responsibly and in the public interest in this area, the Conference of State Bank Supervisors must express its fundamental opposition to efforts being made through S. 3817 to provide a federal solution to what essentially is a problem affecting only two or three states, and in an area that is properly within the prerogative of the states to determine. The Conference believes, therefore, that remedial action in this area should originate at the state level in the absence of compelling factors that would raise this issue to the level of a national problem.

In addition to abrogating state law without justification, the Conference believes that S. 3817 may be viewed as being premature. It is the understanding of CSBS that Tennessee's usury ceiling of 10% which is a constitutional provision, cannot be changed in the regular order of things prior to a constitutional convention in 1977; that it might be mid 1978 before state legislative action could finalize a constitutional amendment raising the usury limitation. However, it is also the understanding of CSBS that a special session of the state legislature could be called for the purpose of securing statutory relief in this area at an earlier date; such statutory action being subject to review by the Tennessee Supreme Court. The Conference believes that such avenues should be fully explored in Tennessee before Congressional action is pursued in this matter.

With respect to Arkansas which is mentioned as one of those states requiring relief from their present constitutionally-determined usury ceiling, it is the understanding of CSBS that this matter may be resolved at the upcoming November general elections in that state. At that time the residents of Arkansas will have the opportunity to vote on the questions of placing interest rate controls in the hands of the Arkansas legislative body, instead of having it remain as a section of their State Constitution. Having interest-setting authority transferred to the Arkansas legislature, it is believed, will facilitate efforts to adjust these rates from time to time to meet changing economic conditions.

In the case of Montana, which is mentioned as having a 10% usury ceiling, it is interesting to note that the Montana state legislature in early 1974, according to information received from state banking officials in that state, considered several bills, and amendments to these bills dealing with questions of whether to amend the present 10% usury limits on loans, and whether to exempt corporations from usury limitations. The Montana state legislature took no action during the 1974 session on amending its present usury provisions. It is not know whether these matters will be considered in Montana's next legislative session.

In addition to the foregoing, S. 3817 raises the question of whether under its provisions a usury ceiling would be imposed on corporate loans in some 32 states where no usury limitations now exist for such loans. And, inasmuch as the discount rate is currently 8%, it would appear that S. 3817 could also abrogate state laws in several states with current usury limitations of 12% on corporate loans.

It is noted that Senator William Brock at the time of introducing S. 3817 characterized it as an emergency measure to avoid unemployment and severe

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[1] American Banker Association publication "State Banking and Financial Data"—A Comparison of State Usury Laws as of 12/31/73 shows following states with no usury ceiling for corporate contract loans: Alaska, California, Colorado, Delaware, Georgia (no limit over $2500.), Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland (no limit over $5000.), Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, South Dakota, Utah, Virginia, Washington, West Virginia, Wisconsin, Wyoming, District of Columbia.

economic repercussion likely to occur as a result of the inability of firms to borrow funds because of current interest restrictions in some states. Therefore, while the Conference opposes S. 3817 in principle, as being an unwarranted usurpation of state law in this area, if the Subcommittee finds this legislation to be warranted, the Conference would urge that the emergency and temporary nature of any legislation enacted in this matter be clearly spelled out in any such bill. This could be accomplished in part by a cutoff provision such as now set forth in Section 5 of S. 3817, limiting the effectiveness of the proposed amendments to no later than June 30, 1977.

In addition, the Conference considers it essential that legislative language accompanying any bill enacted as the result of the introduction of S. 3817, spell out in unmistakeable terms that the legislation is designed solely to serve an emergency situation; that it is intended to give those states desirous of acting in this area sufficient time in which to do so, and that it is not intended to set a pattern or precedent of extending federal regulaiton into areas such as interest rates, which historically have been, and should be retained, as the rightful prerogative of the states to determine.

Sincerely,

LAWRENCE E. KREIDER,
Executive Vice President-Economist.

Senator BROCK. Mr. McLellan, First National Bank of Great Falls, Mont. I've been up there, hunted up in that territory; had a real good time, didn't shoot a thing.

STATEMENT OF ADRIAN O. McLELLAN, PRESIDENT, FIRST NATIONAL BANK, GREAT FALLS, MONT.

Mr. MCLELLAN. I'd like to have you back.

Senator BROCK. It is the prettiest country in the world. Almost as pretty as east Tennessee.

Mr. MCLELLAN. Mr. Chairman, my name is Adrian O. McLellan. I am president of the First National Bank of Great Falls, Mont., and also the Montana Bankers Association Governmental Relations Committee Chairman on National Affairs. I am appearing today on behalf of this organization comprised of all 150 banks in Montana.

At the Montana Bankers Association's annual membership meeting on June 24, 1974, a resolution to support legislation authorizing banks to charge up to 5 percent over the Federal reserve discount rate on certain loans was adopted. This proposed legislation was subsequently introduced by Senators Brock, Baker, Fullbright and Mansfield as S. 3817. We are grateful for Senator Mansfield's interest in the problems of the citizens of Montana, as well as the Nation, as evidenced by his taking a direct and active role in the cosponsorship of this bill.

Montana loan statutes provide that parties may agree in writing for the payment of any rate of interest, not exceeding the rate of 10 percent per annum, and such interest shall be allowed, according to the terms of the agreement, until the entry of judgment. Only three States, Montana, Tennessee, and Arkansas, have 10 percent ceilings on loans to corporations. All other States have a greater limit, including 31 States which have no ceiling at all on loans to corporations.

The 10 percent ceiling on loans to corporations was of no great concern to the financial institutions of Montana until recent months, when the interest rates nationally surged upward, and the prime

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rate continued to climb until it reached its present 12 percent. Money, like any other commodity, gravitates to the highest bidder in a free market. Money normally on deposit in Montana and available for local borrowers is flowing to banks and other financial institutions in those States that can charge corporations higher rates of interest, and in turn pay the highest rate of interest to depositors.

Montana does not have large banks. The largest bank has deposits of approximately $140 million. Banks that have felt the greatest pressure from the lack of lendable funds in the past few months are those banks in the $50 million to $140 million in deposits category. These banks have the greaest loan demand, both from their direct customers and for overline loans to smaller banks in Montana. To satisfy this loan demand to a reasonable extent, several of these banks have had to borrow Federal funds at rates as high as 14 percent recently. Since there is no ceiling on interest rates paid on certificates of deposit in excess of $100,000, many of these banks are paying as high as 11¼ percent on certificates of deposit to cover their loan demand.

In spite of these high rates being paid on certificates of deposit, funds are still leaving the State in sizable amounts and going into certificates of deposit in other States where greater rates can be paid. For example, our bank has lost almost $6 million in certificates of deposit in the past few months to out-of-State banks.

Banks in other Montana cities have experienced the same out-flow of deposits. For example, one of the banks in another Montana city reported a loss of $18 million in certificates of deposit of $100,000 or more in the past months to out-of-State banks.

Deposits normally available to Montana banks and other financial institutions from State and local governments is also flowing out of State. Montana's State Board of Investments placed only about 25 percent of their investable total funds in Montana investments during the 1972–73 fiscal year, and the percentage has decreased in the past fiscal year. Almost 100 percent of the repurchase agreements issued have been placed in out-of-State banks by the State Board of Investments, and these agreements cover from $50 to $100 million in funds. Again the appeal of higher yields pulls this money out of State as Montana banks simply cannot bid as high, being limited to a 10 percent usury ceiling on corporation loans.

During this same period of time, when our bank and others were losing deposits, total loans went up. A compilation of bank call figures for Great Falls illustrates this very well. A year ago—in the June 30, 1973 call figures, as published—the total deposits of the seven banks in Great Falls went up $5 million from the previous call period on March 28, 1973. The loans also went up $5 million, so the increase in deposits and the increase in loans were about identical in that period of 1973.

This year, however, clearly reflects an increase in loan demand as well as an outflow of deposits. On the June 30, 1974 call the total deposits, compared to the deposit figures of April 24, 1974, were down $9,400,000, while the total loans in Great Falls banks were up about $7,700,000—a spread of over $17 million in that brief period.

As previously mentioned, most of this dramatic change took place in larger banks. During this heavy loan demand period, when deposits were going out and the demand for loans was going up, the banks were forced to go into a heavy borrowing position and increased their bills payable and Federal funds purchased. On June 30, 1974, these borrowings and Federal funds purchased amounted to almost $26 million, compared to approximately $10 million the year before, or an increase in borrowed funds of almost $16 million.

A small part of these borrowings were at the Federal Reserve window, but the bulk of these funds came from Federal funds purchased. During this period, the Federal funds rates were far in excess of the rate at which a Montana bank could lend out the money under the 10 percent ceiling. For example, during the month of June 1974, the rates paid by our bank for these Federal funds averaged 11.8 percent, yet the highest rate we could charge on relending these funds was 10 percent. Needless to say, this cannot be continued.

Some Montana banks were willing to pay more for funds than they were able to get back under our loan rate ceiling on the theory that this high interest rate nationally was a temporary situation and the banks are obligated to keep their customers and their employees in business.

Now, however, the banks find themselves in a liquidity squeeze combined with deteriorating earnings. These banks are now forced to decline loans they would normally consider making, in order to maintain or restore a reasonable liquidity position, and due to the fact they cannot sell participations to other banks and institutions outside the State. The 10 percent ceiling on Montana loans makes these loans unattractive to the banks and other institutions in other States where there is no such ceiling.

Reports are now coming in that banks are having to decline loan requests for companies wishing to start new projects or expand existing projects. One bank reports that it had to decline a loan of $100,000 to a company to set up a seed cleaning plant because the bank would have to go into the Federal funds to get the money to cover the loan, which could not be made at more than 10 percent.

On the date of the request the Federal funds rate was about 12⅞ percent. The result was not only the loss of employment to build the plant, but also the loss of employees to operate the plant.

It is reported that a proposed 36 apartment complex in Kalispell, Mont., had to be shelved because the building corporation was unable to find interim financing at Montana rates.

Another bank reported that it was interested in financing a large seed and grain operation in north central Montana which necessitated a large overline loan from a large west coast bank. However, the west coast bank withdrew from negotiations for the project when it learned that Montana had a 10 percent interest ceiling.

Another bank reported that a motel construction project was dropped because the company could not find financing due to the rate structure in Montana.

The legislation under consideration here, which would provide a temporary period that would permit Montana banks to charge corporations the same rate of interest they would have to pay in 47 other States, will not solve all of the lending problems caused by the 10-

percent rate ceiling in Montana because many borrowers are not corporations.

However, if banks were permitted to charge corporations a higher rate, tied to the discount rate, then the banks, in turn, could go out and compete for higher rate certificates of deposit to cover these loans to corporation, and thus develop more deposits and relieve the pressure to cut down or hold down on loans of all types. It would appear that those banks that are now sustaining their present loan level with some funds acquired at rates in excess of the Montana lending rate will have to decline to renew some of their lines of credit or existing loans.

In summary, we would urge that this committee recommend passage of S. 3817 as a measure to give temporary relief to a serious financial situation in Montana, which will no doubt get worse if this legislation fails to pass.

I review this as a temporary relief measure. I think the authors have done a commendable job in the writing of this bill and I would urge its adoption in its present form without further amendment. Thank you very much.

Senator BROCK. You make an interesting point that I think we ought to develop a little bit in the statement there over the last page when we talk about if we allowed higher rates to corporations on large loans, that would allow the bank to go out and get more money, pay more money.

Mr. MCLELLAN. That is right.

Senator BROCK. To receive these through whatever device, Federal funds if necessary. Which in turn would relieve pressure on the regular deposits which could be made for consumer or smaller loans.

Mr. MCLELLAN. That is right.

Senator BROCK. Now it is a fact that a bank like any other business is going to take care of its essential customers first.

Mr. MCLELLAN. That is right.

Senator BROCK. And if those by and large are major corporations in the community, there just simply is no money at all at a price for small borrowers.

Mr. MCLELLAN. That is right.

Senator BROCK. By passage of this legislation, we not only would give corporate borrowers access to funds in Montana, Tennessee and Arkansas, but we would also have a greater availability of funds, residual funds for the smaller borrower, is that not a fair statement?

Mr. MCLELLAN. Very fair.

Senator BROCK. So across the board we would increase the availability of credit in these affected States?

Mr. MCLELLAN. That is correct.

Senator BROCK. You suggest the passage of the bill without amendment. I would simply ask you this, would you be concerned if we shifted the emphasis from corporations to a minimum loan figure? I do see the point of those who argue that the corporations by definition would be discriminatory to unincorporated or partnership corporations.

Mr. MCLELLAN. I see it also but I think it opens up a whole area where it is hard to find the correct figure, the correct vehicle. I think from our standpoint we look on this as a temporary means whereby we have to change our State law. I think if it is passed as proposed it will help solve the problem, but if it is opened up it will be difficult to solve.

Senator BROCK. Thank you very much. I appreciate it. We next have a distinguished panel from our neighboring State of Arkansas. Gentlemen, before you begin, I would like to note a letter from your Senator, Senator Fulbright, to the chairman of the subcommittee, in which he expressed his very sincere regret to not being able to be here. He has a previous commitment so he couldn't be here even though he wanted to be here to introduce you to the committee.

And I think you will appreciate that he did express his interest in your testimony and his support of the legislation. May I ask you—without objection, to insert this letter into the record.

[The letter from Senator Fulbright follows:]

U.S. SENATE,
Washington, D.C., July 31, 1974.

THOMAS J. MCINTYRE, *Chairman,*
Subcommittee on Financial Institutions,
Committee on Banking, Housing and Urban Affairs,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: While a long-standing commitment to be elsewhere keeps me from personally introducing the distinguished Arkansans who will testify before you today, I do want you to know that I endorse their appearance in connection with S. 3817, legislation which I have cosponsored designed to enable the banking industry in the States of Arkansas, Montana, and Tennessee to make loans to corporate customers at rates of interest comparable to those charged in other States to corporate borrowers.

Edward M. Penick, Chairman and Chief Executive Officer, Worthen Bank and Trust Company; H. L. Hembree, Chairman and CEO Arkansas Best Corporation; Robert Wickard, President, Wickard and Company; Ed Cherry, President, Bank of Northeast Arkansas, and Professor John Dominick of the University of Arkansas, are all able and highly respected leaders in our State and are particularly well-informed in the areas of business and finance. I believe that their knowledge of Arkansas's own experience with interest rates will be most helpful to the Committee, and I am sure that the testimony of these gentlemen will significantly contribute to your record on S. 3817.

Sincerely yours,

J. W. FULBRIGHT.

Senator BROCK. Because of our time problems, I would ask you to summarize, as best and as directly as you can, your statements in order to give the other witnesses time to present their cases as well. So who wants to start?

STATEMENTS OF EDWARD M. PENICK, CHAIRMAN OF THE BOARD, WORTHEN BANK & TRUST CO., LITTLE ROCK, ARK.; ROBERT H. WICKARD, PRESIDENT, WICKARD & CO., LITTLE ROCK, ARK.; EDWARD H. CHERRY, PRESIDENT, BANK OF NORTH EAST ARKANSAS; JOHN DOMINICK, PROFESSOR OF BANKING, UNIVERSITY OF ARKANSAS; AND H. L. HEMBREE, CHAIRMAN, ARKANSAS BEST CORP., FORT SMITH, ARK.

Mr. PENICK. Mr. Chairman, I am Edward Penick. I am chairman and chief executive officer of the Worthen Bank & Trust Co., a national bank in Little Rock. I would like to submit my previously prepared testimony for the record.

Senator BROCK. It will be put into the record (see p. 44).

Mr. PENICK. First I would like to submit an opinion from the attorney general of the State of Arkansas which is strongly in support of the constitutionality of this as it applies to the Arkansas law. There has been some question raised by our State bank commissioner as to its applicability to State banks and this opinion as of July 22d strongly supports that and I would like to enter that in the record.

Senator BROCK. We will have it put in the record at this point.

[The opinion of the attorney general, State of Arkansas follows:]

STATE OF ARKANSAS,
OFFICE OF THE ATTORNEY GENERAL,
Little Rock, Ark., July 22, 1974.

Re Opinion No. 74–94
H. C. ADAMS, *Commissioner,*
State Bank Department,
200 University Tower Building,
Little Rock, Ark.

DEAR MR. ADAMS: This is in response to your letter requesting an opinion as to the constitutionality of a bill proposed by Senator Brock of Tennessee to amend 12 U.S.C. 1830. The proposed bill would, among other things, allow State chartered banks insured by the Federal Deposit Insurance Corporation to charge interest in excess of the ten percent (10%) Arkansas Constitutional limit.

The questions presented by you raise three issues:

1. Whether Congress by law may preempt a state constitutional provision?

2. Whether the activities of a state chartered Federal Deposit Insurance Corporation insured bank are so local in character as to exclude them from the control of Congress under Article I, §8 of the United States Constitution?

3. Whether the specific provisions of the proposed legislation submitted to our office wou'd be valid and constitutional with regard to state chartered F.D.I.C. insured banks?

The answer to the first issue is c'ear. That the U.S. Congress has the power to preempt the Arkansas Constitution is not open to question. Article VI of the United States Constitution provides, *inter alia:*

"This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land; and the Judges in every state shall be bound thereby, any thing in the Constitution or Laws of any state to the contrary notwithstanding."

As to the second issue, that banking, whether by state chartered or national banks, is involved in interstate commerce does not seem to be open to question. In *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 1 L.Ed. 915 (1963) the United States Supreme Court held that banks were subject to federal anitrust laws. In so holding the Court stated:

"Commercial banks are unique among financial institutions in that they alone are permitted by laws to accept demand deposits. This distinctive power gives commercial banking a key role in the national economy. For banks do not merely deal in, but are actually a source of money and credit; when a bank makes a loan by crediting the borrower's demand deposit account, it augments the Nation's credit supply. Furthermore, the power to accept demand deposits makes banks the intermediaries in most financial transactions (since transfers of substantial moneys are almost always by check rather than by cash and, concomitant'y, the repositories of very substantial individual and corporate funds. The banks' use of these funds is conditioned by the fact that their working capital consists very largely of demand deposits, which makes liquidity the guiding principle of bank lending and investing policies; thus it is that banks are the chief source of the country's short-term business credit."

In a footnote to the above case, the Court stated:

"No argument is made in this case that banking is not commerce . . . such an argument would have no merit."

Once the Congress determines that an activity is in interstate commerce its power to regulate is extremely broad. In *National Labor Relations Board* v.

Jones and Laughlin Steel, Inc., 301 U.S. 1, 81 L.Ed. 873 (1937), the United States Supreme Court stated:

"Although activities may be intrastate in character when separately considered, if they have such a close and substantial relation to interstate commerce that their control is essential or appropriate to protect that commerce from burdens and obstructions, Congress cannot be denied the power to exercise that control. The fundamental principle is that the power to regulate commerce is the power to enact all appropriate legislation for its protection and advancement and to adopt measures to promote its growth and insure its safety."

Section 5 of the Federal Deposit Insurance Act provides, *inter alia:*

"Subject to the provisions of this Act . . . any state non-member bank, upon application to and examination by the Corporation and approval by the Board of Directors may become an insured bank . . ."

This language is a Congressional grant to state non-member banks to become an insured bank under the Federal Deposit Insurance Act. Several cases have arisen discussing the effect of such association by state banks. The case of *Weir* v. *United States*, 92 F. 2d 634 (7th Cir. 1937) (cert. denied 268 U.S. 704, 69 L.Ed. 1167, 45 S. Ct. 638) involved a criminal prosecution under the penal provisions of the FDIC Act relating to the embezzlement of funds of an insured state bank. In affirming the conviction, the Court upheld the constitutionality of the FDIC Act by stating:

". . . the creation of the corporation (FDIC) was within the constitutional power of the government . . ."

In upholding the constitutionality of the F.D.I.C. Act, the Court indicated its basis for such action by saying:

"Its obvious intent was, by insuring deposits to prevent runs on banks by depositors, to preserve solvency of insured banks, and thus to keep open the channels of trade and commercial exchange."

This language is a strong indication that this court is sanctioning the regulation of banking, at the Federal level, due to its important, if not vital, influence on interstate commerce. The Court further said:

"Embezzlement . . . It tends to destroy the solvency of the bank, to cause closing thereof and, thus, to block the open channels of commercial exchange essential to the efficient operation of the government's fiscal and financial undertakings."

This latter quoted language indicates that, in addition to the Commerce Clause, Congressional regulation of banking is based upon the Constitutional provisions relative to the monetary system. This portion of the opinion also indicates that an interrelationship exists between "commercial exchange" and the operation of the "government's fiscal undertakings". The Court draws an inference that the fiscal operations of the government are dependent upon the channels of commercial exchange. Commercial exchange in this context would certainly include interstate commerce and, thus, resulting regulation pursuant to the Commerce Clause. This language recognizes that a further purpose of the F.D.I.C. was to promote the soundness of banking.

The law of the State of Indiana, in which state this case arose, allowed state banks to associate themselves and to participate in organizations formed pursuant to Federal legislation, where the purposes of such organization were not inconsistent with any law of the state.

With reference to this State Act, and F.D.I.C. insurance; the Court held:

"To the extent of its participation in the federal legislation, each bank became an instrumentality of the federal government, enjoying its remedial legislation and bound by its legal limitations and responsibilities."

Language similar to the last quoted phrase is found in *United States* v. *Doherty*, 18 F. Supp. 793 (D.C.D.N. 1937), affirmed at 94 F. 2d 495 (8th Cir. 1938) (cert. denied 303 U.S. 658, 58 S. Ct. 763, 82 L. Ed. 1118), interpreting a Nebraska statute.

For other cases dealing with state chartered banks which are members of the Federal Deposit Insurance Corporation, see *Westfall* v. *United States*, 274 U.S. 256, 71 L.Ed. 1036, 47 S. Ct. 629 (1926) and *Hiatt* v. *United States*, 4 F. 2d 374 (7th Cir. 1925) (cert. denied 268 U.S. 704, 69 L. Ed. 1167, 455 S. Ct. 638).

Given the broad power to regulate commerce as set out above, it appears that the United States Congress has the authority to establish interest rates which

F.D.I.C. insured state chartered banks may collect. This power would also include the authority to establish penalties for collecting usurious interest.

As to the third issues raised by your question, I must inform you that the Attorney General is charged with the duty and responsibility of defending and upholding the Constitution and the laws of the State of Arkansas. It is my understanding that the draft of the proposed legislation which you enclosed with your request has already undergone substantial amendment. Therefore, I must decline to speculate on the specific draft of the document you enclosed until I can examine the final or at least current proposed wording.

Very truly yours,

JIM GUY TUCKER.

Mr. PENICK. We are a panel of two lenders and two borrowers and a college professor who is our moderator. We have one of the largest lenders on a large corporate borrower and a small lender and smaller financer. The constitution of Arkansas provides not only 10 percent simple interest maximum but 1 point which is extreme is the penalty for usury is voidance of the entire contract.

The borrower does not have to pay principal or interest. He can also keep whatever collateral he may have. This discourages any financial institution from taking any risk as far as usury is concerned. Worthen Bank & Trust bank is the largest financial institution in Arkansas but ranks only 276th in size of financial institutions throughout the United States. Arkansas banks are comprised of 85 percent of banks under $25 million in deposits.

We in Arkansas have been trying to do something about changing the usury law for many years. We have tried three times in recent years. The third attempt is now underway to amend our constitution. In 1953 we tried to amend it. We tried in 1970 in a constitutional convention to amend it. We now have a referendum election that will be voted on in November. There is a difference of opinion on whether or not it will pass. The point I would like to make is we are not asking for congressional help without practically having exhausted every effort we could to find relief.

There is a case now pending entitled *First National Bank of Mena, Ark.* v. *Nowlin* which would authorize national banks to discount notes over a long period of time allowing them to earn more than 10 percent. This is on appeal to the Eighth Circuit Court of Appeals in St. Louis.

The other point is that this matter falls most heavily on the larger lending institutions. We are not able to keep the large deposits. Yet we are called upon to finance the larger borrowers of the State. We are not able to do so so the larger financial institutions feel this most severely.

The bank which I represent has been on a funds allocation basis since February of 1973. Just this week at the request of the comptroller's office we sent him a documented list of declined loans naming borrowers, type of loan, type of collateral, showing $64 million of loans that we would have made if we had had funds available.

The larger banks of the States are heavily involved in the Federal funds markets. We have also sought to utilize the Federal Reserve debt authority. Worthen Bank has three times tried to get relief from Federal Reserve. Last fall when we had the largest crop we ever had, we made an application to the Federal Reserve for agricultural credit in the amount of $20 million. We were declined. They said it was too much. We reduced it to $12 million. They said it was contrary to monetary policy. We did not get the money. We were only able to finance the crops because they moved through the harvesting process very rapidly. The crops were good and they sold them. In May of this year we again made an application to the Federal Reserve because we had been told that they were reconsidering their attitudes towards making available the discount window to banks in our situations.

We were again declined on the basis that we could not justify those loans.

Business and industry in Arkansas is hurting very badly as you will hear from the gentlemen on this panel. We appreciate your efforts, Senator, in this matter and we think Arkansas is particularly being damaged by not being able to compete in the national money markets for funds to help a growing and developing State that must import all of its capital. At this time I would like to ask Mr. Robert Wickard to give his testimony.

Mr. Wickard. Mr. Chairman, Wickard & Co., Inc. is a general construction company with business both in residential and commercial construction. I also do considerable development on a personal basis. We do approximately $2 million a year in volume.

Our long record of service in the construction industry has permitted us excellent banking relations in the past. We enjoy solid credit with several of the larger banks in the central Arkansas area.

To cite the oppressive effect of the 10 percent usury law on our business, I only have to point to two undeniable facts.

One, as of July 1, 1974, we have only $360,000 worth of construction volume on our schedule. As of this same time 1 year ago, July 1, 1973, we had over $2.1 million.

Two, our work force has had to be cut by a third. Twenty-five people have been laid off due to lack of business. Normally, at this time of year we would be taking on extra summertime help for the peak period of our business.

Let me cite you several example of the kind of construction declines that have caused a serious impact on housing and commercial development for us.

Maumelle New Town is a HUD-sponsored new city in Arkansas. We were originally scheduled to construct eight homes in this area at approximately $40,000 each and 64 zero lot line homes at about $28,000. We were turned down by three banks and two savings and loans. One savings and loan has finally agreed to commit to two of the eight houses with the understanding that it will not exceed $80,000. No money is to be disbursed in July and only limited finance will be available in August. The balance will be spread out over at least 6 months.

The Foxcroft Townhouse project, a series of medium-priced single-family dwellings, estimated at $600,000 in construction costs, has had to be abandoned because of lack of funds.

A 50-unit apartment housing complex of low-income efficiencies and single-bedroom dwellings was to be built on a site of a church in downtown Little Rock. This project, estimated to cost approximately $160,000, has had to be shelved. We still own the land at the cost of $150,000 and have cleared the site, but cannot move.

Countryplace, a townhouse project of 43 medium-priced units, has been shelved recently. Its cost: $2 million.

We also own the property for this project at a cost of $210,000. We are now paying interest on all of this land, but are unable to develop it.

We currently have an option on University Avenue to build a garden type office complex estimated to cost $1.5 million. We are unable to proceed on this project and will lose the option.

We have purchased a 30,000 square feet educational building of a church which was to be converted to office space for a government agency. Since we are unable to secure the $200,000 estimated for remodeling, this project has been temporarily abandoned.

Office and warehouse plans at an estimated cost of $50,000 have been shelved due to no money.

These trends paint a bleak picture for our business. If it continues, and we quite frankly see little relief in sight, housing in the central Arkansas area will suffer a substantial setback.

Growth of commercial office space will face serious cutbacks. Payrolls and the construction-related industries will no doubt suffer similar downturns.

I am presently preparing to go out of State to obtain additional funds. By establishing a Texas corporation in Dallas we hope to borrow funds and channel them into Arkansas.

I have already funded one warehouse project this way. I think this testifies to the fact that I, and others in our business, are willing to pay the money necessary if we can be assured of adequate credit.

I personally am very pessimistic about any early changes in our usury law. I fear that without some immediate relief from a bill such as the one you are proposing the situation can easily worsen and become even more protracted.

Mr. CHERRY. Mr. Chairman, I am Ed Cherry, president of one of the smaller State banks in Arkansas. More specifically located in the Mississippi Delta Craighead County, Jonesboro, Ark.

Our bank, the Bank of Northeast Arkansas, because of location, is devoted to the agricultural lending function as well as commercial and consumer functions of credit.

We are fortunate in that we are surrounded by land which is suited to the production of cotton, rice, soybeans, wheat, milo and last, but not least, cattle.

Our town is located on the top of Crowley's Ridge and has considerable number of rolling hills devoted to the cattle industry.

We also are pleased to have several industrial plants, namely General Electric, F.M.C. Corporation, Walker Manufacturing Company—a division of Tenneco—Crane Company, Colson Corporation, Wolverine World Wide, Inc., A.D.T., Stor-All Manufacturing Company, and Southern Marketing Affiliates, to name just a few.

These things are all being accomplished with a population of less than 30,000.

These remarks are made only to alert you to the fact that our area even though small is, of necessity, large in credit to many varied corporate businesses as well as large agricultural operations.

One of our largest problems begins in the approval of lines of credit to our crop production people in the early spring of each year.

We approve their needs at a predetermined interest rate of the crop year.

Credit demands and rates are reviewed on an annual basis. If an increase is necessary in a line of credit, then the rate is adjusted to the competitive rate at that particular moment.

From March of this year our rate has remained static while our costs have risen dramatically. If money had remained in our area, if Arkansas was not a capital poor State, if our demands had not been so great, we would have no problem. Quite the contrary is the case today.

Our supply of money has dried to the point of being a mere trickle. We are faced with having to go to the Federal funds market for reserves which in the past two weeks has fluctuated from 12⅜ percent to as high as 14½ percent.

Arkansas has many advantages, the least of which is the 10 percent maximum rate on loans to one and all. If you can tell me how I can loan money at 10 percent if I have paid 12 percent, much less 14 percent, I will return to Crowley's Ridge and stay there forever believing there really is a Santa Claus.

I deeply regret not having had the opportunity of convening the Arkansas State Bank Commission prior to coming here. As chairman of this Commission I would have liked to report the consensus of opinion of our combined body.

Mr. Adams, our Commissioner, was out of the State as well as myself, so it was not possible.

Because of the ability of banks in States to loan at higher rates, we became concerned about how many of our deposits were leaving our bank to out-of-state competition.

This came about by our customer's ability to negotiate higher rate for $100,000 and over certificate of deposits.

When this increase first began, our assets totaled approximately $14 million. In a period of 90 to 120 days we had documented a loss of 700,000 to competition.

This, then, is our plight. If Arkansas bankers' hands are tied, then all should be treated likewise. If there are advantages in New York, then we should have at least an equal fighting chance.

None of us here from Arkansas can predict with any degree of certainty the outcome of our attempt to remove the 10 percent usury law from our antiquated constitution. This will not be known until our November general election.

In my area it is apparent to me that consumer education on this question will be most difficult and is one reason I feel that the successful removal of this law has less than a 50–50 chance.

If my opinions are correct, it becomes imperative for something to be done, particularly before another agricultural crop is started.

I am not at all certain how all bankers feel about this bill. However, I wish to quote one statement of Edwin Jones, President of First Union Group of St. Louis.

So long as bankers are divided, legislators are reluctant to work for passage of any kind of banking legislation. When bankers unite and speak with one voice, legislators are willing to weigh proposed legislation on its own merit.

Gentlemen, this has merit.

Thank you.

Mr. PENICK. Dr. John Dominick will now speak.

Mr. DOMINICK. Mr. Chairman, my name is John Dominick; I hold the chair of banking at the University of Arkansas.

I appreciate having the opportunity to discuss with you the impact of Arkansas' 10 percent usury ceiling on the Arkansas economy.

The 10-percent simple interest limitation was placed in the Arkansas Constitution in 1874. Its purpose was to assure fair and equitable treatment for borrowers.

With the high interest rates of today, the law has become discriminatory—and those whom the law was designed to protect are now hurt the worst.

The 10-percent ceiling is an arbitrary restraint on interstate commerce and it is a threat to the economic viability of the Arkansas economy.

(1) To be more specific, the 10-percent ceiling has led to an outflow of funds from the State, thereby reducing the availability of loanable funds to consumers, homeowners and businesses.

The money market is probably the most fluid market in the Nation. During times of high interest rates, Arkansas banks cannot compete in this market for funds on a competitive basis. We cannot sell large CD's at 12 percent and then lend the funds at 10 percent and remain profitable. We can't buy Federal funds at rates of 12–16 percent and expand loans at 10 percent.

Arkansas is a capital-poor State. To sustain our rate of growth we have to rely on out-of-State sources of funds. Two of these sources come from out-of-State loans and the sale of loan participations to out-of-State banks.

With a 10-percent ceiling, why would out-of-State banks want to lend in Arkansas? And why would out-of-State banks want to buy participations in Arkansas? They don't—in fact, the situation is just the reverse. Out-of-State banks are selling loan participations to in-State banks at rates of 12 percent and better. Clearly, this reduces the supply of loanable funds to Arkansas residents.

At the end of 1973 I surveyed large Arkansas-based firms to determine the ability of Arkansas banks to service their credit needs. In total, the 47 respondent firms obtained $156.2 million or 80 percent of their bank loans out of State. As a result of borrowing out of State, these firms had to keep most of their deposit balances out of State. In total, this amounted to $50 million or 75 percent of their deposits. This has the effect of reducing the credit base of Arkansas.

(2) When credit is "tight" and rates are high, high risk loans and costly loans are squeezed. This means that consumer loans, mobile home loans, home construction loans, risk capital loans, and loans to marginal borrowers are curtailed.

A survey of Arkansas banks with deposits in excess of $25 million was conducted in June 1974. 92 percent of the respondent banks reported that they had adjusted their loan policies within the past 90 days due to higher rates. This took the form of requiring more security, fewer loans, shorter maturities, higher rejection rates, and higher compensating balances.

(3) The 10-percent ceiling has a devastating impact on risk capital and risk takers. There can be no adjustment in the risk element of lending with a State interest ceiling of 10 percent when the national prime rate is 12 percent. This restricts risk taking and, hence, the formation of new businesses in Arkansas.

(4) Surveys of furniture dealers, automobile dealers, appliance dealers, and mobile home dealers reveal that it is becoming more difficult for them to sell their customer credit contracts to financial institutions.

The survival of many dealers depends upon their ability to sell indirect paper—our 10-percent ceiling has led to higher rejection rates, unusually high dealer reserves, high acquisition costs and, in some instances, to selling the paper at a discount plus a 10–percent rate.

Dealers have been forced to raise the prices of their goods in order to maintain profit margins. Price surveys conducted by Dr. Gene Lynch at the University reveal that prices of consumer durables are considerably higher in Arkansas than in surrounding States. (One survey was conducted in 1968 and another has just been completed.) In effect, this means that cash buyers are subsidizing the credit customer.

One mobile home dealer reported that his customer credit rejections are usually 30 percent, but with tight money they have jumped to 70 percent.

Another mobile home dealer reported that he made a profit of $22,500 in 1973, but that his dealer reserve increased $35,000. He said, "I have a negative cash flow of $13,000, but I'm making a profit of $22,500." He says, "Can you understand my financing problems?"

Clearly we do. It's easy to understand why this dealer is having a problem financing his business.

Fourteen months ago we had 268 mobile home dealers in Arkansas; 2 weeks ago we had 142; and 1 week ago we had 133. It's projected that at this time next year we'll have 50 or 60.

It's difficult to finance mobile homes in Arkansas at a rate of 10 percent when the FHA financing rate on mobile homes is in excess of 11 percent.

(5) Lower cash prices of consumer durables in neighboring States encourage Arkansas residents to shop out of State, especially if they live near border cities. Part of this is due to the fact that dealers in these areas tend to move to another State in order to offer competitive prices.

A prominent example is Texarkana, Ark.-Tex. A number of merchants on the Texas side moved from Arkansas in recent years, giving as their reason the Arkansas 10-percent ceiling.

The following table provides an illustration of this point:

Year	Automobile dealers		Furniture and appliance dealers	
	Arkansas	Texas	Arkansas	Texas
1955	13	25	11	20
1973	4	43	6	32

(6) Loans and deposits of the Arkansas banking system are still rising. Many of our smaller banks have not experienced severe financial disintermediation. Most people don't have the amount of funds required to invest in money market instruments. Consequently, funds become "trapped" in convenience money, that is, savings deposits and consumer CD's. The new variable rate notes are designed to attract this type of money.

Unless our 10-percent ceiling is changed, we can't compete with these instruments—and it is likely that in the future we will experience severe disintermediation in Arkansas. This would cripple our economy.

A Federal solution is about the only way to accomplish swift change. The usury problem is a complicated issue which the public doesn't fully understand.

Educating the public on this issue would be very lengthy and expensive—and before this could be done, it might be too late. We need federal regulation now. We aren't asking for special privileges. We are asking for the right to compete for funds in a free market economy.

This is the American way.

Thank you, sir.

Senator BROCK. Thank you.

Mr. PENICK. Mr. Hembree?

Mr. HEMBREE. Mr. Chairman Brock, my name is H. L. Hembree. I am chairman of Arkansas Best Corp., Fort Smith, Ark. Also I am president of the Arkansas State Chamber of Commerce.

I strongly support the State effort to repeal Arkansas' restrictive 10-percent usury law and support passage of the Brock bill as a measure designed to provide temporary relief to the hard pressed economy and financial institutions of Arkansas. Arkansas—more than any other State that I know—needs a stronger banking industry to support its growth, and clearly immediate relief from our 10-percent interest ceiling is in the best interest of this industry and the entire state.

My company—Arkansas Best Corp—is a diversified holding company which was formed in 1966 through the merging into the holding company of several existing companies with the principal company being Arkansas-Best Freight System, Inc. ABF is a class 1 motor common carrier operating in 19 States from New York and the Carolinas on the east to Texas and Kansas on the west and Wisconsin, Illinois, and Pennsylvania on the north to Louisiana and Georgia in the south. It ranks about 18th in total revenues in the United States; and, more importantly, 14th in its operating efficiency.

Another major subsidiary—Riverside Furniture Corp.—manufactures multiple lines of quality household furniture of medium price for chain store merchandisers and independent family stores across America. Riverside's manufacturing facilities consist of six plants totaling nearly 1 million square feet all located in Fort Smith. Other wholly owned subsidiaries operate in tire retreading, real estate holding, and data processing.

Our company is publicly held and listed on the New York Stock Exchange. We have some 5,000 shareholders residing in almost every State of the Union. ABC's total revenues exceeded $118 million in 1973.

My company's current lines of credit exceed $33 million and have grown about 15 percent annually. It is only reasonable to anticipate that our own growth will require increased use of credits in the future. We do business either directly or through our subsidiaries with approximately 50 banks. Generally speaking, our corporate financing is handled in five States, and predominately with New York financial institutions.

From my personal and our corporate experience, it is my belief that many of our Arkansas-based institutions and growing companies have found their prospects diminished by inadequate credit available in the State. In the past and presently, Arkansas companies, which have been nurtured and helped by the Arkansas banking industry in their formative years, have had to look beyond our own Arkansas banks as their businesses grew and expanded. This phenomena has occurred—with all due credit to the very good job that Arkansas banks do—because Arkansas has no really large financial institution capable of providing the credit lines and the wide array of sophisticated financial services that a corporation like ours and hundreds of others operating here in Arkansas required. More importantly, the State cannot develop such institutions while saddled with an archaic and restrictive 10 percent simple interest ceiling on all forms of credit.

To illustrate one aspect of this problem, I can think of at least a dozen major expansions that have occurred in Fort Smith alone within the last 5 years, each of which have had to have major non-Arkansas credit. It was with great disappointment that I was forced to admit in each of these cases that we had no banks in the State that possessed the resources to serve these companies.

Presently my company is utilizing several services which are provided by out-of-State financial institutions which could be more appropriately handled here in Arkansas. Such services include financial engineering, mathematical models, corporate financial planning, pension fund management, investment advisory services, and real estate or long-term financing for various corporate activities. Where banks exist that are large enough to provide these services, they are usually found to be extremely profitable to the bank and in turn support further economic development in a State. But such banks cannot develop under an interest ceiling that it totally out of step with today's economy.

In a social context, I feel that we are in danger of losing our greatest natural resources in Arkansas—that being our trained young people. Our schools, colleges, and universities are producing students with capabilities of progressive leadership, if only we provide them an environment and opportunity. But these young people will leave our State if they cannot find a parity of economic opportunities between Arkansas and her sister States.

Gentlemen, Arkansas seems to be forever presented with "do or die" types of situations. We have now through the Brock bill and our own State efforts an opportunity to start catching up with the rest of the country. I do not suggest that the Arkansas banking industry will melt away if we do not achieve some measure of interest rate parity. I do suggest that our Arkansas economy is in real danger of withering away as other competing State economies are able to adjust to changing economic conditions while ours it not. Given the current and projected state of our Nation's economy over the next few years, the recommendations you make to the full committee on this bill may very well indeed be one of the last opportunities we have to modernize our Arkansas interest rate structure without first suffering a grave economic setback. I am hopeful of the success of our State's initiated efforts; but, if we should fail in our first attempt this fall, your bill may well mean the difference between economic survival and economic chaos for Arkansas.

Thank you.

Senator BROCK. Thank you, very much.

Gentlemen, I have an awful lot of questions, but we're so short on time. In order to get the testimony of the next panel of witnesses, I'm going to forego most of them.

I would like to ask one question which is particularly bothersome to me and I'll ask it of the nonbusinessman in the group; Professor, if you will:

Are you concerned about the liquidity of Arkansas' financial institutions without some remedy to this situation if interest rates continue as they are?

Professor DOMINICK. Yes, sir; I am. Because in a bank or financial institution we have two types of liquidity. One type we call a protective liquidity and this is your ability to meet deposits withdrawals. The other type is lending liquidity and we don't have much of that.

Senator BROCK. You don't have any right now.

Professor DOMINICK. No, sir. What we want is the right to compete for these funds so we can get our fair share.

Senator BROCK. I have had some comment by some people that you really wonder why the Congress should be bothered since it is really just a problem that affects Tennessee, Arkansas, and Montana.

My response was there is no such thing as a problem that is localized to Tennessee, Arkansas, and Montana. If our institutions are damaged or jeopardized that will have a very, very quick and measurable impact on institutions in other States, would you not agree with that?

Professor DOMINICK. Yes, and we're still a member of the Union.

[Complete statements of the previous witnesses follow:]

WORTHEN BANK & TRUST CO.,
Little Rock, Ark.

GENTLEMEN: My name is Edward M. Penick, I am Chairman and Chief Executive Officer of the Worthern Bank & Trust Company, N.A., of Little Rock, Arkansas; a $400 million commercial bank.

I appreciate the opportunity to present you with information regarding the impact of the Arkansas 10% usury restrictions on Arkansas' economy and our financial institution. We witness daily the exodus of capital from our State and experience the frustrating inability to attract the additional capital to our capital poor economy.

The usury restriction has been with Arkansas since Arkansas' Constitution was passed in 1874. We are the only State in the Union that still has its usury restriction in its Constitution. While other states have similar usury limits, they are generally riddles with exemptions. Our restriction is for 10% simple interest across the board with no exceptions. The penalty for usury in Arkansas is forfeiture of the principal and interest or voidance of the entire contract.

The effect of this law on the Arkansas economy when interest rates reach their present levels is a complete slow-down in the financing of larger business and industry in Arkansas. I am submitting to you statistical facts and information in support of the need for some immediate relief from the effects of this usury restriction. If Arkansas banks and other financial institutions are to be given the opportunity to participate in the money markets of the country, we must obtain some flexibility in our current situation. Only with additional flexibility will the Arkansas citizen be afforded the benefits of the competitive market place.

In addition to the points made in the prepared statement I will present, I want to make the following comments.

1. Arkansas is a capital poor state and has been a capital poor state from its beginnings. It must import capital to support its economy. Without the ability to attract capital, we cannot continue to grow for we do not have any large financial institutions in our state. The bank of which I am the Chief Executive Officer is the largest financial institution in the state. Its total assets are approximately $400 million. It is the 276th largest financial institution in the United States. All our borders are flanked by billion dollar plus financial institutions. Faced with this situation, our larger business and industries, those that create large numbers of jobs, have to go outside the state to seek their financing.

Compounding our capital poor problems is a differential in the 10% simple interest rate and the actual market rate existing in the economy today. We are, first unable to attract capital to Arkansas on a 10% basis, and second, the owners of capital residing within the State of Arkansas are exporting their money to seek the higher rates of return in money centers and in our adjoining states. If we can only earn 10% on our assets, we cannot hope to compete with the rates on the larger negotiable certificates of deposit when they reach 11 and 12% levels we see today. As a result the fiight against inflation in which we are all involved, is causing a disproportionately heavy burden on Arkansas and similar states who are deprived of free market competition for funds.

2. Today a number of efforts have been made and are being made to change the Arkansas usury law, or to change its effect or the interpretation by the Arkansas courts. Arkansas businessmen realize that they must pay a market rate for funds and are willing to pay this rate, but due to the severity of the penalty for usury in Arkansas, they cannot interest financial institutions in lending them funds that are in any way threatened with usury.

In an effort to clarify the legal effect of the Arkansas usury law, there is a case now pending before the Eighth Circuit Court of Appeals which case will test the legality of a national bank in Arkansas being authorized to charge rates in excess of 10%. The title of this case is *First National Bank of Mena vs. Nowlin*, and it is hoped that an affirmative decision in this case will give some relief to the national banks in the state. This, of course, would not be helpful to the general lenders of funds. It would apply only to national banks. Secondly, we are strongly supporting an effort to change our 100 year old constitutionally usury provision. There will be on the November ballot a proposed constitutional amendment placing in the hands of the Arkansas legislature the authority to set maximum interest rates. Past efforts to change the usury law indicate that this will be an uphill battle. In 1953 an attempt to amend the constitution did not get on the ballot due to a successful challenge of the title of the amendment. Again in 1970 we had a constitutional convention and an effort was made to get a provision in the proposed new constitution that would change the law. The provision was not entered and in November of that year the people of Arkansas rejected the constitution.

Today, we are again addressing this issue. Over 200,000 signatures were submitted on referendum petitions to amend the constitution. This provision will be on the November ballot.

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Pursuing another avenue of assistance, financial institutions in the state have sought emergency credit through the Federal Reserve System. Our bank applied to the Federal Researve in 1973 and again in 1974 for emergency credit in order to finance the agricultural economy of our state. In both instances the Federal Reserve declined our applications on the basis that it was contrary to monetary policy. In our latest rejection they said that we were not hurting badly enough since we could go into the market and purchase Fed funds at 13 or 14%. Apparently the Federal Reserve was not particularly concerned with whether or not this would eliminate the profitable operation of the largest financial institution in the state.

The point I make is that we are trying and the financial institutions in the state are trying in various and different ways to find relief to an adverse economic situation. Our efforts to date have met with little success. It would seem that the flow of funds between states is a major part of interstate commerce and must be regulated from the national standpoint. Consequently, the Brock Bill presents the best opportunity for relief of the devastating effects of Arkansas' 10% usury restriction.

3. The argument is sometimes made that the passage of this Bill would be detrimental to the consumer. I would argue just the opposite, and make these points:

(1) Without relief from the 10% ceiling, we must reduce our most expensive and least profitable loans. These are the consumer loans. Consequently, there will be fewer funds for the consumer if the 10% ceiling is retained without relief. If we continue to purchase larger amounts of Fed funds at whatever the market rates are, the profitability of this organization is severely impaired. Consequently, we have no other choice but to reduce expenses. Such a reduction simply means that the level of services to the public will suffer.

(2) Housing in our state is suffering, as will be indicated to you by one of the major developers of housing who is in our group. Most large real estate developments and multi-family housing projects are put together by corporation who are willing and able to pay the market rate for funds. Most of the men who manage these corporations realize the plight that Arkansas financial institutions are in and the look at the purchase of money the same as they look at the purchase of lumber, cement, labor, and any other product. They are willing to pay a market price for them. Arkansas law prevents this. The passage of the Brock Bill would allow the major housing developers in our state to resume business.

(3) The ability of the Arkansas banks to seek funds, pay market rates for them, and have funds available to finance the development of business and industry in our state will stimulate the economy by creating job for people who, in the final analysis, are the consumers in our economy. If we cannot compete for funds in the market, we have no other choice but to limit and restrict the financing of industry in our state. In the final analysis, this will mean the reduction in jobs and the loss of growth opportunities for many of our developing companies.

4. Arkansas' usury restriction is most damaging to the larger financial institutions who serve the larger, corporate borrowers. The owners of large certificates of deposit, $100,000 and over, are inclined to place those with the larger, more strongly capitalized banks. They naturally favor those that they are most familiar with. However, when the rate differential is 1½ to 2 points, we cannot be competitive. Though we can persuade them to keep their money at home when the rate differential is much smaller, we find a complete inability to talk to a major certificate of deposit owner about loyalty to the local financial institutions when he must sacrifice 1½ to 2 points. Larger businesses and industries of our state look to the larger banks to finance their credit requirements. We cannot do this at 10%. A study on bank holding companies was recently completed by Dr. John Dominick, who is a professor at the University of Arkansas and occupies the Chair of Banking sponsored by the Arkansas Bankers Association. As part of his study, he analyzed the 100 largest locally controlled business organizations in our state as to where they banked and why. His study found that those firms that responded had $66.2 million in bank deposits. $16.6 million were deposited in banks in the State of Arkansas, and $49.6 million were deposited in out of state banks. In other words, these companies had 25.1% of their deposits in Arkansas and 74.9% of their deposits

in other states. Of course, their deposits follow loans, and the loan figure indicates about the same. $197.1 million in bank loans, $40.9 million or 20.8% in Arkansas banks, and $156.2 million or 79.2% in out of state banks. This indicates very clearly that the larger the company, the greater reliance it must have on out of state banks to provide its needed credit.

A strong profitable banking industry is essential to support the growth and development of all business and industry. Without profitable banks who are willing to take the risk of financing new and existing business, we will kill entrepreneurship in Arkansas. The key to this is the ability of the banks to pay the investing public a rate of interest that will attract their funds and the ability of the banks to operate profitably is tied directly to eliminating the 10% usury restriction and allowing them to participate in the market for funds.

SUMMARY

As I have mentioned, we have tried the state courts, we are trying a case in the national courts, we have tried before to amend our constitution, and are now trying again to amend our constitution, but in the current situation with interest rates three and four points above the maximum rate of interest Arkansas can charge, we are in an emergency position. We must have some relief now and Congress is the only source that can give us immediate relief from this situation. Without this relief, Arkansas will be paralyzed, both from the development of the private business sector and from the ability of the public sector, i.e., the various governments, to support their financial expansion programs. This cannot be allowed to happen in our state. We want only to be able to be competitive in the general market with the other larger financial institutions of adjoining states. Our customers want to have credit available for them when they need it. Credit is only one of the essential elements of production an dits price like that of labor, raw materials, and others, must be allowed to move upward and downward with the market and must be allowed to fluctuate in a national market without the interference of state borders.

I appreciate the opportunity to appear before you and I will be happy to answer any specific questions that you may have.

Sincerely,

EDWARD M. PENICK,
Chairman and Chief Executive Officer.

WICKARD & CO., INC.,
Little, Rock, Ark.

GENTLEMEN: Wickard and Company Inc. is a general construction company with business both in residential and commercial construction, I also do considerable development on a personal basis. We do approximately $2 million a year in volume. Our long record of service in the construction industry has permitted us excellent banking relations in the past. We enjoy solid credit with several of the larger banks in the central Arkansas area.

To cite the oppressive effect of the 10% usury law on our business, I only have to point to two undeniable facts. One, as of July 1, 1974, we have only $360,000 worth of construction volume under contract on our schedule. As of time time one year ago, July 1, 1973, we had over $2.1 million. Two, our work force has had to be cut by a third. Twenty-five people have been laid off due to lack of business. Normally, at this time of year we would be taking on extra summer time help for the peak period of our business.

Let me cite you the kind of construction declines that have caused a serious impact on housing and commercial development for us.

Maumelle New Town is a HUD sponsored new city in Arkansas.

We were originally scheduled to construct eight homes in this area at approximately $40,000 each and 64 zero lot line homes at about $28,000. We were turned down by three banks and two savings and loans. One savings and loan has finally agreed to commit to two of the eight houses with the understanding that it will not exceed $80,000. No money is to be dispursed in July and only limited finance will be available in August. The balance will be spread out over at least six months.

The Foxcroft Townhouse project, a series of medium priced single family dwellings, estimated at $600,000 in construction costs has had to be abandoned because of lack of funds.

A 50 unit apartment housing complex of low income efficiencies and single bedroom dwellings was to be built on a site of a church in downtown Little Rock. This project, estimated to cost approximately $560,000, has had to be shelved. We still own the land at the cost of $150,000 and have cleared the site, but cannot move.

Countryplace, a townhouse project of 43 medium priced units, has been shelved recently, its cost . . . $2 million. We also own the property for this project at a cost of $210,000. We are now paying interest on all of this land but are unable to develop it.

COMMERCIAL OFFICE BUILDING

We currently have an option on University Avenue to build a garden type office complex estimated to cost $1.5 million. We are unable to proceed on this project and will lose the option.

We have purchased a 30,000 square feet educational building of a church which was to be converted to office space for a government agency. Since we are unable to secure the $200,000 estimated for remodeling, this project has been temporarily abandoned.

Office and warehouse plans at an estimated cost of $50,000 have been shelved due to no money.

These trends paint a bleak picture for our business. If it continues, and we quite frankly see little relief in sight, housing in the central Arkansas area will suffer a substantial setback. Growth of commercial office space will face serious cut-backs. Payrolls and the construction related industries will no doubt suffer similar downturns.

I am presently preparing to go out of state to obtain additional funds. By establishing a Texas corporation in Dallas we hope to borrow funds and channel them into Arkansas. I have already funded one warehouse project this way. I think this testifies to the fact that I, and others in our business are willing to pay the money necessary if we can be assured of adequate credit.

I personally am very pessimistic about any early changes in our present usury law. I fear that without some immediate relief from a bill such as the one your are proposing the situation can easily worsen and become even more protracted.

ROBERT WICKARD, *President.*

BANK OF NORTHEAST ARKANSAS,
Jonesboro, Ark.

I am Ed Cherry, President of one of the smaller state banks in Arkansas. More specifically located in the Mississippi Delta Craighead Country, Jonesboro, Arkansas. Our bank, Bank of Northeast Arkansas, because of location, is devoted to the agricultural lending function as well as commercial and consumer functions of credit. We are fortunate in that we are surrounded by land which is suited to the production of Rice, Cotton, Soy Beans, Wheat, Milo and last but not least Cattle. Our town is located on the top of Crowley's Ridge and has considerable number of rolling hills devoted to the cattle industry. We also are pleased to have several industrial plants namely General Electric, F. M. C. Corporation, Walker Mfg. Co. (a division of Tenneco), Crane Co., Colson Corporation, Wolverine World Wide Inc., A. D. T., Stor-All Mfg. Co. and Southern Marketing Affiliates to name just a few. These things are all being accomplished with a population of less than 30,000. These remarks are made only to alert you to the fact that our area even though small, is of necessity, large in credit to many varied corporate businesses as well as large individual agricultural operations.

One of our largest problems begins in the approval of lines of credit to our crop production people in the early Spring of each year. We approve their needs at a predetermined interest rate and historically have adhered to that rate for the duration of the crop year. Credit demands and rates aare reviewed on an annual basis. If an increase is necessary in a line of credit then the rate is adjusted to the competitive rate at that particular moment. From March of this year our rate has remained static while our costs have risen dramatically. If money had remained in our area, if Arkansas was not a capital poor state, if our demands had not been so great we would have no problem—quite the contrary.

Our supply of money has dried to the point of being a mere trickle. We are faced with having to go to the Federal funds market for reserves which in the past two weeks has fluctuated from 12⅜% to a high of 14½%. Arkansas has many advantages the least of which is the 10% maximum rate on loans to one and all. If you can tell me how I can loan money at 10% if I have paid 12% much less 14% I will return to Crowley's Ridge and stay there forever believing there really is a Santa Claus.

I deeply regret not having had the opportunity of convening the Arkansas State Bank Commission prior to coming here. As Chairman of this Commission I would have liked to report the consenses of opinion of our combined body. Mr. Adams, our Commissioner was out of the state as well as myself so it was not possible.

Because of the ability of banks in states to loan at higher rates we became concerned about how many of our deposits might leave our bank to out-of-state competition. This would come about by their capability to negotiate higher rate for $100,000.00 and over Certificate of Deposits. When this increase first began, our assets totaled approximately 14 million dollars. In a period of 90 to 120 days we had documented a loss of 700 thousands to competition.

This then is our plight. If Arkansas bankers hands are tied then all should be treated likewise. If there are advantages in New York then we should have at least an equal fighting chance.

None of us here from Arkansas can predict with any degree of certainty the outcome of our attempt to remove the 10% usury law from our antiquated constitution. This will not be known until our November general election. In my area it is apparent to me that consumer education on this question will be most difficult and is one reason I feel that the successful removal of this law has less than a 50–50 chance. If my opinions are correct it becomes imperative for something to be done particularly before another agricultural crop is started.

I am not at all certain how all bankers feel about this bill however I wish to quote one statement of Edwin Jones, President of First Union Group of St. Louis. So long as bankers are divided, legislators are reluctant to work for passage of any kind of banking legislation. When bankers unite and speak with one voice legislators are willing to weigh proposed legislation on its own merit. Gentlemen this has merit.

Thank you.

EDWARD H. CHERRY,
President.

STATEMENT OF DR. JOHN A. DOMINICK, CHAIR OF BANKING, UNIVERSITY OF ARKANSAS

Gentlemen: My name is John A. Dominick; I hold the Chair of Banking at the University of Arkansas. I appreciate having the opportunity to discuss with you the impact of Arkansas' 10% usury ceiling on the Arkansas economy.

The 10% simple interest limitation was placed in the Arkansas Constitution in 1874. Its purpose was to assure fair and equitable treatment for borrowers. With the high interest rates of today, the law has become discriminatory—and those whom the law was designed to protect are now hurt the worst. The 10% percent ceiling is an arbitrary restraint on interstate commerce and it is a threat to the economic viability of the Arkansas economy.

(1) To be more specific, the 10% ceiling has led to an outflow of funds from the state, thereby reducing the availability of loanable funds to consumers, homeowners and businesses. The money market is probably the most fluid market in the nation. During times of high interest rates, Arkansas banks cannot compete in this market. We cannot sell large CD's at 12% and then lend the funds at 10% and remain profitable. Large CD money has virtually disappeared from the state.

Arkansas is a capital-poor state. To sustain our rate of growth we have to rely on out-of-state sources of funds. Two of these sources come from out-of state loans and the sale of loan participations to out-of-state banks. With a

10% ceiling, why would out-of-state banks want to lend in Arkansas? And why would out-of-state banks want to buy participations in Arkansas? They don't—in fact, the situation is just the reverse. Oue-of-state banks are selling loan participations to in-state banks at rates of 12% and better. Clearly, this reduces the supply of loanable funds to Arkansas residents.

At the end of 1973 I surveyed large Arkansas based firms to determine the ability of Arkansas banks to service their credit needs. In total, these firms obtained $156.2 million or 80% of their bank loans out-of-state. As a result of borrowing out-of-state, these firms had to keep most of their deposit balances out-of-state. In total, this amounted to $50 million or 75% of their deposits. This has the effect of reducing the credit base of Arkansas.

(2) When credit is "tight" and rates are high, high risk loans and costly loans are squeezed. This means that consumer loans, mobile home loans, home construction loans, risk capital loans, and loans to marginal borrowers are curtailed. A survey of Arkansas banks with deposits in excess of $25 million was conducted in June, 1974. Ninety-two percent of the respondent banks reported that they had adjusted their loan policies within the past 90 days due to higher rates. This took the form of requiring more security, fewer loans, shorter maturities, higher rejection rates, and higher compensating balances.

(3) The 10% ceiling has a devastating impact on risk capital and risk takers. There can be no adjustment in the risk element of a national prime rate of 12%. This restricts the formation of new businesses in Arkansas.

(4) Surveys of furniture dealers, automobile dealers, appliance dealers, and mobile home dealers reveal that it is becoming more difficult for them to sell their customer credit contracts to financial institutions. The survival of many dealers depends upon their ability to sell indirect paper—our 10% ceiling has led to higher rejection rates, unusually high dealer reserves, high acquisition costs and, in some instances, to selling the paper at a discount plus a 10% rate. Dealers have been forced to raise the prices of their goods in order to maintain profit margins. Price surveys conducted by Dr. Gene Lynch at the University reveal that prices of consumer durable are considerably higher in Arkansas than in surrounding states. (One survey was conducted in 1968 and another has just been completed). This means that cash buyers are subsidizing the credit customer.

One mobile home dealer reported that his customer credit rejections usually run 30%, but with tight money they have jumped to 70%. Another mobile home dealer reported that he made a profit of $22,500 in 1973, but that his dealer reserve increased $35,000. It's easy to understand why this dealer is having a problem financing his business.

Fourteen months ago we had 268 mobile home dealers in Arkansas; two weeks ago we had 142; and one week ago we had 133. It's difficult to finance mobile homes in Arkansas at a rate of 10% when the FHA financing rate on mobile homes is in excess of 11%.

(5) Lower cash prices of consumer durables in neighboring states encourage Arkansas residents to shop out-of-state, especially if they live near border cities. Part of this is due to the fact that dealers in these areas tend to move to another state in order to offer competitive prices. A prominent example is Texarkana, Arkansas-Texas. A number of merchants on the Texas side moved from Arkansas in recent years, giving as their reason the Arkansas 10% ceiling. The table at page 41 provides an illustration of this point.

(6) Loans and deposits of the Arkansas banking system are still rising. Many of our smaller banks have not experienced severe financial disintermediation. Most people don't have the amount of funds required to invest in money market instruments. Consequently, funds become "trapped" in convenience money, i.e., savings deposits and consumer CD's. The new variable rate notes are designed to attract this type of money. Unless our 10% ceiling is changed, we can't compete with these instruments—and it is likely that in the future we will experience severe disintermediation in Arkansas. This would cripple our economy.

A Federal solution is about the only way to accomplish swift change. The usury problem is a complicated issue which the public doesn't fully understand. Educating the public on this issue would be very lengthy and expensive—and before this could be done it might be too late. We need Federal regulation now. We aren't asking for special privileges. We are asking for the right to compete for funds in a free market economy.

Statement of H. L. Hembree, Chairman of the Board & Chief Executive Officer, Arkansas Best Corporation

Mr. Chairman Brock and gentlemen: I strongly support the state effort to repeal Arkansas' restrictive 10% usury law and support passage of the Brock bill as a measure designed to provide temporary relief to the hard pressed economy and financial institutions of Arkansas. Arkansas—more than any other state that I know—needs a stronger banking industry to support its growth, and clearly immediate relief from our 10% interest ceiling is in the best interest of this industry and the entire state.

My company—Arkansas Best Corporation—is a diversified holding company which was formed in 1966 through the merging into the holding company of several existing companies with the principal company being Arkansas-Best Freight System, Inc. ABF is a Class 1 motor common carrier operating in 19 states from New York and the Carolinas on the east to Texas and Kansas on the west and Wisconsin, Illinois and Pennsylvania on the north to Louisiana and Georgia in the south. It ranks about 18th in total revenues in the United States; and, more importantly, 4th in its operating efficiency. Another major subsidiary—Riverside Furniture Corporation—manufactures multiple lines of quality household furniture of medium price for chain store merchandisers and independent family stores across America. Riverside's manufacturing facilities consist of six plants totaling nearly one million square feet all located in Fort Simth. Other wholly-owned subsidiaries operate in tire retreading, real estate holding and data processing.

Our company is publicly held and listed on the New York Stock Exchange. We have some 5,000 shareholders residing in almost every state of the union. ABC's total revenues exceeded $118 million in 1973.

My company's current lines of credit exceed $33 million and have grown about 15%. It is only reasonable to anticipate that our own growth will require increased use of credits in the future. We do business either directly or through our subsidiaries with approximately 50 banks. Generally speaking, our corporate financing is handled in five states, and predominantly with New York financial institutions.

From my personal and our corporate experience, it is my belief that many of our Arkansas-based institutions and growing companies have found their prospects diminished by inadequate credit available in the state. In the past and presently, Arkansas companies, which have been nurtured and helped by the Arkansas banking industry in their formative years, have had to look beyond our own Arkansas banks as their businesses grew and expanded. This phenomena has occurred—with all due credit to the very good job that Arkansas banks do—because Arkansas has no really large financial institution capable of providing the credit lines and the wide array of sophisticated financial services that a corporation like our and hundreds of others operating here in Arkansas required. More importantly, the State cannot develop such institutions while saddled with an archaic and restrictive 10% simple interest ceiling on all forms of credit.

To illustrate one aspect of this problem, I can think of at least a dozen major expansions that have occurred in Fort Smith alone within the last five years, each of which have had to have major non-Arkansas credit. It was with great disappointment that I was forced to admit in each of these cases that we had no banks in the state that possessed the resources to serve these companies.

Presently my company is utilizing several services which are provided by out-of-state financial institutions which could be more appropriately handled here in Arkansas. Such services include financial engineering, mathematical models, corporate financial planning, pension fund management, investment advisory services ad real estate or long-term financing for various corporate activities. Where banks exist that are large enough to provide these serives, they are usually found to be extremely profitable to the bank and in turn support further economic development in a state. But such banks cannot develop under an interest ceiling that is totally out-of-step with today's economy.

In a social context, I feel that we are in danger of losing our greatest natural resource in Arkansas—that being our trained young people. Our schools, colleges and universities are producing students with capabilities of progressive leadership, if only we provide them an environment and opportunity. But these young people will leave our state if they cannot find a parity of economic opportunities between Arkansas and her sister states.

Gentlemen, Arkansas seems to be forever presented with "do or die" types of situations. We have now through the Brock bill and our own state efforts an opportunity to start catching up with the rest of the country. I do not suggest that the Arkansas banking industry will melt away if we do not achieve some measure of interest rate parity. I do suggest that our Arkansas economy is in very real danger of withering away as other competing state economies are able to adjust to changing economic conditions while ours is not. Given the current and projected state of our nation's economy over the next few years, the recommendations you make to the full committee on this bill may very well indeed be one of the last opportunities we have to modernize our Arkansas interest rate structure without first suffering a grave economic setback. I am hopeful of the success of our state's initiated efforts; but, if we should fail in our first attempt this fall, your bill may well mean the difference between economic survival and economic chaos for Arkansas.

Senator BROCK. Mr. Mitchell and Mr. Andrews and Mr. Burdett, our next panel.

STATEMENTS OF WILLIAM W. MITCHELL, PRESIDENT, TENNESSEE BANKERS ASSOCIATION; NELSON ANDREWS, PRESIDENT, McCLURE'S DEPARTMENT STORE, NASHVILLE, TENN.; AND J. GARRETT BURDETT, PRESIDENT, TENNESCO, KNOXVILLE, TENN.

Senator BROCK. I have your statements.

I want to just compliment the people that have been here this morning from Tennessee, Arkansas, and Montana. I have never participated in a hearing where the testimony was more to the point and as brief as the way we have had it here today. I appreciate it. We have accomplished an awful lot.

Mr. MITCHELL. Thank you.

I'm William Mitchell. I'm president of the Tennessee Bankers Association this year. I'm also a chairman of the board of the First National Bank of Memphis, Tenn. I will certainly briefly summarize my testimony (see p. 61 for full statement).

During recent years unusually high rates of inflation and national policies designed to control this inflation have tended to make obsolete the usury laws written under very different economic and social conditions.

We in Tennessee believe immediate passage of this legislation is imperative to the well-being of the people of Tennessee as well as to those people in other States that have the same antiquated usury laws.

First we believe that the ceiling that has been set before the prevailing market rates do not protect anyone. There are three reasons.

One is those ceilings limit the flow of funds into the State. They encourage the flow of funds out of the State. And third, and this is longlasting, they limit the real economic growth of the affected areas.

We have brought with us evidence that both local lenders and out-of-State lenders have reduced their lending in the State of Tennessee, not because of any general tightness in the economy but solely because of the 10 percent usury law.

One Tennessee banker, when asked to summarize his current loan policy, put it this way:

Our present policy is very restrictive in that we are not making loans to any new customers and we plan to reduce our loans to present customers by 20 percent to 25 percent before September of this year from their April levels.

Another Tennessee banker describes his policy this way: "We are soliciting no new loan business whatsoever."

We believe statements such as these are typical of the positions being taken by Tennessee lenders.

As I mentioned before, Tennessee is a capital-poor State. Because of this fact, the large commercial banks in Tennessee have been dependent upon outside-purchased money to finance the State's economic growth.

To sustain the State's current level of growth, the eight largest Tennessee banks are purchasing over $2 billion at rates between 11 and 13 percent.

Because of the region's heavy dependence on agriculture, this situation will become even more severe as the demand for loans at these banks increases this fall to finance the marketing and storage of what is expected to be a heavy agricultural crop. Our major banks have continued to absorb losses associated with these borrowed positions in the hope that relief would come from either a special session of our legislature or from the significantly lower money market rates that were widely forecasted by both private and Government economists during the early part of 1974.

Unfortunately, neither scenario has materialized and this obviously unprofitable dependence upon purchased funds leaves these banks no alternative except to cut back on their commitments. This change in their basic balance sheet structure will necessarily reduce the availability of funds in the State.

A recent discussion with Robert Cannon, president of the Tennessee Mortgage Bankers Association, suggest to some extent the degree to which national lenders have also withdrawn funds from Tennessee. In that discussion, Mr. Cannon said that he could document at least $75 million of commercial construction projects that could not be completed because national funds have left the State since the first of the year. He went on to say several large national insurance companies have completely withdrawn from making loans in the State of Tennessee.

Third, as the flow of loanable funds into our State has been restricted, it is our belief that the economy of the State of Tennessee has been adversely affected. In support of this hypothesis, Dr. Pat Choate, Tennessee Commissioner of Economic Development, recently stated that through the first 6 months of 1974, he could definitely attribute the loss of at least $200 million of capital investment to the 10 percent usury law.

Dr. Choate went on to point out that the majority of these losses were expansions planned by relatively small Tennessee firms that did not have access to national money markets.

Based upon current tax rates and median family income of $7,500, a $200 million loss in capital investment means an approximate $15 million loss in State and local government taxes per year and the loss of at least 14,000 jobs.

And fourth, having demonstrated, I believe conclusively, that the economy of Tennessee is being adversely affected by the current usury laws. You will find on pages 32–35 of our testimony a brief discussion of the legislative problems we have encountered in Tennessee.

We are attempting to have the Tennessee statutes changed; however, because of the State constitutional issues involved, it is possible that this process could take several years. In the meantime, Tennessee's economic growth, especially Tennessee-generated growth, would be totally dependent on national monetary policy.

Finally, since these periods of tight money and high interest rates are beyond the direct control of Tennesseans, or any other individual State or group of States, we feel that the passage of this legislation will help insure a more even application of restrictive monetary and fiscal policies throughout the Nation instead of singling out individual geographic regions.

Thank you.

Senator BROCK. Thank you.

Without objection, the entire statement and the appended supporting materials, which are excellent, will be put in the record.

Mr. ANDREWS. Senator, I am Nelson Andrews, president of McClure's Department Stores. McClure's is a family-owned corporation operating five stores in Nashville and Middle Tenn. These range from ladies specialty stores doing a volume of $150,000 a year to small department stores in the slightly over $1,000,000 category. Our competition consists of other stores similar to our own but principally comes from national chains including Sears-Roebuck, J. C. Penney, Allied and Mercantile.

You have undoubtedly heard much of the plight of the lenders to this type of business, but let me today speak principally to the problems of the small business borrower in Tennessee.

We are, of course, tied to the general business climate which is now suffering and will continue to suffer under conditions that exist in regard to interest rates in Tennessee. We share, along with other businesses, the bad effects of a poor business climate, but let me first speak to the more immediate and specific problem that faces us. I would like to put several facts before you to give you a frame of reference of this problem.

First of all, we require two kinds of money to operate our business—somewhat longer term capital and short-term seasonal borrowings. The longer term capital finances our expansion—in our case we have within the year completed our newest and largest store and we plan that this borrowing will be repaid over a longer period of time out of contemplated profits. Our seasonal borrowings are on a short term basis and are used to finance the peaking of inventory and accounts receivables, principally in the fall and Christmas seasons. Our profits come principally in the fall and Christmas seasons, so obviously the aforesaid borrowings are essential to our profit picture.

The source of our borowings is entirely from our banking connection in Nashville, Tenn. We are neither large enough nor financially strong enough to float bonds or sell commercial paper. Being a closely held corporation, we do not have the opportunity of selling additional stock to raise new capital. Unlike national corporations, we cannot go to the New York or other money center banks for loans, because their loan demand is also high and they are in no position to make what they would consider small loans to distant borrowers who have not previously been customers of their banks. If such arrangements could be made, they would naturally and properly insist that we move our bank accounts out of our Tennessee banks to their institutions. This, of course, would compound the problems of the availability of credit to other smaller Tennessee borrowers. The necessity of some of Tennessee's larger borrowers having to do this has undoubtedly affected our ability to receive our full credit needs from our Tennessee bank. In any event, we are totally dependent on the aforementioned bank for the source of our borrowings.

Now to the specific problem we face. If credit is to be refused by the bank in Tennessee, and at this point this seems logically to be the only solution they have [certainly we must expect a rationing of valuable funds], and if in turn that means we would not be able to obtain seasonal borrowings, the fact is that we simply could not compete with those competitors who have access to borrowings outside of Tennessee. In even simpler terms, if Allied or Sears-Roebuck or Mercantile could and would bring in the proper inventories for the Christmas season and we could not and did not, we would be in an extremely critical and serious position as to profits and, in fact, survival. In this regard we are like all other retail businesses in Tennessee who are dependent upon sources within Tennessee for their seasonal borrowings. Because of the money supply situation, we have, of course, completely stopped any expansion plans that we had entertained and have curtailed other promotional efforts that would have required additional capital.

The conflict between Tennessee's usury laws and the cost of funds imported in Tennessee by banks and other financial institutions is well known by the business community in Tennessee. Businessmen know that Tennessee banks are rationing credit by refusing many loans that would ordinarily be made by insisting that those loans that must be made for essential business operations be reduced to minimal amounts.

In June of this year we adopted the Master Charge and Bankamericard programs to lessen the need for accounts receivable borrowing. This is but one illustration that we are doing what we can to continue to operate our business in the restrictive environment created by our outmoded usury laws.

Specifically the problem we have got is we have to compete. If we can't compete for money on a fair and competitive basis we are going to be out of business. We understand the problems of the banks but we also feel that banks can and will pull in their horns, so to speak. All they have to do is lessen their lending by a borrowing lending ration or a money cost lending ration if it is profitable for them and if they do that it is the borrower on the other end that is going to feel the real crunch. I think in Tennessee up until now, and you can look at the larger banks' statements to see this. They have bent over backwards to take care of borrowers like us but they are not going to for long do this. We understand too the problems of inflation. This hits harder in Tennessee. We have to survive there. If we have that crunch in Tennessee we are dependent upon it there and no place else. In conclusion, we are not asking for any unfair advantage. We don't want to borrow money or get along on any other basis than a competitive with other corporations.

We ask for the accessibility to capital and as these national competitors have. We ask for the right to compete.

Thank you.

Senator Brock. Thank you.

Mr. Burdett.

Mr. Burdett. My name is J. Garrett Burdett. I am president of Tennesco, Inc., a savings and loan service corporation owned by 12 Federal savings and loan associations ranging from Bristol, Tenn. to Union City, Tenn. I appear before you today as a representative of the Tennessee Savings and Loan League whose board of directors has adopted a resolution of support for this proposed legislation on behalf of all 75 Federal savings and loan associations in Tennessee.

The responsibility for providing the funds for housing the citizenry of our State has been, in large measure, assigned to our industry throughout the years. The funds obtained by our industry are deposited for much shorter periods than the periods required by our citizenry to feasibly plan to repay loans of a size required to purchase homes. This has continuously caused the savings and loan industry to find itself with loans comprising its portfolio which carry interest rates lower than their currents rates paid on deposits. This, of course, forces the industry to obtain rates from new borrowers or other types of investments which will offset the below cost loans in their portfolios. The housing needs of this nation must be met. More and more, we have seen the growth of multifamily housing as the most economical method of housing our average citizen. This type of housing is produced by the knowledgeable, sophisticated developer, who must carefully study his market versus current material and money costs, and then decide whether to borrow now or wait. His decision is one made by a man who knows the costs, knows the market place, and after careful consideration, makes his final decision on his ability to produce this housing at interest rates currently available in the market place. His decision is then carefully analzed by the lender with whom he negotiates, and he, too, must be fully satisfied that the rate to be charged can be supported between parties fully knowledgeable, cognizant of their business responsibilities, and desirous of filling the need for housing the people in the community.

Present capital requirements of this nation coupled with the inflationary trend with which we are all familiar, have forced the Federal Reserve to restrict the money supply. The price the banking industry must pay for daily funds has been running between 12 and 12½ percent. Should the savings and loan industry, in view of their cost squeeze, make loans on real estate when prohibited from getting maximum returns, or should they invest in outside higher yielding investments? Are we to expect our banks to make us loans for loan warehousing and other short-term needs at 10 percent, when they are paying 12 percent for overnight funds?

It appears to me that the only answer to the problem of equalization of the flow of funds throughout the economy in times requiring such remedies as we now face is the ability to lend and borrow on equal terms area by area.

The sophisticated borrower, able to negotiate at arms length, must be able to obtain funds or face the collapse of his business. For these reasons, we dutifully request your support of this legislation.

Thank you, Mr. Chairman, and members of the committee for your kind attention.

Senator BROCK. Thank you very much.

I was struck on several portions of the testimony that some of the figures were just awesome. The statement showed that we lost $200 million in investment in the state of Tennessee. That is incredible. You are talking about at least 10,000 unemployed Tennesseans that would be employed today.

Mr. MITCHELL. 14,000.

Senator BROCK. It depends on the kind of an industry. Some are more capital intensive than others but 10,000 or 15,000 for a job you are talking about, somewhere between 10,000 or 15,000 people or families that could be on the payroll today. That is incredible.

I don't know if it is possible to really give a specific answer, Mr. Mitchell, but can you give me some estimate of the outflow of funds or the disintermediation over the past 6 months as a result of the imbalance between Tennessee rates and those nationally.

Mr. MITCHELL. Your questions relates to the amount of money that may have left Tennessee?

Senator BROCK. Either that or didn't come in?

Mr. MITCHELL. This would not be possible to estimate. One example, I know that in Memphis, the Light, Gas, and Water Division and properly so, several, oh, 10, 20, 30 millions of dollars were deposited in New York banks because they paid a higher rate than did the Tennessee banks, although I think they are changing that policy now. But that is just one example and I am sure there must be dozens of others but I just don't have a figure on it.

Senator BROCK. You remember back in 1966, when we had that credit crunch and we ran into some disintermediation in Tennessee. We lost, as I remember, a couple of reports, it seems to me we lost maybe $250 million, $150 million.

Mr. MITCHELL. Whatever that figure was it disturbs me that I think we are still feeling that. I don't think we have ever recovered really from that and this adds to it.

Senator BROCK. What I am getting at is not only do you not have the $200 million that would have been invested in the plant development or expansion either way but you also have the outflow of funds and it just has to happen because money is going to find the price.

Mr. MITCHELL. It is like any other commodity.

Senator BROCK. Well, it is more fluid than most.

Mr. MITCHELL. I like to use the example of gasoline. If we had prices limiting us to 30 cents a gallon, I don't think we would get much gasoline and money is just as fluid.

Senator BROCK. Let me switch the question, I think Mr. McLellan raised the point that if we could pass this legislation either as it is or with some minimum figure to other than corporations as well, that what that would do would be to draw more money into the institutions and not only relieve pressure on the large corporate borrower but also would relieve pressure on small borrowers, the consumer loan type as well.

Mr. MITCHELL. Yes, I am one that really believes we should make the money market a free money market available to everyone. I know there are these psychological restrictions we have in reasoning.

I do believe, however, the present bill restricted to corporations will indirectly be helpful to other than corporations for this reason: I think that it will allow the lending institutions to lend to the corporations their purchased money, thus making more of their regular time and demand deposits available for others. And I don't believe really that consumers have been injured over the country where there are 8 percent or 10 percent limits on individual rates and you have no limit on corporate rates.

Senator BROCK. Well, the basic responsibility in this Congress is to act a good deal more responsibly in monetary affairs. But until that millennium arrives we have to deal with the specific problem of Tennessee firms and families.

I just would like to maybe throw you a broad question. What steps have you all taken in the bank to deal with this. You know, you have to be facing an enormously difficult choice. Do you continue to serve your best customers or what?

Mr. MITCHELL. It is important, of course, for a banking institution to adjust to the existing circumstances and we have had to do this. As an example, in the last 90 days, I suppose, our overall loans have been reduced $130 million.

We have to really, I guess, the word is ration credit. We have to make judgments based on other than price, based on the customer's past service with us, based on the nature of the request. But in all these measurements, we have not been able to fulfill a duty and responsibility, which we have long prided ourselves on and that is to contribute to the continued growth in the business and economic affairs of our area because it is taking all our time and effort to just stay even with what the usury requirements are. And what concerns us even more, especially in our area of the State and I rather suspect in other areas too, is that this is summertime and the loan demand usually is less then than it is in the fall and wintertime. With respect to commodities, there are literally hundreds of millions of dollars needed which will have to come from someplace to finance the marketing of the cotton and tobacco and soybean crops, as well as lending the money for increased inventories for fall and winter seasons—Christmas season as mentioned a moment ago—and not at the prices they had to pay 2 or 3 years ago but the higher prices. I think the pressures are just beginning.

Senator BROCK. So do I. I think it is fair to state as a fact that you are lending money at a rate below that which you're paying for money, is that not factual?

Mr. MITCHELL. Yes, that is correct. As a result our corporation, I believe the first 6 months of this year earned about 10 percent less than it did the first 6 months of last year and for the last 3 months about 20 percent less than before.

Senator BROCK. Some people up here believe that banks have a money tree and don't have to adhere to the normal laws of supply and demand and profitability. I wonder, Mr. Mitchell, how long you can continue to loan money at a rate below which you pay for it?

Mr. MITCHELL. As I mentioned early, we are fast turning ourselves around. The banks can position themselves. It is the customers who will really suffer.

Senator BROCK. Don't you run some hazard though in terms of liquidity? What bothers me is that you are stretching your capability to its maximum right now.

Mr. MITCHELL. Absolutely, yes.

Senator BROCK. And if you do and if we had some adverse development on a national basis, would you not be in a far greater hazard as a result of your current policy of trying to at least keep Tennessee businesses operating. To me you are stretching your reserve position, you are stretching your viability to the point where you are in more jeopardy than you would like to be or should be, I think.

Mr. MITCHELL. I think there is less resiliency. I think this must be improved and this is going to be improved.

Senator BROCK. Well, if you improve your resiliency at the price of eliminating McClure's Department Stores, Mr. Andrews is not going to be very happy.

Mr. MITCHELL. This is exactly what will happen.

Senator BROCK. That is the price we pay unless something is done. Either we jeopardize the bank, its liquidity and hopefully that has to affect its solvency as well. Or you jeopardize McClure's and other small businesses in Tennessee, since we have no access to credit outside of the state. That is choice you will have to face.

Mr. MITCHELL. I think you mentioned you were facing this now to some extent.

Mr. ANDREWS. Yes.

Senator BROCK. Mr. Burdett, you are in sort of a different field, a more specialized field. As I gather, your institution serves these savings and loans.

Mr. BURDETT. Senator, our corporation was formed under certain sections of the Federal regulations a year-and-a-half ago for the purpose of expanding the abilities of this group of savings and loan associations because this is the middle group with assets from $15 million to about $65 million. What we were trying to do is to allow them to provide in their community loans, which they individually could not do. By combining this group together this would give us a composite of about $450 million in assets, where we could make the industrial loan and the multi-family loan and so forth, which historically in savings and loans is not done.

We found, of course, great problems, with that. In 15 months from scratch things change. But I would point out one thing: And I think the situation that exists right now, as I say, the savings and loan individually has portfolios which include loans going back to 5¾ percent at the present time in their portfolio. As a result of the situation as it exists today in Tennessee, most of them are taking their current liquidity and increased savings and going to the Federal funds market because they can make more money in the Federal funds market than they can making loans and stay liquid at the same time. It is hard for me to at the present time to pull my people out of the Federal funds market and into the lending market, because they can't afford to borrow money at the bank. My banker is in a position, he's got to loan me money at 10 and borrow it at 12.

The thing that really concerns me is that since we are not able to make construction loans or short term loans in these bounds in Tennessee, I have gone to Georgia frankly. Three of the major loans made in the last 2 months I have loaned to Georgia, because I can get the rate that justifies my people coming out. The thing that concerns me is that we have brought the industry to an absolute halt in the state of Tennessee and there is no way around it.

Senator BROCK. Let me ask you this question; I think there is—well at least the potential for somebody asking if we allow these corporate loans or larger loans, what effect does that have on the smaller borrower. Well, now, in your instance, what effect would this legislation have on your ability and in turn the ability of the participating institutions to make regular loans for home purposes?

Mr. BURDETT. Let me say this: of course in my operation we do no single family business. My stockholders do this and I leave them this market. Let me take two positions. Let me try to give you their position and my position. The first thing is if it is at all possible I feel that it would be highly advantageous if you went to the minimum loan amount as adverse to the corporate structure because the average builder normally is not a corporation and he's going to have to go and incorporate in order for us to do business with him.

Now, let's go to the single family loan, the single family loan today as are most project loans, at the rate position that the average citizen in the State of Tennessee has got a real problem as far as borrowing for a house is concerned. A $30,000 loan is $315 a month for principal and interest plus taxes and insurance, so he has to make $20,000 a year.

Senator BROCK. In other words, you are telling me if we pass this bill it will not make it more difficult to get a home loan. If you can't afford it now, you can't afford it then.

Mr. BURDETT. That is right. You're not going to stop anything.

Senator BROCK. We're back to a very specific industry here, home building. When we are talking about commercial loans the answer that Mr. Mitchell and Mr. McLellan gave me was that this kind of approach would not only get more money for the large corporate borrower, but it would free up more money for the smaller borrower too. I don't see that happening in your instance.

Mr. BURDETT. No, sir.

Senator BROCK. Neither do I see a negative impact.

Mr. BURDETT. No, I don't think you have a negative impact. The only thing you will do is make it possible for the developer who does multifamily work. It will make it possible for him to produce multifamily projects in the State of Tennessee, where he can't do it now.

Senator BROCK. In some words, we do not affect the individual homebuyer one way or the other but we do have a potential for improving the market industry.

Mr. BURDETT. As far as the overall housing picture is concerned you have to better the individual.

Senator BROCK. Gentlemen, I am sorry, we have run out of time but your testimony has been very much appreciated.

Mr. MITCHELL. Thank you.

Senator BROCK. The meeting will be adjourned subject to the call of the chair.

[Whereupon, at 12:30 p.m., the meeting was adjourned, subject to the call of the chair.]

[Complete statements of the previous witnesses and additional material follow:]

TESTIMONY OF W.W. MITCHELL

PRESIDENT OF TENNESSEE BANKERS ASSOCIATION

AND

CHAIRMAN OF BOARD AND CEO OF FIRST NATIONAL BANK OF MEMPHIS

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SUMMARY OF W.W. MITCHELL'S TESTIMONY

OPENING REMARKS.

During recent years unusually high rates of inflation and national policies designed to control this inflation have made usury laws written under very different economic and social conditions obsolete. We, in Tennessee, believe immediate passage of this legislation is imperative to the well-being of the people of Tennessee, as well as to those people in other states that have antiquated usury laws and have as yet been unable to receive relief from their respective state legislatures.

First, we believe that interest ceilings, when set below prevailing market rates, do not protect anyone. Instead, they directly limit the flow of loanable funds into controlled markets, and indirectly, because of the lack of loanable funds, limit the real economic growth of the effected regions. There has been a great deal written concerning the effect of price controls and specifically, interest rate controls to support this hypothesis. We have included for your use a complete bibliography of recent research into this area. In summarizing this research, Dr. Robert Lindsay, Professor of Finance at

New York University, recently categorized the effects of interest ceilings on an economy into the following two classes:

1. Lenders of loanable funds will ration available funds, thus pushing some borrowers out of the controlled market into the uncontrolled market. However, a research paper prepared for the St. Louis Federal Reserve Bank by Norm Bowsher (soon to be published), pointed out that those people denied credit in the controlled market are often unable to obtain credit in the uncontrolled market, thus completely limiting their ability to obtain additional credit.
2. Further credit rationing occurs because lenders also have an incentive to switch some of their available funds from the controlled market to the uncontrolled market thus enabling them to obtain a higher return. In our particular case, this implies that lenders, especially outside lenders that do not depend heavily on Tennessee as a source of funds, have an incentive to shift funds out of Tennessee to other regions where they can get a higher return. Since Tennessee is a capital poor state dependent upon funds generated outside of the state, this is extremely detrimental to our economy.

Second, we have brought with us evidence that both local lenders and out of state lenders have reduced their lending in the state of Tennessee not because of any general tightness in the economy, but solely because of the 10% usury law. One Tennessee banker when asked to summarize his current loan policy put it this way: "Our present policy is very restrictive in that we are not making loans to any new customers and we plan to reduce our loans to present customers by 20% to 25% before September of this year from their April levels." Another Tennessee banker describes his policy this way: "We are soliciting no new loan business whatsoever." We believe statements such as these are typical of the positions being taken by Tennessee lenders.

As I mentioned before, Tennessee is a capital poor state. Because of this fact, the large commercial banks in Tennessee have been dependent upon outside purchased money to finance the state's economic growth. To sustain the state's current level of growth the eight largest Tennessee banks are purchasing over $2 billion at rates between 11 and 13 percent. Because of the region's heavy dependence on agriculture, this situation will become even more severe as the demand for loans at these banks increases this fall to finance the marketing and storage of what is expected to be a heavy agricultural crop. Our major banks have continued to absorb losses associated with these borrowed positions in the hope that relief would come from either a special session of our legislature or from the significantly lower money market rates that were widely forecasted by both private and government economists during the early part of 1974.

III

Unfortunately, neither scenario has materialized and this obviously unprofitable dependence upon purchased funds leaves these banks no alternative except to cut back on their commitments. This change in their basic balance sheet structure will necessarily reduce the availability of funds in the state.

A recent discussion with Robert Cannon, President of the Tennessee Mortgage Bankers Association, suggests to some extent the degree to which national lenders have also withdrawn funds from Tennessee. In that discussion, Mr. Cannon said that he could document at least $75 million in commercial construction projects that could not be completed because national funds have left the state since the first of the year. He went on to say that [redacted] several [redacted] large national insurance companies have completely withdrawn from making loans in the state of Tennessee.

Third, as the flow of loanable funds into our state has been restricted, it is our belief that the economy of the state of Tennessee has been adversely affected. In support of this hypothesis, Dr. Pat Choate, Tennessee Commissioner of Economic Development, recently stated that through the first six months of 1974, he could definitely attribute the loss of at least $200 million of capital investment to the 10% usury law. Dr. Choate went on to point out that the majority of these losses were expansions planned by relatively small Tennessee firms that did not have access to national money markets. Based upon current tax rates and median family income of $7,500, a $200 million loss in capital investment means an approximate $15 million loss in state and local government taxes per year and the loss of at least 14,000 jobs.

And fourth, having demonstrated, I believe conclusively, that the economy of Tennessee is being adversely effected by the current usury laws. You will find on pages 32-35 of our testimony a brief discussion of the legislative problems we have encountered in Tennessee. We are attempting to have the Tennessee statutes changed; however, because of the state constitutional issues involved, it is possible that this process could take several years. In the meantime, Tennessee's economic growth, especially Tennessee generated growth, would be totally dependent on national monetary policy.

Finally, since these periods of tight money and high interest rates are beyond the direct control of Tennesseans, or any other individual state or group of states, we feel that the passage of this legislation will help insure a more even application of restrictive monetary and fiscal policies throughout the nation instead of singling out individual geographic regions.

V

LOAN POLICY STATEMENTS OF 7 LARGEST

TENNESSEE BANKS

BANK A:

"Our present loan policy is very restrictive in that we are not making loans to new customers. In addition, we plan to reduce our loans to present customers 20 to 25 percent before September of this year."

BANK B:

"Through the bank's various loan committees, we have exercised much greater selectivity this year in making loans of all types. In spite of this, loans rose steadily through May due largely to commitments made during late 1973. Some easing was experienced in June as a result of this selective and restrictive policy. With over $300 million of funds purchased at money market rates which now exceeds significantly the maximum rates that may be charged under Tennessee law, we have forced to be more selective and cut allocations to Tennessee borrowers. We are endeavoring to reduce loans outstanding of all types by $50 to $75 million and no major new loan commitments are currently being made."

BANK C:

"Our loan policy in general is a restrictive one. In the real estate loan area, we have ceased all solicitation of both permanent and construction loans. We are asking our present customers who apply for mortgage credit to delay these projects. On existing funded real estate construction loans, we are taking steps to enforce closing dates by all permanent lenders. On existing real estate loan commitments not funded, we are requesting these customers to either delay or cancel projects if no investment has been made. On commercial or industrial loans we are becoming highly selective in granting the credit needs of our well established customers and are enforcing previous repayment agreements. Solicitation of new relationships in which credit is involved is being avoided. Our agricultural loans originate through our correspondent banks as a result of overlines. In order to meet selective demands, we are being forced to curtail other lending programs. On direct installment loans we are requiring a larger down payment and shorter terms thus reducing our risks. We are limiting installment loans to our customers carrying deposit accounts. On indirect installment loans, we are limiting the amount loaned on new merchandise to the dealer's cost, and on used merchandise to wholesale values. Shorter maturities are also being required in this area."

BANK D:

"Expecting $180,000,000 commodity loan demand in 1974-75 season. 1973-74 commodities reached $100,000,000 level. Must fund most of 1974-75 crop out of state (New York) -- Are making no new commercial or residential construction commitments. Funding only past commitments. -- Any loan increases are attributable to funding of prior commitments and inflows of downstream participations which are tied to the region's agricultural cycle. -- Loan demand is still strong in the Southeastern region. -- We are attempting to bring our total loan figure to $700,000,000 by the end of August because of the high cost of market funds. -- We are soliciting no new loan business whatsoever. -- Line borrowers are being asked to use other sources of credit because of our tight money situation and interest problems."

BANK E:

"We are restricting our loans to existing customers or new prospects whose relationship with us is of a permanent nature and will provide a total yield including deposit relationships to cover the cost of funds plus operating margin. We are insisting on repayment schedules and are considering only loans of a productive nature. We have a priority list with speculative loans, loans out of our area, brokers' loans, commerical paper and loans involving marginal credit at the lowest priority. We are remaining active in the real estate residential market but are extremely restrictive in the commerical real estate area. Our installment loans are basically limited to reinvesting pay backs, and we have curtailed dramatically our floor plan obligations."

BANK F:

Early in 1974 as rapidly increasing rates began approaching our upward permissable level, we instituted a policy of loan allocation and restraint. This policy was primarily directed toward commerical and real estate loans; however, all lending activities have been touched by this decision.

We desire a reduced level of commerical and real estate loans and have been funding with rare exception only existing committments which were outstanding when our restraint policy was instituted. We constantly reveiw existing loans in these categories with a desire for their liquidation. New applications for these loans , which are both creditworthy and desirable, are generally refused. It is impossible for us to grant new loans when our initial direct costs will exceed our gross revenues.

Our restraint policy is both firm and stringent. It is also mandatory.

BANK G:

"Because of the very high cost of CD's and other short term funding sources, we have attempted to restrict growth of loan commitments in all areas. For example, our average loans for February, 1974 were 241 million and in June of 1974 they averaged 242 million."

THE CHAMBERLAIN COMPANY

Mortgage Bankers • Realtors • Insurors
Chattanooga • Nashville • Oak Ridge

J. R. CHAMBERLAIN, JR.
PRESIDENT

July 24, 1974

Mr. James E. Smith
Comptroller of Currency
U. S. Treasury Department
Washington, D. C. 20220

Dear Mr. Smith:

I am writing in respect to the extreme hardship our company finds itself in because of the Tennessee Usury Rate of ten percent. Our company is involved in mortgage banking, both permanent and interim, and real estate development. We have offices in Nashville, Chattanooga, and Oak Ridge and we have been in business approximately forty years. The operation of our company has almost come to a complete standstill because of the present money market and the inability of being able to attract funds into our operation because of the ten percent maximum limit.

In respect to our mortgage banking operation, we have investors who are in the market for permanent loans in Tennessee but we have been unable to obtain the necessary warehousing because of our ten percent limit. These loans are both residential and commercial and are both insured and conventional. We also have the same problem concerning construction financing in that funds are just not available because of our interest rate ceiling. Although housing starts are down substantially throughout the country, the starts are down considerably more than the nationwide average in our areas of operation in Tennessee. As an example, housing starts through May, 1974, in Hamilton County, Tennessee, were 791 units as compared with 1,825 units during the like period of 1973 and 1,884 units for the like period of 1972. This represents a decrease of close to 60 percent.

Our subsidiary development corporation named Statewide Enterprises, Inc. has a permanent, as well as a construction, commitment for the construction of 250 additional apartment units at Lakeshore in Chattanooga. The construction commitment

620 LINDSAY STREET AT OAK • CHATTANOOGA, TENNESSEE 37403 • TELEPHONE 615-266-4111

Mr. James E. Smith
July 24, 1974
Page 2

is by a real estate investment trust at three percent above prime and a local leading nationally chartered bank is the lead lender. This project cannot get started because of our ten percent limit. This is the second phase of a very successful project and a delay in construction is causing an extreme economical hardship on us since the land is purchased, final working drawings have been paid for, construction costs are increasing rapidly, in addition to the loss of income from the units themselves.

In respect to other developments of ours, we presently have six single-family subdivisions in which construction is completely halted. In two of these subdivisions there have been no housing starts in at all as the road work and other improvements were completed when the market started its abrupt turnaround. These projects are presently in a very negative cash flow position.

The millions of dollars being lost by Tennessee mortgage companies, real estate firms, builders and developers is staggering because of the inability to compete in the national money market. Prompt action is sorely needed to relieve this extreme situation.

Respectfully,

J.R. Chamberlain Jr.
J. R. Chamberlain, Jr.

JRC:bad

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Life and Casualty Insurance Company of Tennessee

ALLEN M. STEELE
PRESIDENT

Life and Casualty Tower
NASHVILLE, TENNESSEE 37219
615/254-1511

June 7, 1974

The Honorable Winfield Dunn
Governor of Tennessee
State Capitol
Nashville, Tennessee

Dear Governor:

This is to urge your favorable consideration to the proposal for an increase in the ceiling on interest rate which may be charged by banks to larger users of credit.

In my view there are three principal points: The first is that banks are entitled to the opportunity for reasonable profit on money which they lend to commercial borrowers. Under present conditions existing throughout this country the ten percent ceiling imposed on the rate which may be charged in a substantial measure denies Tennessee banks this opportunity and even in many instances requires doing business at a loss in order to meet the needs of their customers.

The second point is the one which I would particularly emphasize. That is, the real detriment caused to business and commercial interests within the state under present conditions by this artificially imposed limit. As you know, a large majority of the other states have entirely or to all practical effect removed the artificial limit in the manner (loans to corporations in excess of $50,000, or etc.) in which the local banking industry is seeking. It is simply an economic fact of life that when the rate for money charged in the market place across the country is higher than the ceiling rate in Tennessee, then the supply of money which otherwise would be available for Tennessee business borrowers becomes depressed and limited and flows instead to these other areas where the rate is not so constricted. Our Company is a lender across the country and from close involvement in its lending activities for a number of years I know firsthand the restricting effect on the availability of credit in those areas where there is an artificial limit lower than the going market rate. There isn't any question but that, if the market rate for money remains above ten percent across the country, the formation of new businesses and the progress and well-being and growth of existing businesses in Tennessee will be substantially hampered by the ten percent limit in our state.

The third point is that while a limit on the rate charged to the small or unsophisticated user of bank credit is entirely valid, there is no more validity to placing a ceiling on the rate charged to a knowledgeable business borrower than there is in placing a ceiling on the price which he may charge for his service or product, of course absent the monopoly situation and assuming the free competition which does in fact exist.

With personal regards,

Sincerely,

Allen

Allen M. Steele

AMS/dl

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CUMBERLAND
CORPORATION

ENGINEERED PRODUCTS
CHATTANOOGA, TENNESSEE 37401 • P. O. BOX 1446 • Phone 615/267-4473

July 24, 1974

Mr. James E. Smith
Controller of the Currency
U. S. Treasury Department
Washington, D.C.

Dear Mr. Smith:

This is to inform you of recent difficulties experienced by Cumberland Corporation in borrowing funds for working capital additions. These difficulties stem from the 10% limitation set by the state constitution on interest chargeable by Tennessee banks.

As is customary with us, borrowed funds are used periodically for working capital additions as sales volume fluctuates. Cumberland Corporation bid on and secured a large government contract early this year. (Army & Air Force Exchange Service, Dallas, Texas). This order necessitates a significant build-up in inventory and receivables. When we approached our local bank, we were informed that, due to the interest limitation mentioned above, funds were not available. It then became necessary for us to go outside of Tennessee for our needs. The loan we secured was through a financial corporation at an exorbitant interest rate. In addition, a recent decision by us not to participate in a large Chicago Post Office bid was significantly influenced by this same funds shortage.

It seems to us that some sort of relief for the Tennessee banks in the matter of the 10% interest limitation would be most helpful to the industry of this state.

Sincerely,

CUMBERLAND CORPORATION

W W Robinson Jr

W. W. Robinson, Jr.
President

WWRJr:1r

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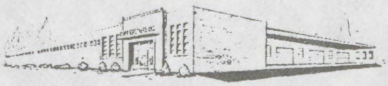
DUFF BROTHERS, INC.



200 NORTH HOLLY STREET (37404) • P.O. BOX 31 • CHATTANOOGA, TENNESSEE 37401

May 28, 1974

TO: MEMBERS OF THE TENNESSEE GENERAL ASSEMBLY

FROM: DUFF BROTHERS, INC.
T. O. Duff, Jr., President
Terrell Fugate, Vice President
Frank F. Duff, Vice President and Treasurer
Herbert H. Swafford, Secretary

We are writing to you because of the very serious situation Tennessee Business men find themselves in with the restrictions placed on banks to limit amount of interest charged to the constitutional limit of 10%. Banks are unable to borrow at the higher National rate and in turn make funds available to the Corporations of this State.

We know you considered a bill concerning this during your last session but no action was forth coming. Since that date, costs of money have spiralled and we find ourselves in a precarious position for financing our business needs and the needs of our customers. This Company is engaged in supplying drug and prescription products to a large area of our State and our ability to meet these needs is being seriously impaired due to the critical shortage of corporate money in Tennessee. Our business is essential in supplying health needs to Hospitals and Pharmacies in this area.

For the good of the economy of our State and for the future of the small Businessman who is the backbone of our economy, we urge that you give favorable reconsideration to a bill permitting corporations to pay in excess of 10% for loans.

We urgently need help!

Sincerely,

T O Duff Jr
T. O. DUFF, JR.

Frank F. Duff
FRANK F. DUFF

Terrell Fugate
TERRELL FUGATE

Herbert H. Swafford
HERBERT H. SWAFFORD

Full Line-Full Service Wholesale Druggists MEMBER NWDA WHOLESALER

COOK INDUSTRIES, INC. / 2185 DEMOCRAT ROAD, MEMPHIS, TENNESSEE 38116 / (901) 396-8600

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May 30, 1974

The Honorable Winfield Dunn
Governor of Tennessee
Nashvilie, Tennessee 37219

Dear Winfield:

In the conduct of our business, it is essential that we borrow large sums of money - tens of millions of dollars - and we rely heavily on our banks in Tennessee to supply these funds. The market for short term money today is considerably in excess of the 10% legal rate in Tennessee. We are gravely concerned over this matter.

I am writing to ask your assistance in doing anything possible to change our laws so our Tennessee banks can be competitive in supplying funds for the growing needs of our communities.

I shall greatly appreciate anything you can do.

Sincerely,

Edward W. Cook
President

EWC/mm

STONE FORT LAND COMPANY
118 East 8th Street
Chattanooga, Tennessee 37402

May 30, 1974

The Honorable Dan W. Oehmig
State Senate
American National Bank Building
Chattanooga, Tennessee 37402

Dear Dan:

I feel confident that it has been brought to your attention by others that Tennessee faces a very severe crisis in the regulations applied to interest rates on loans.

While we recognize that interest rates are at an all time high and the payment of such interest is indeed painful, it is also imperative that we recognize that our State law restricts the ability of Tennessee companies to properly move forward with projects requiring loans. As a matter of fact, because of the constitutional restrictions, many projects have already been stopped completely or postponed indefinitely. This company alone has approximately $15,000,000 worth of work that will fall in one or the other of these categories. The short and long term result will be a severe slow down in the growth for our State and will result in very significant job loss for our people. It is imperative that if Tennessee is to continue to grow that we be able to compete in the money market for funds that we at present cannot do. I urge you to favorably consider a bill permitting corporations to contract to pay more than 10% for loans. The future of the State and the job opportunities for thousands of our people will depend upon your favorable consideration of this matter.

Very truly yours,

T. A. Lupton, Jr.
President

TALjr:am

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GENESCO

NASHVILLE, TENNESSEE, U.S.A. 37202

31 May 1974

FRANKLIN M. JARMAN
CHAIRMAN

Governor Winfield Dunn
Capitol Building
Nashville, Tennessee 37219

Dear Governor Dunn:

I am writing you because I am deeply concerned about the current economic situation facing the State of Tennessee. As you know, Tennessee is one of only three states that impose a 10 percent ceiling on loans to corporations. Under the restrictive monetary policies of the Federal Reserve, the current prime rate nationally is 11 3/4 percent. This means that Tennessee banks are now in the position of paying out more for money than they are able to charge for it.

The natural result of this imbalance is that the banks must either continue to lose money or to sharply reduce their lending. Both of these possibilities have very serious consequences for the economic growth and development of Tennessee.

As a result, I would strongly urge you to call a special session of the legislature to consider passing legislation which would permit Tennessee banks to be competitive with the rest of the nation. I realize that in many quarters this will be an unpopular action. I also realize that the passage of such an action would increase the cost of GENESCO's borrowings in Tennessee. But the consequences for the state are so potentially serious and so pressing that I would like to urge your attention to this matter.

Sincerely,

F. M. Jarman

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Tennessee Taxpayers Association

1070 Capitol Hill Building, Nashville, Tennessee 37219 (615) 242-1854

May 31, 1974

STATE CHAMBER DIVISION

Mr. Robert Gilliam
Tennessee Bankers Association
21st Floor, L & C Tower
Nashville, Tennessee 37219

Dear Bob:

Retailers, wholesalers, manufacturers, utilities, and other business organizations in Tennessee are now unable to obtain an adequate supply of bank credit for inventories, receivables, and capital expansion. Some businesses have abandoned plans to build new facilities because loans are unavailable.

It is the judgment of the Board of Directors of the Tennessee Taxpayers Association that the interest ceiling of 10% must be increased, at least for corporate borrowers, if Tennessee is to meet competition of neighboring states for economic growth. Unless interest rates are increased, business activity will slow down, the number of job opportunities will decline, and unemployment rates will increase. It is our strong conviction that the shortage of bank credit will become much more serious during the summer of 1974.

The Association and its State Chamber of Commerce Division urge lending institutions and state government to examine every possible method of changing the Tennessee Constitution and laws to permit an increase in the limit on interest rates.

Very truly yours,

Don Jackson

Donald W. Jackson
Executive Vice President

DWJ/st

Organization and Newspaper Editorial Support Endorsing a Higher Interest Rate Ceiling for Corporations in Tennessee.

Newspaper:

Knoxville Journal
The Daily News (Memphis)
Memphis Press Scimitar
The Commerical Appeal (Memphis)
The Tennessean (Nashville)
The Nashville Banner
The Chattanooga Times
The Chattanooga News - Free Press
The Jackson Sun
Johnson City Press - Chroncile
Dyer Reporter
Gainesboro Times
Bristol Virginia - Tennessean
Cookeville Dispatch

Trade Associations:

Tennessee Bankers Associaton
Tennessee Savings & Loan League
Mortgage Bankers Association of Tennessee
Tennessee Manufactures Association
Tennessee Taxpayer Association
Chattanooga Manufactures Association
Tennessee Building Materials Association
State Chamber of Commerce
Memphis Chamber of Commerce
Nashville Chamber of Commerce
Chattanooga Chamber of Commerce
Milan Chamber of Commerce
Union City Chamber of Commerce

The interest rate issue

Sen. Neal. Rep. Burks

have the key to

continued economic growth

Cookeville Dispatch
June 11, 1974

If for no other reason, Putnam County's legislative delegation, which includes Sen. Vernon Neal and Rep. Tommy Burks ought to sit down and take a close look at the very real bind that the state's bankers find themselves in.

Indeed, the immediate future of the school board's building program faces an uncertain road because no later than last week the county cancelled a bond sale because—

1. The bond resolution passed called for a ceiling of six per cent interest annually.

2. Nobody in the money market wanted the bonds at that rate, thus nearly $4 million worth of school construction has been delayed, possibly for the remainder of the year.

There is some important background information the people ought to be aware of when we talk of bankers and interest rates. The 1870 Tennessee Constitution put a 10 percent lid on interest rates and it has stood the test for more than a century. Now, however, with the sort of inflation being experienced around the world, that interest rate lid is similiar to looking through a glass darkly. In a word, the framers of the Constitution did not forsee such inflationary sisituations as is the case today.

Simply said, interest rates on on corporate borrowing in most of the states today have been pushed close to 12 percent. When Tennessee banks have to go out of the state to "buy" money to loan to their corporate customers, they lose money. In their present financial condition, few banks are in a position to absorb the loss. So they curtail loans.

Tommy Lynn, president of the First National Bank of Cookeville; Charles R. Miller Jr., president of the Citizens Bank of Cookeville, Bob Hudson, president of the Bank of Cookeville—and the words of these men can be believed because, aside from desiring to build sound financial institutions, they have a vital stake in the welfare of the community—all believe the situation is serious enough for a special call of the General Assembly in order that special legislation could be enacted to lift the constitutional lid on the interest rates.

They believe that Putnam County and in fact the entire state is being placed at a serious economic disadvantage, and so do many other businessmen.

What does damage to the state's economic health also does damage to the pocketbooks of each individual. Being placed in the position of curtailing or even not loaning money at all for corporate construction for new structures or for expansion can rapidly cause economic decay. And thus the pocketbook power of families follows a parallel pattern.

Senator Neal and Rep. Burks and all other men running for public office ought to forgo the temptation to use this as a political issue—and take a hard, firm and realistic look—and do what's best for the economic health of the state and our county.

The legislature has the key to unlock a dangerous door. If used properly everyone will benefit; if twisted into a political football, then short-term political gain will speed up economic dry rot.

Bristol Virginia-Tennessaan
June 11, 1974

As We See It

A Tennessee Crisis

An ancient provision in an outmoded state constitution has Tennessee bankers in a serious bind and if the critical emergency isn't corrected soon, it will have serious consequences for the state's economy.

An analogy perhaps best explains the problem. Assume you sell shoes and only shoes and it costs you $10 to buy wholesale a pair of shoes and yet assume a state law prohibited you from charging more than $8 retail for that same pair of shoes. You would lose $2 per pair and it wouldn't matter if you sold one pair or one million pairs a week, your loss would still be $2 per unit.

That, in essence, is the problem facing Tennessee bankers. And if it just pertained to the profit made by the banking institutions, we wouldn't be nearly so concerned but it goes far beyond that.

A provision written into the state constitution in 1870 sets a ceiling of 10 per cent on business loans. That means that banking institutions lending money in Tennessee to corporations can only charge a maximum of 10 per cent interest on that money.

For more than a century, Tennessee got away with that. But the state finds itself now in the midst of a construction boom by corporations — new plants, expansions, etc. — which is one of the most impressive in the nation.

Tennessee corporations and even many of the new plants coming into the state logically turn first to Tennessee banks for their loans for capital needs.

And that's the rub. The increasing demands for money for lending purposes is forcing the Tennessee financial institutions — banks, mortgage bankers, savings and loan associations — to go out of state to "buy" the necessary money where the interest rates are currently 11½ or higher. Indeed, only Tennessee, Arkansas and Montana, of the 50 states, suffer from outdated constitutional provisions limiting interest on corporate loans at 10 per cent. It's like the pair of shoes: Tennessee bankers have to pay 11½ or more interest on money they "buy" but they can only charge 10 per cent interest on that same money after they loan it to Tennessee corporations.

What is this situation doing? Tennessee financial houses are being forced to curtail loans, thus bringing about the obvious slowdown to Tennessee construction. J. Robert Cannon, of Nashville, president of the Tennessee Mortgage Bankers Association recently said that $50,000,000 in construction projects are being delayed in Tennessee because of a lack of financing.

A grade schooler can soon surmise the consequences. Unless relief is forthcoming soon, Tennessee will experience its own recession with continued high prices but sharp reductions in construction industry employment, lost jobs, stagnating industrial activity and expansion, goods and services curtailed, fewer consumer loans and general economic chaos.

Unless there is emergency relief, it won't be long before Tennessee's economic boom turns into a bust.

There are solutions. The most obvious, of course, is to amend the constitution and remove that restrictive interest ceiling provision. But a constitutional convention could not even be called under state law until 1977 to consider the matter and the state's economic experts — not just bankers — say that will be too late.

Another solution — and, as we've already noted, it really isn't a solution at all — is simply for banks to continue the trend of curtailing corporate loans.

The Tennessee legislature this year had the problem before it but as it has done in many areas over the past four years, it looked the other way.

So what bankers and many economists in the state are calling for now is a special legislative session to enact legislation which would permit corporate borrowers to contract for the payment of interest rates higher than the 10 per cent limit. It would have to be tested in the courts but it appears the only logical and immediate solution to a problem which needs immediate attention.

This appears an equitable solution because such a law would apply only to corporate loans which, of course, involve the big money demands for Tennessee financial houses. The proposed law would have no effect on smaller consumer loans which don't pose a problem anyway because the state's banks are forced to "buy" money from out - of - state to meet the smaller consumer demands anyway.

Proponents of the change are correct when they say the present situation is making Tennessee a financial island in the large financial market sea. The big money lenders are not going to lower their interest rates to Tennessee banks simply because the state banks can't charge enough interest to the corporate borrowers to recover their losses. The time has come for the governor and the legislature to acknowledge the crisis and do something about it.

Nashville Banner

1100 Broadway, Nashville, Tenn. 37202—255-5401
Nashville's Oldest Newspaper—Founded 1876

12 - Wednesday, June 5, 1974

A BIBLE THOUGHT

Therefore to him that knoweth to do good, and doeth it not, to him it is sin. — **James 4:17.**

Interest Limit Threatening State Growth

TENNESSEE'S "money pinch" — the limitation of 10 per cent on corporate loans — is making the record rate of inflation a dangerously acute problem for corporations seeking dollars for modernization, expansion and other capital improvements.

Financial houses — bankers, mortgage bankers, savings and loan associations — see the 10 per cent ceiling as a vehicle traveling well down the road to a full-scale "credit crunch" and maybe a recession in this state.

They say their hands will be tied in lending sufficient money to Tennessee corporations, however unappealing the high cost of interest, at a time when customers may need it most.

This state — particularly the larger urban areas — has experienced a breathtaking era of construction and progress.

Gleaming shafts of steel and concrete and glass jut into the skies from Memphis to Bristol.

Nashvillians are most familiar with skyline changes. Their city has become the showcase of the South in construction development.

It appears now that the showcase lights may dim — or even go out.

The problem is that in order to obtain funds necessary to meet today's unprecedented loan de- 15
mand, Tennessee banks are being forced to purchase money on the open market at rates of 11 ½ per cent — and higher — and then reloan the same money in Tennessee at no more than 10 per cent.

Its effect is vividly painted, matter-of-factly, by W. W. Mitchell, chairman of First National Bank of Memphis and president of the Tennessee Bankers Association:

"Tennessee banks want very much to continue to meet the credit needs of their customers, even if it means suffering short term losses. But such losses cannot be sustained over a long period of time."

Two roads are open. The first is relief from Tennessee's constitutional 10 per cent interest limitation.

The second is for banks to sharply reduce their lending, a step that would dry up the supply of capital necessary to keep the state financially healthy and to finance its continued growth.

Tennessee lenders saw the "credit crunch" coming. And they saw with disappointment the failure of the General Assembly to permit corporations to obtain loans at national money market levels.

The measure applied only to corporations and not to consumer loans — automobile, credit card, home mortgage and others.

The lenders say if this bill had passed and had been upheld by the courts, they could have breathed easier about Tennessee's economy crisis.

And the economy crisis is the avenue to no money to build new factories, business and apartments and no money to finance new equipment and inventories.

The net result would be the loss of jobs, purchasing power and tax revenues — at all levels of government.

D. Roscoe Buttrey, president of Nashville's Third National Bank, set the tone: "If Tennessee is made an island in the large financial market sea and the states around us are able to drain funds out of our economy, it will affect everyone in the state and is a set of circumstances we just cannot afford."

The waters of the "credit crunch" sea have already nearly isolated Tennessee. Only Arkansas and Montana are stranded, like Tennessee, with the 10 per cent limitation.

Banks in the other no-limit states can siphon money out of Tennessee because they can pay lenders higher rates on their deposits.

The cold, hard fact is that, whether done now or later, it simply does not make sense for Tennessee borrowers to be unable to get the money available in 47 other states.

The illness is paralysis of progress.

The cure is relief from the interest limit.

Tennessee's banks are asking legislative action. Such action, which would have to come in the form of a special session of the legislature, appears doubtful before the August primaries.

Many legislators say they aren't convinced the interest squeeze has reached the critical stage.

But the danger is there. And it is real.

And it has to be dealt with, sooner or later, if Tennessee's forward economic progress is to be sustained.

Memphis Daily News
June 12, 1974

BANKS' FUTURE DIM UNLESS CHANGED

(This is the third in a series of articles pertaining to corporate credit and loans.)

"Recently, I had contact by phone with three of the leading insurance companies of America which refused to approve loans or even take applications in Tennessee," says Wallace E. Johnson, Vice Chairman of Holiday Inns.

Because of the ten per cent ceiling limitation set on large corporate loans by the Legislature in the 1870's, Tennessee has become one of three states to have such restrictions. Because of the refusal of loans in the Johnson case, which would be best exemplified by a statement made by Johnson in which he said that these "insurance companies did not want to take the risk of being sued because of a violation" and they said to him, "if you need any money down in Mississippi, Wallace, we would be glad to oblige."

The banks in Tennessee, according to Johnson, are in an extensively self-damaging position. The law says that a ten per cent ceiling is the limitation, however, when interest is involved in the total concept, which ends up as 11½ per cent, there is no way that the banks can make money, thus hindering the borrowing and loaning public and corporations.

Money is grossly flying from Tennessee and going to other states, Johnson further said. Because of this flight, there has been a direct effect on home building and real estate. Consumer purchasers are mounting up from 18 to 33 per cent.

In a letter to Governor Winfield Dunn, Johnson expressed the over all views of many corporations: "The State of Tennessee, in my opinion, is suffering because of the ceiling placed on interest charges that our Tennessee banks can charge their customers. In the interest

Wallace E. Johnson

of continuing growth and development of our State, and so that we can remain in competition with our sister states, I would strongly recommend that a special session of the legislature be called for the purpose of passing the necessary legislation to permit Tennessee banks to increase their interest rates in line with what the current market demands. . . . I realize that it could cost Kemmons Wilson and me additional money if such legislation is enacted, but in the long run it is in the best interest of the future of our State to allow our banks to be competitive in the money market of our country."

In conclusion, Johnson said to Governor Dunn that if something was not done along those lines that "we" would find that industry would not be attracted to Tennessee nor will expansion take place from within because the banks would not be able to afford the luxury of putting loans on the books where they would loose money each time they did so.

Memphis Press-Scimitar
A Scripps-Howard Newspaper
CHARLES H. SCHNEIDER, Editor
W. FRANK AYCOCK JR., Business Manager
Telephone 526-2141; Want Ads, 526-8892; Circulation, 525-7801
Address: 495 Union Avenue, Memphis, Tenn. 38101
Page 6 Monday, June 3, 1974
Give Light and the People Will Find Their Own Way

Tennessee's Money Problem

Money, as is the case with all commodities, has a way of seeking the best market.

It is this simple fact of economic life that has the Tennessee banking industry in a serious bind.

At the bottom of the problem is the Tennessee Constitution, ratified in 1870, which forbids the lending of money at more than 10 per cent interest. Only two other states have similar limitations on interest rates—Arkansas and Montana.

But money has become scarce and now interest rates of 11 per cent and higher are being charged across the country. This means that money for loans is bypassing Tennessee in favor of areas where it can earn a higher rate of return.

Tennessee bankers fear that if they are unable to supply the funds needed for plant expansion, new construction and inventory, the state is in for serious economic setbacks.

* * *

The situation was summed up by J. Robert Cannon, of Nashville, president of the Tennessee Mortgage Bankers Association, who reported that construction projects totaling $50,000,000 are being delayed in the state because of a lack of financing.

Cannon warned: "If we see a continued drying up of short-term bank credit in Tennessee, there will be a lot of unemployment in the construction industry. It is one of the first and hardest to be hit by conditions such as we have now."

William W. Mitchell, chairman of the First National Bank of Memphis and president of the Tennessee Bankers Association adds another warning. Banks in states where there are no interest limits, he says, are able to siphon off money from Tennessee and re-lend it at higher rates. If something isn't done, Mitchell says, Tennessee's money supply will be cut off.

Not a very bright prospect for a state that is striving to forge ahead in industry and commerce.

The Bankers Association has launched a statewide campaign in support of a special session of the Legislature to act on a bill designed to remove the 10 per cent limit on loans to corporations. The bill would not apply to individuals and would have no effect on consumer credit. Although a similar bill was held up in the 1974 session of the Legislature because of an opinion from the Attorney General's office that it was unconstitutional, the bankers believe their new bill will pass the test and are willing to back it up in appeals to the U.S. Supreme Court if necessary.

* * *

Governor Dunn is reported to be reluctant to call a special session of the Legislature to act on a measure that might be unconstitutional. We hope the Governor explores the matter further because this is a problem that cries out for early solution.

Of course, the Constitution could be changed, but the very earliest a convention could be called for that purpose would be 1977. That, the bankers say, would be too late.

COMMERCIAL APPEAL, MEMPHIS, TENNESSEE June 12, 1974

Limit On Business Loans Is Fought

By BRUCE SANKEY

Economists at Memphis State University and the University of Tennessee in Knoxville have joined state bankers and some businessmen in asking for an end to Tennessee's 10 per cent limit on business loans.

"We must accept the fact that our money market is national and the flow of funds is affected by economic factors, not state boundaries," says a new report issued by the Bureau of Business and Economic Research in the College of Business Administration at MSU.

"If we do not, the Tennessee economy will suffer from unsatisfied credit needs of its industrial and commercial firms which may well lead to economic stagnation, the report adds.

UT's Center for Business and Economic Research said that with almost all other states having no limit for corporate loans, "it seems clearly to be in the interest of the Tennessee economy as a whole to eliminate the statutory limit."

Tennessee is one of but three states (the others are Arkansas and Montana) having a 10 per cent ceiling on interest rates that can be charged for business loans.

State bankers, who must purchase funds in the national money market at rates exceeding the state lending limit, are leading a vigorous effort aimed at getting legislative relief from the ceiling.

Paul R. Lowry, director of Memphis State's business bureau, said it was his opinion that the conditions of today with prime above 11 per cent are a much greater threat to the state's economy that the money crunch of 1968-69.

"National economic indicators suggest that the prime interest rate will remain above 10 per cent for a long period of time," says Lowry. "If this happens, Tennessee commercial banks will not be able to provide financial services required by Tenenessee business firms without some relief from the 10 per cent limitation on loans."

Lowry said the restriction on loan rates and the resulting low rates paid by Tennessee banks for funds will certainly cause a "large outflow of time deposits from the state and a drying up of outside funds flowing into the state.

CORPORATE CORNER

SEC Fines Firm

The Securities and Exchange Commission has penalized a Memphis investment company and its manager after finding that the concern manipulated the price of shares being offered to the public.

The firm, Financial Investments Corp., made short sales a week or so before the effective dates of registrations covering public offerings of the same stocks, the SEC said.

This, the government agency continued, "caused the market prices of those stocks to fall and hence depressed the prices at which the shares covered by the registation statements were sold to the public."

A short sale is the sale of borrowed stock with the expectation that the price will decline, allowing the seller to repurchase the stock at a lower price.

Financial Investments was suspended from the securities business for six months.

Edward Stewart, Financial Investments manager, was barred permanently from the securities business, although he will be allowed to apply for permission to re-enter the business after a period of time.

Index Shows Increase

The Memphis "Help-Wanted Advertising Index" registered another increase in April, The Conference Board reports.

At 175 (1967-100), the seasonally-adjusted index is 9 points above March's reading and 11 points above February's 164 mark. The April index also is 7 points above its level of a year ago.

The Help-Wanted Index measures the volume of classified advertising in Memphis' two major newspapers. It is considered a "coincident" indicator of general business. A gain in the index, claims the Conference Board, often precedes a decline in the unemployment rate.

TREND OF STAPLE PRICES

NEW YORK, June 11—(AP)—The Associated Press weighted wholesale price index of 35 commodities advanced to 352.48.

Previous Day 349.37, Week Ago 340.71, Month Ago 338.32, Year Ago 276.94.

	1974	1973	1972	1971
High	374.75	351.71	232.28	195.13
Low	331.97	231.53	194.22	184.58

1926 average equals 100.

Editorial)

CHATTANOOGA NEWS-FREE PRESS

ROY McDONALD • Publisher | FRANK McDONALD President | LEE ANDERSON Editor

Published Weekday Afternoons and Sunday Mornings

THURSDAY, MAY 30, 1974

It's Your Welfare That's Involved

These are some things nobody wants: Jobs lost, industrial activity and expansion stagnating, the provision of goods and services curtailed, consumer loans unavailable, a general chaos in our economy as we slip backward.

But all of these things, and more, could come if there is not relief from the Tennessee Constitution's limit of 10 per cent on interest rates, while much higher rates are being offered elsewhere throughout the country.

Most of us do not like high interest rates—but they are better than a lack of available money.

Interest, after all, is simply the wages that money can earn for the work it does. Just as workers seek the best pay they can get, so money goes where the interest is highest. If Tennessee has lower interest rates than other states, then money leaves Tennessee and goes elsewhere, creating economic degeneration here that would be harmful to all of us.

The obvious solution, therefore, is to remove the Tennessee constitutional limit on interest rates completely, and let them set themselves in the free market, by dealing between willing lenders and willing borrowers.

Unfortunately, that isn't easy to do.

Tennessee's Constitution written in 1870 provided the top limit of 10 per cent on interest rates. The idea was to protect the people from usurers. It seems probable that the Constitution's authors were not thinking about corporate business needs because there simply were few corporations then and conditions in 1870 did not indicate the problems of today.

If enough sentiment to amend the Constitution could be generated, the process would take until 1976 to complete. That's too long to wait.

So it has been proposed that an effort be made to interest a majority of Tennessee's senators and representatives in the dire need; to justify a call by the governor of a special session of the Tennessee General Assembly for the purpose of passing a law removing the 10 per cent limit.

While we favor the intended result, we do not think legislative action of this kind can change the Constitution. The next step of proponents, therefore, would be a move to take the new law in a test case to the Tennessee Supreme Court. There it would be contended that the intent of the framers of the 1870 Constitution did not include corporate finance (as is probable) and that willing corporations may voluntarily divest themselves of the protection of the 10 per cent limit and accept loans at higher rates at their own discretion.

Again, we favor that result but not the method. It would be up to the court to decide.

That the need is great, however, should not be in doubt. Tennessee is one of only three states with such a low limit as 10 per cent. The others are Arkansas and Montana, neither so highly industrialized as Tennessee and thus without Tennessee's needs. Four states have 12 per cent limits, two 15 per cent, three 18 per cent, one 21 per cent, 37 no limit.

No one should get the idea that action to raise the interest rate ceiling is "for the bankers." We are not primarily concerned about the bankers' welfare but we are deeply concerned about the welfare of Tennesseans who need business to be able to borrow the money to buy the supplies and maintain and expand the plants that provide jobs and meet payrolls and provide us with goods and services.

Interest rate limits should be eliminated as quickly as possible in the proper way and left to compete, up and down, on the free market in the private enterprise tradition that has built America.

THE COMMERCIAL APPEAL
A Scripps-Howard Newspaper
GORDON HANNA, Editor
Published by The Memphis Publishing Co., 495 Union, Memphis, Tenn. 38101
W. FRANK AYCOCK JR., Business Manager
Consolidated July 1, 1894 { The Memphis Commercial .... Established 1889; The Appeal .... Established 1840; The Avalanche .... Established 1867 }
Page 6 Tuesday, June 4, 1974

Banks In A Bind

INFLATION OF THE sort being experienced around the world today was not within the vision of the framers of Tennessee's 1870 Constitution. The 10 per cent ceiling they put on interest rates stood the test of more than a century, even so. But in 1974 it has put Tennessee's bankers in a bind.

In simple terms, interest rates on corporate borrowing in most of the states today have been pushed close to 12 per cent. When Tennessee banks have to go out of the state to "buy" money to loan to their corporate customers, they lose money. In their present financial condition, few banks are in a position to absorb the loss. So they curtail loans.

The situation has come to a head within the weeks since the 88th General Assembly ended its 1974 working session. In the eyes of the bankers, it is serious enough to get them out hustling for a special legislative session in hope of breaking through the interest ceiling.

THE CHANGE SOUGHT by the bankers makes sense under current market conditions. But it's no small quest.

One hindrance is that this is an election year. There are races for governor and for most legislative seats. A special summer session that would interrupt legislative contests would not be popular. There also is the danger that it might spill over into other issues.

At this early stage, we have seen how quickly demogoguery can rear its ugly head in the interest rate question. Just a day after bankers had met with legislators across the state last week, Ray Blanton, one of several Democratic candidates for governor, fired a blunderbuss charge. Raising interest rates, he said, would be "rather foolish." First of all, he ignored the fact that legislation would not, could not, raise rates, but that it would waive the right to claim usury if a loan customer agreed to pay above 10 per cent, as he would if he went out of Tennessee to borrow. Nor did he mention that this would affect only corporations that borrow money, not individuals seeking money for a down payment on a house, or money for a new car, or any other purpose.

A fast whistle should be blown on every candidate who tries to politicize this economic problem. But it is nevertheless a fact of life that the bankers must expect difficulties from those who put a demogogic twist on the facts.

Even without the obstacle of an election and misleading statements by candidates, the bankers have a tough job. They must convince Gov. Winfield Dunn that a special legislative session would be advisable. They must show legislators it is imperative to act without delay. Otherwise, it would seem to make sense to take up the problem at the 1975 session beginning in January.

If this 10 per cent ceiling is actually holding down development in Tennessee, if it is costing the state jobs, if over the long run we are going to suffer lasting economic damage, these things must be clearly demonstrated by both the bankers and the businesses which claim they are hurting because money is not available at their nearest bank.

Whether a waiver law would hold up under the state Constitution cannot be established without a full court test. But the negative opinion issued by former state Atty. Gen. David Pack need not be regarded as final.

IF TENNESSEE IS being placed at a serious economic disadvantage, there is no question about the need for trying to correct that through legislation. The question is how soon it must be done — or *can* be done.

(EDITORIAL)

ESTABLISHED 1869

The Chattanooga Times

ADOLPH S. OCHS, *Publisher, 1878-1935*

Published Every Day in the Year by The Times Printing Company

RUTH S. HOLMBERG
Publisher

A. WILLIAM HOLMBERG
President and General Manager

HARVEY D. MEDEARIS
Treasurer

NORMAN BRADLEY
Editor

JOHN N. POPHAM
Managing Editor

RAY HOWE
Editorial Production

PAGE 6 SATURDAY, JUNE 1, 1974.

Bankers' Plight Is Public Problem

If money can be thought of as just another product bought and sold on a competitive market, one begins to understand the predicament of Tennessee bankers.

They have to go into the big financial centers and "buy" money at an interest rate of 11 or 11½ per cent, but are prohibited by an ancient constitutional clause from "selling" it to their own borrowers at a rate greater than 10 per cent.

The effect is obvious. They cannot afford to take the losses for long on the huge sums needed to serve corporate customers. Money will simply flow into other states where it can command a "better price" in terms of interest, and the supply in Tennessee will tend to dry up. Plant expansions will be put off, inventories reduced, production slowed, employment curtailed for the lack of readily available funds.

This is why the bankers are asking legislators to consider passage of an act permitting corporate borrowers to contract for the payment of interest rates higher than the constitutional ceiling of 10 per cent. The measure obviously would have to be tested promptly in the courts to make sure such willing agreements would be fully enforceable.

If such a plan were considered in a vacuum, it should be opposed as pure subterfuge to get around a constitutional limitation. Given the present nationwide conditions of inflation and the readiness of large corporations to pay what they must for needed financing, it can be rationalized as necessary to meet an emergency. Tennessee cannot be made an island of low interest rates in a sea running at a high tide of money charges. The state's restriction, imposed a century ago, will have no effect on the general economy. Instead, the state and its people will be penalized by an artificial barrier against adjusting to conditions as they are.

The legislature would do well to grant the banking industry this degree of flexibility with full recognition it still may be declared invalid under an outmoded restriction.

Tennessee's Larger Banks Are Rationing Credit

THE NASHVILLE BANNER, Thursday, June 27, 1974

By JIM BENNETT

Tennessee's larger banks are rationing credit rather than take losses because of the gap between the 13 per cent cost of money and the 10 per cent interest rate ceiling.

"Credit rationning is certainly taking place," said Robert Seaver, associate manager of the Tennessee Bankers Association here.

"The state's large and medium-sized banks simply can't afford to do anything else," he added.

Tennessee is one of three states where the banking industry has been caught in a pinch because of the high price of money as opposed to the interest it can earn.

Tennessee's constitution sets the maximum interest rate at 10 per cent, however, state bankers must pay up to 13 per cent for money bought through the Federal Reserve System.

Seaver said one Nashville bank, identified only as one of the three largest in the city, reports that its construction loan-portfolio has been reduced 20 per cent compared with the same period one year ago.

The same bank has not made any new committments for construction loans during the first quarter of this year, Seaver said.

Another Nashville bank has turned down applications for commercial loans during the past two months amounting to $38 million.

"This was not because of credit worthiness but because of the shortage of loan money," Seaver said. "This points out very vividly the problem that has developed."

Earlier this week, W.A. Mitchell, president of the TBA, said that since April, one of the state's largest lending institutions has cut by more than $100 the average amount of funds borrowed at high cost.

Mitchell said the institution reported it could not afford to continue loaning money purchased at a higher rate in the national market.

Mitchell and Seaver both said Tennessee's banking industry plans to continue its effort to pursuade the state legislature to act quickly to remove the interest rate ceiling on corporate loans.

Such a bill is pending in the legislature. It allows corporations to waive their constitutional guarantee that they will not be charged more than 10 per cent interest for borrowed money.

Seaver and Mitchell said there was no substance to reports that the banking industry wasn't pushing as hard now for the legislation.

"That's just not the case and we regret that this has been implied in some news reports," Seaver said. "If anything we have intensified our efforts to educate the public on the seriousness of the problem."

Kingsport Times

Loan Money Drying Up, Bank Reports

July 11, 1974

By LEE OLESON
Times-News Staff Writer

Tennessee's so-called "usury law" is drying up the assets of local lending istitutions and threatening growth around Kingsport, a Kingsport banker says.

For months local bankers have been saying that the state law that puts a 10 per cent limit on loans has threatened their business, and now First National Bank of Sullivan County has facts to support that view.

The county's biggest bank is a sound financial condition, but during the first six months of 1974 loans rose at a much faster rate than deposits, according to the bank's statement of condition released last week.

Loans and discounts rose from $65 million to $87 million, over 30 per cent, during those six months. Deposits only rose about 12 per cent, from $120 million to $136 million in the same time.

As a result, a spokesman said, the bank will soon be faced with the prospect of denying loans to potential borrowers. One of those potential borrowers is requesting money for construction of the Fort Henry Mall.

"I don't know if we can make the loan now," said bank president John W. Andersen.

Most of First National's loans are for under $100,000 — loans for medium-sized local businesses, car loans, home improvement loans, and the bank must now tighten its "lines of credit" to many of these borrowers, Andersen said.

Andersen said that in the last two weeks one depositer has withdrawn a total of $600,000 in time certificates for this simple reason: he can get higher interests in any other state.

A century old constitutional provision puts a 10 per cent maximum on interest rates, and since early this year the so-called "prime rate" has been much higher than 10 per cent: 11, 11½, 11¾ and now 12 per cent.

Thus a person or corporation can borrow money at the 10 per cent maximum in Kingsport and, theoretically, loan the same money in another state at a higher interest rate.

The prospect isn't far-fetched. Recently Andersen had a request for a large loan from a local company with out-of-state connections. And when he checked other banks in Bristol and Johnson City, he found that they had received identical letters for identical loans, Andersen said.

And Upper East Tennessee is a convenient place from which to find higher out-of-state interest: Virginia has no interest limit, North Carolina has a 10 per cent limit on loans of from $50,000 to $100,000 but a 12 per cent limit on loans from $100,000 to $300,000 and no lilmit above that. Kentucky has no interest limit either, and Georgia has no limit on loans over $2,500.

In order to find more cash, the bank has sold millions of dollars in U. S. government bonds, and other bonds and securities.

Monday First National Bank officials renewed a call for a constitutional convention to raise the interest ceiling. One proposl would give the legislature the authority to change the interest ceiling, so a constitutional change won't be necessary every time the prime rate goes too high.

Kingsport Times-News
May 30, 1974

Home loans 'available'

Commercial Loan Money Tightens

By LEE OLESON
Times-NEws Staff Writer

The nationwide increase in so-called "prime" interest rates has threatened to put a damper on industrial and commercial expansion around Kingsport, according to local officials in banks, savings and loan associations, and mortgage companies.

There is still money available for home mortgages, but the availability of that money is being threatened by the increase in the prime rate to 11 and 11½ per cent, the officials say.

Tennessee law puts a limit of 10 per cent on the interest that lending institutions can charge for money for commercial and industrial loans. But mortgage bankers, who borrow money at the prime rate from out of state for local commercial loans, say that now they must loan money at a loss or not loan money at all.

Although local officials say they know of no cancellations of local commercial or industrial projects because of the commercial money shortage, they say eventually such cancellations are inevitable.

"We can see a trend," said one local savings and loan official, who asked that his name not be used.

Local savings and loan association officials emphasized, however, that a present money is available for home mortgage — and at 8½ to 9½ per cent interest, well below the so-called "prime rates" usually set by New York or Chicago banks for large corporate borrowers.

Wednesday night officials from several Kingsport financial institutions met in Johnson City to discuss the problems with financial officials from other East Tennessee cities, and at the same time the Tennessee Bankers Asociation released a statement calling for lifting of the state 10 per cent limit on loans.

The TBA statement sid the 10 per cent limit is causing "a severe financial pinch" on the state's economy, and asked that the legislature remove the limit.

George Deal of Kingsport's Schumacher Mortgage Co., Inc. emphasized the lifting of the 10 per cent limit would not necessary bring an increase in interest on home mortgage loans.

"We're not asking the legislature to raise the ceiling on residential loans — but only to consider increasing the ceiling on loans for commercial expansions and corporate improvements," Deal said.

Deal said the shortage of money for local commercial credit is "becoming serious." At Schumacher Mortgage, Deal said, most of the loan money comes from out-of-state at 11 or 11½ per cent and unless the credit ceiling is lifted "we're going to be left holding the bag."

He said the squeeze on commercial loan money has already started and unless there's a change "you just won't find new industry coming here."

Only two other states, Montana and Arkansas, have limits as low as 10 per cent. Last year North Carolina had a eight per cent credit ceiling and after the prime rate went above eight per cent in North Carolina "you couldn't find anyone to make a loan on residential houses," according to Fred Chetwood of Bennett and Edwards Agency, Inc.

Local banking and savings and loan officials re afraid that if interest rates continue going up outside the state, eventually money in local savings accounts will begin moving out of state into bonds and notes, which offer yields of 8 and 8½ per cent. This would mean that local savings and loan associations would no longer have money for home mortgages, thu sputting a stop to residential as well as commercial expansion.

The increase in interest rates is modest compared to other inflationary increases, especially building costs, one local bank pointed out. "Material for building has gone up must faster than interest rates," the banker said. "Money is still cheap (to borrow) in relation to everything else."

JOHNSON CITY PRESS-CHRONICLE, Sunday, June 9, 1974

JOHNSON CITY TENN PRESS-CHRONICLE.
WHAT THE PEOPLE DON'T KNOW WILL HURT THEM

Opinion

A bind on Tennessee

A current problem of Tennessee banks is also a problem of Tennesseans in general.

Tennessee banks are fenced in by the state constitution, which limits them to a maximum interest charge of 10 per cent at a time when rates in most other states are 11, 11½ and 11¾.

The result is that when our banks go out of state to "buy" money to lend their corporate customers, they are in a poor competitive position. They have to pay so much that they are left with no gain, or even a loss, when they loan the money out at 10 per cent.

In this kind of market, in-state people with money to put into savings begin going out of state where interest is higher, and of course out-of-state people who may have been saving in Tennessee now move their accounts to other states.

Thus Tennessee is long on money going out and short on money coming in, and this affects the whole economy—and hence, the whole people.

So acute is the pinch that the banking industry is urging a special session of the General Assembly at the earlist possible date to consider remedial legislation. (It is not possible to amend the Constitution in time to help, the amending process being so cumbersome that it would be a matter of years before relief could come from this route.)

What the banks propose is an act permitting corporate borrowers (not individuals) to contract in writing for loans higher than 10 percent. Justification would be on the basis of overriding public interest and the existence of a competitive emergency, the reasoning being that those who wrote the 10 per cent limitation into the constitution in 1870 could not have forseen the conditions of 1974.

Granting the need and the logic, can the constitution be supplemented or bypassed in this manner? Admittedly, this is a question for the courts, and a quick test would be sought should the enabling legislation be passed

Since the higher rates would apply only to corporate borrowers, and would in no way affect consumers and their loans—and since judicial sanction would have to be obtained—we favor a call of the legislature to consider the matter.

THE NASHVILLE TENNESEAN
July 16, 1974

Ex-Fed Governor Says 10% Interest Crippling Region

By FRANK GIBSON

Continuance of the 10% ceiling on interest rates in Tennessee could cripple the region's economic development, according to J. Dewey Daane, a former governor on the Federal Reserve Board.

Daane, also former deputy undersecretary of the Treasury, was in Nashville yesterday making plans to move his family here. He will assume his duties as Frank K. Houston professor of banking and finance at Vanderbilt University this fall.

EXPLAINING that the ceiling, which Tennessee bankers are attempting to have removed by a constitutional amendment, limits the flow of funds into the area, Daane said:

"There is no reason I can see why one region should be hurt more than others by this process, but in effect that is what it means. Ceilings limit the flow of funds and make them more difficult to get."

Daane said when such a ceiling is imposed in one region and not in another the market is distorted.

"THIS REGION has been expanding greatly and in my judgment it is a region with great potential, but you're going to cripple it," Daane said.

Daane, 55, retired as a member of the Federal Reserve Board more than three months ago after almost 35 years service in the federal reserve system. He was appointed to that board in 1963 by President John F. Kennedy.

He is a 1939 graduate of Duke University and received both his master of public administration and doctor of public administration from Harvard University.

BECAUSE OF of his experience in debt management, Daane was the Federal Reserve's liaison with the Treasury Department on government financing.

In an interview yesterday, Daane conceded that while higher interest rates add something to the costs that are part of inflation, "from an overall point of view, they (higher interest rates) contribute more importantly to the dampening of the demand that is necessary if inflation is to be contained."

HE DECLINED to make predictions on the future of interest rates in this country but said that higher interest rates and inflation is not altogether a national problem.

He predicted that gold will play a diminishing role as a monetary reserve in the world market.

LG&W Exports Funds For Interest, Miffs Memphis Banks

By BRUCE SANKEY

Memphis Light, Gas & Water Division has moved vast sums of money out of Memphis banks because it can get measurably higher interest rates elsewhere.

The public utility currently has more than $54 million on deposit in the Chemical Bank of New York.

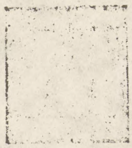
The transfer has caused considerable grousing among Memphis bankers who claim they can't compete for LG&W funds with big Eastern banks while operating under Tennessee interest-rate restrictions.

Some bankers contend that LG&W's action will further slow Memphis' economic growth because the funds will not be available here for lending purposes.

And others criticize the utility's money management on more philosophical grounds, maintaining that local institutions should aid the city's banks during the financial crunch which is worsened for them by Tennessee's usury ceiling.

"In a state with constitutional restrictions, such as Tennessee's, it is difficult for banks to serve their communities when public institutions are exporting the funds of the community the bank is trying to serve," said one banker.

Calvin R. Henze, LG&W president, freely admitted LG&W has moved substantial amounts of its surplus and other funds to New York within the past two months, and said the action was motivated by the higher interest rates paid there.



"Being in the utility business, we should do the best we can for our rate payers (Memphis customers)," Henze said.

And that means, he explained, putting the utility's funds where they can earn the highest interest return.

LG&W puts its money up for bids just like it does its contracts. The best bidder — that is, the financial institution that will pay the highest interest rate — gets to keep the money until MLGW needs it.

"Our basic policy is, when bids are the same or equal then we leave the money in Memphis banks," Henze said. "But recently, the rates of other banks have been quite a bit higher than Memphis banks' bid on money," he added.

Friday, LG&W put some funds up for bid. There were three offers, an 8.05 per cent bid from a Memphis bank, an 11 per cent bid from another Memphis bank, and a 12.30 per cent bid from a New York bank.

"The difference between 11 per cent and 12.30 per cent on a million dollars is $13,000 in interest on an annual basis," Henze said.

On $54 million, that's a difference of about $700.000, and that kind of economic sense is why LG&W placed its money with the New York bank. "That basically is how our board has looked at it," Henze said.

Memphis banks, of course, don't see it that way, nor does the state of Tennessee.

As a matter of policy, the state is keeping its funds in Tennessee banks during the money squeeze and while the usury law remains unchanged.

"I look at state money as a state resource," said Treasurer Harlan Mathews in a telephone conversation from Nashville.

"As long as banks in Tennessee want it and need it and will pay a reasonable rate, we will keep state money here," he added.

W. W. Mitchell, board chairman of First National Bank of Memphis and president of the Tennessee Bankers Association, said there was little First National could do to meet competition for LG&W funds.

"Even though we are not the primary depository bank for LG&W we have over the years bid, with frequent success, on the division's surplus funds by issuing our certificates of deposit.

"We have not, however, been the successful bidder recently," Mitchell said.

"It becomes more apparent in situations such as now exist in Tennessee that unrealistic ceilings can distort credit flow when competitively determined market rates rise above such ceilings and there is no provision that allows corporations in Tennessee to borrow money at market rates," he continued.

It is the contention of Memphis bankers that since they can charge no more than 10 per cent for loans, they can't bid on money such as LG&W's at 12 per cent.

"Were we able to bid more aggressively — and therefore more competitively — we could attract LG&W's funds and make them available for expansion of business in Tennessee," said Mitchell.

WHAT $100,000,000 OF
PRIVATE CAPITAL INVESTMENT
RETURNS IN TAX REVENUES TO
TENNESSEE ANNUALLY

TOTAL REVENUES	$7,896,235
STATE PORTION	$4,737,303 (60%)
LOCAL PORTION	$3,158,932 (40%)

ANNUAL
STATE REVENUES GENERATED
FROM $100,000,000 PRIVATE
CAPITAL INVESTMENT

TAX	AMOUNT
Franchise & Excise	$ 480,000
Income	102,812
Inheritance & Estate	214,111
Gasoline, Gasoline Inspection, Motor Vehicle Fuel	1,325,932
Tobacco	395,081
Beer, Mixed Drinks, Alcoholic Beverages	226,377
Motor Vehicle	465,835
Other	280,060
Sales	1,010,230
TOTAL	$4,500,438

These categories represent 95% of state revenues collected. Inflating to 100% would represent $4,737,303 * (60%)

ANNUAL
LOCAL REVENUES GENERATED
FROM $100,000,000 PRIVATE
CAPITAL INVESTMENT

TAX	AMOUNT
Property	$2,000,000
Sales	432,378
TOTAL	$2,432,378

These categories represent 77% of local revenues collected. Inflating to 100% would represent $3,158,932 * (40%)

On basis of 100% ———————— GRAND TOTAL $7,896,235 *

TAX REVENUE WORKSHEET

I. SELECTED 15 EXAMPLE FIRMS

Property Value: Average Property Value = 8,287,458

1. 1,558,746	6. 793,106	11. 3,403,029	
2. 3,194,414	7. 3,972,759	12. 40,779,441	
3. 9,000,092	8. 3,921,850	13. 4,918,879	
4. 15,297,587	9. 2,459,062	14. 2,066,530	
5. 2,474,471	10. 18,956,783	15. 11,515,128	TOTAL 124,311,877

II. FRANCHISE AND EXCISE PAID BY 15 EXAMPLE FIRMS

1. 6,090	6. 1,189	11. 5,105	
2. 22,751	7. 13,677	12. 79,780	
3. 34,259	8. 38,787	13. 7,378	
4. 121,888	9. 6,988	14. 3,099	
5. 40,094	10. 133,432	15. 84,340	TOTAL 598,857

Average Franchise and Excise Paid = 39,924

III. TOTAL WAGES AND SALARIES PAID BY 15 EXAMPLES

1. 21,975	6. 600,000	11. 998,245	
2. 1,930,988	7. 1,858,015	12. 29,291,615	
3. 3,100,863	8. 1,391,702	13. 1,465,711	
4. 11,652,627	9. 1,331,216	14. 591,381	
5. 1,950,178	10. 9,067,568	15. 7,181,821	TOTAL 72,433,905

Average Wages and Salaries = 4,828,927

IV. COMPUTED FRANCHISE AND EXCISE TAX RATE

$$\frac{\text{Average Franchise and Excise Paid}}{\text{Average Property Value}} = \frac{39,924}{8,287,458} = .48\%$$

V. FOR CAPITAL INVESTMENT OF $100,000,000 @ .48% RATE = $480,000 Franchise and Excise Paid

VI. Using rounded 1969 Tennessee median family income of $7,500, calculated approximate number of employees:

$$\frac{\text{Average Wages and Salaries}}{7,500} = \frac{4,828,927}{7,500} = 644$$

VII. Computed capital investment per employee:

$$\frac{\text{Average Value of Property}}{\text{Approximate number of employees}} = \frac{8,287,458}{644} = \$12,869 = \text{Capital Investment Per Employee}$$

VIII. For capital investment of $100,000,000 @ $12,869 capital investment per employee = 7,771 jobs created

IX. State sales tax for family of 3-4 @ income of $7,500 for 1 year per Federal Income Tax Form 1040 shows tax of $130 for 1 year.

Multiplied by 7,771 job holders = 1,010,230 State Sales Tax

X. Local sales tax is computed by taking 3/7 or 42.8% of State Sales Tax Total:

$1,010,230
.428
$ 432,378 = Local Sales Tax

XI. From Tennessee Taxpayers Association, ascertained that property tax rate of $4.00 per $100 of assessed value; with property being assessed @ 50% of total value - was a representative formula for the state:

$100,000,000
.50
$ 50,000,000 = Taxable Property ÷ 100 = 500,000 x 4.00 = 2,000,000 = Local Property Tax

The following state taxes are calculated on the per capita average paid to the Department of Revenue in 1973; also, it is assured that each wage earner represents a family of 3.5 persons, or for this example 27,199 persons.

XII. Income = $ 3.78 Per Capita
27,199
$102,812 = State Income Tax

XIII. Inheritance and Estate = $ 7.87 Per Capita
27,199
$214,111 = State Inheritance and Estate Tax

XIV. Gasoline and Gasoline Inspection and Motor Vehicle Fuel = $ 48.75 Per Capita
27,199
$1,325,932 = State Gas Tax

XV. Tobacco = $ 14.53 Per Capita
27,199
$395,081 = State Tobacco Tax

XVI. Beer, Mixed Drink, Alcoholic Beverage = $ 8.32 Per Capita
27,199
$226,377 = State Beer, Mixed Drink, Alcoholic Beverage Tax

XVII. Motor Vehicle = $ 17.13 Per Capita
27,199
$465,835 = State Motor Vehicle Tax

XVIII. Other (includes Motor Vehicle Title and Registration; Business; Priviledge; Gross Receipts; Other) = $ 10.30 Per Capita
27,199
$280,060 = State Other Taxes

Article 11, Section 7 of the Constitution of Tennessee provides as follows:

> "The Legislature shall fix the rate of interest, and the rate so established shall be equal and uniform throughout the State; but the Legislature may provide for a conventional rate of interest, not to exceed ten per centum per annum."

Section 47-14-104, Tennessee Code Annotated (Exhibit 3(A)) sets a maximum interest rate of ten per cent (10%) except for small loan companies and certain types of instalment loans.

A strong effort was made in the 1974 Tennessee General Assembly to effect the passage of legislation to permit a corporation to waive the defense of usury, but the bill was never approved by the committee to which it was assigned. Since the adjournment of the General Assembly, continued efforts have been made by the Tennessee Bankers Association to persuade the Governor to call a special session for this purpose, but he has not seen fit to do so.

There is some doubt as to the constitutionality of such a statute. As a matter of fact, the Attorney General of Tennessee issued an opinion dated February 22, 1974 (Exhibit 3(B)) that the General Assembly is without authority to authorize waiver of the interest rate limitation by any borrower when such waiver would result in the exaction of interest in excess of that constitutionally permissable. Thus it will be difficult, and perhaps impossible, to obtain relief for banks in Tennessee without a constitutional amendment.

Article 11, Section 3 of the Constitution of Tennessee (Exhibit 3(C)) provides for amendments proposed by two successive general assemblies or by a convention called by referendum. Any such amendments proposed must ultimately be ratified by referendum. An amendment proposed by two successive general assemblies must be ratified at the next general election in which a Governor is to be chosen, which after November, 1974 will be November, 1978. No constitutional convention may be held ofterner than once in six years, and the last such convention was held in 1971. Thus under either method constitutional relief would be delayed at least until 1977.

EXHIBIT 3 (A)

47-14-104. Legal rate of interest—"Usury" defined.—(1) The legal rate of interest shall be six per cent (6%) per annum but contracts may be made in writing for the payment of a rate of interest not greater than ten per cent (10%) per annum payable on the unpaid principal. Every excess over these rates is usury, except as otherwise provided. Provided that no discount may be charged on any loan contracted under this provision resulting in an effective rate of interest of more than ten per cent (10%) per annum over the stated term of the loan. Notwithstanding the foregoing, this contract rate shall not apply to loans or credit extended under the "Industrial Loan and Thrift Companies' Act," § 45-2007 (f); nor shall it apply to instalment loans of banks and trust companies and building and loan associations on which interest is deducted in advance or added to the principal as provided in § 45-433 and § 45-1412. [Code 1958, § 1944 (deriv. Acts 1835-1836, ch. 50, §§ 3, 4); Shan., § 3493; Code 1932, § 7302; T. C. A. (orig. ed.), § 47-1604; Acts 1969, ch. 61, § 1.]

Cross-References. Home improvement instalment loans by federal savings and loan associations, § 45-1412.

Instalment loans by banks and trust companies, charges authorized, § 45-433.

Law Reviews. Bank Credit Cards In Tennessee—Usury?, 3 Memphis State U. S. Rev. 51.

Cited: Gunther v. White (1972), — Tenn. —, 489 S. W. (2d) 529.

NOTES TO DECISIONS

ANALYSIS

1. Interest.

2. —Statutory Basis.

The enactments of the federal congress in relation to lawful interest charges by federally chartered financial institutions were controlling despite contrary enactments of the state legislature and United States Code, title 12, § 1757 (F. C. A., tit. 12, § 1757) authorized a federally chartered employees' credit union to charge interest of one per cent per month despite any defense of usury made under the state statutes. Birdwhistell v. Y-12 Employees Federal Credit Union (1967), 57 Tenn. App. 621, 422 S. W. (2d) 896.

The right to interest is statutory, and its positive allowance must be confined to demands and obligations specified in a statute; otherwise, allowance is discretionary in jury or chancellor. Draper v. Great American Ins. Co. (1970), 224 Tenn. 552, 458 S. W. (2d) 428.

10. Usury.

Usury is an extraction of interest, compensation for the use of money, exceeding the legal rate per year. Wilson v. Dealy (1968), 222 Tenn. 196, 434 S. W. (2d) 835.

31. —Contracts Not Usurious on Face.

In determining whether an instrument is usurious on its face, the "face" is not confined to one side of the paper, but a separately signed security or pledge agreement on the reverse side of a note is a separate instrument and the pledge is not on the face of the instrument and its provisions cannot invalidate the note. Birdwhistell v. Y-12 Employees Federal Credit Union (1967), 57 Tenn. App. 621, 422 S. W. (2d) 896.

47. —Late Charges.

Provision for payment of one and one-half per cent per month on account of employment agency where such account was not paid when due which represented an attempt to liquidate damages for failure to make timely payment did not constitute usury so as to render contract void. Wilson v. Dealy (1968), 222 Tenn. 196, 434 S. W. (2d) 835.

Whether a "late charge" in excess of the legal rate of interest constitutes usury depends on whether the charge is made as consideration for extension of time for payment or as compensation for the damage done the creditor by the debtor's failure to pay the debt when due, the former constituting usury but not the latter. Wilson v. Dealy (1968), 222 Tenn. 196, 434 S. W. (2d) 835.

EXHIBIT 3 (B)

STATE OF TENNESSEE
OFFICE OF THE
ATTORNEY GENERAL
SUPREME COURT BUILDING
NASHVILLE, TENNESSEE 37219

DAVID M. PACK
ATTORNEY GENERAL & REPORTER

OPINION NO. 132

TO: Member of General Assembly

DATE: February 22, 1974

QUESTION

As to the constitutionality under Article XI, section 7 of the Constitution of this State of S.B. 1816 as proposed to be amended by Amendment No. 1. The thrust of said bill is to permit a corporation chartered at least sixty days prior to the borrowing of money to waive any constitutional right not to pay interest in excess of the rate allowed by law, and further to waive any and all remedies, defenses and other legal consequences provided for in the case of usurious loans. The amendment would restrict such loans to those over $50,000. Said article and section of the Constitution requires the General Assembly to fix the allowable rate of interest in the State and restricts to 10% per annum the maximum amount which may be provided for.

OPINION

It is the opinion of this office that the General Assembly is without authority to authorize waiver of the interest rate limitation by any borrower when such waiver would result in the exaction of interest in excess of that constitutionally permissible.

ANALYSIS

The courts have recognized in certain cases a right in the citizen to waive or relinquish constitutional guarantees. Such cases appear, however, to be confined to rights which are entirely personal to the citizen. Constitutional provisions which are intended primarily for the benefit of the public, or in which vital interest is shared by the public, cannot be waived by the individual. See generally the discussion in the concurring opinion of Justice Chambliss in the case of *State ex rel. Lea v. Brown*, 166 Tenn. 669, 695f.

It seems hardly to be doubted that Article XI, section 7 of the Constitution was intended to benefit the public at large rather than merely individual borrowers of money. This conclusion is implicit in the command to the General Assembly to make the rate of interest equal and uniform throughout the State. Such an admonition would be without meaning if individual borrowers, albeit of a limited class, were permitted to use different rates as their circumstances might dictate.

The case of *Caldwell and Company v. Lea*, 152 Tenn. 48, 272 S.W. 715, urged in support of the proposition that the constitutional provision is waivable, in actuality does not deal with anything except the power of the legislature to classify loans within the 10% limitation. It upheld a statute specifying a higher permissible interest rate for long-term bonds and notes of $50,000 or more. The higher interest rate, however, was well within the constitutional limitation. The case cannot, therefore, stand as authority for the proposition that the constitutional limitation may be waived or ignored by a legislatively specified class of borrower.

MILTON P. RICE
Deputy Attorney General

EXHIBIT 3(C)

Sec. 3. Amendments to Constitution.—Any amendment or amendments to this Constitution may be proposed in the Senate or House of Representatives, and if the same shall be agreed to by a majority of all the members elected to each of the two houses, such proposed amendment or amendments shall be entered on their journals with the yeas and nays thereon, and referred to the general assembly then next to be chosen; and shall be published six months previous to the time of making such choice; and if in the general assembly then next chosen as aforesaid, such proposed amendment or amendments shall be agreed to by two-thirds of all the members elected to each house, then it shall be the duty of the general assembly to submit such proposed amendment or amendments to the people at the next general election in which a Governor is to be chosen. And if the people shall approve and ratify such amendment or amendments by a majority of all the citizens of the State voting for Governor, voting in their favor, such amendment or amendments shall become a part of this Constitution. When any amendment or amendments to the Constitution shall be proposed in pursuance of the foregoing provisions the same shall at each of said sessions be read three times on three several days in each house.

The Legislature shall have the right by law to submit to the people, at any general election, the question of calling a convention to alter, reform, or abolish this Constitution, or to alter, reform or abolish any specified part or parts of it; and when, upon such submission, a majority of all the voters voting upon the proposal submitted shall approve the proposal to call a convention, the delegates to such convention shall be chosen at the next general election and the convention shall assemble for the consideration of such proposals as shall have received a favorable vote in said election, in such mode and manner as shall be prescribed. No change in, or amendment to, this Constitution proposed by such convention shall become effective, unless within the limitations of the call of the convention, and unless approved and ratified by a majority of the qualified voters voting separately on such change or amendment at an election to be held in such manner and on such date as may be fixed by the convention. No such convention shall be held oftener than once in six years. [As amended: Adopted in Convention May 27, 1953; Approved at election November 3, 1953; Proclaimed by Governor November 19, 1953.]

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THE AMERICAN BANKERS ASSOCIATION 1120 CONNECTICUT AVENUE, N.W., WASHINGTON, D.C. 20036

September 18, 1973

Interest Rate Ceilings Under 12 U.S.C. §85

May national banks, under 12 U.S.C. §85, charge interest "at a rate of one percentum in excess of the discount rate on 90-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located", even if this figure is greater than the interest rate generally allowed in that State and greater than the rate limited for State banks in that State?

In my opinion the answer to this question is in the affirmative. While no Federal cases have been found specifically ruling on this precise issue, the legislative history of the provision, including both the explanations in Senate and House Banking and Currency Committee Reports and Senator Glass's explanation of the proposal in 1931, make it in my judgment entirely clear that this was the intention of Senator Glass, of the Senate and House Banking Committees, and of the Congress, which was reflected in appropriate statutory language to give effect to this intention.

Section 85 of Title 12, U.S. Code (Section 30 of the National Bank Act; R.S. §5197) provides as follows:

§85. Rate of interest on loans, discounts and purchases.

Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. The maximum amount of interest or discount to be charged at a branch of an association located outside of the States of the United States and the District of Columbia shall be at the rate allowed by the laws of the country, territory, dependency, province, dominion, insular possession, or other political subdivision where the branch is located. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

It has always been clearly recognized as a matter of Constitutional law that the Congress may if it wishes enact Federal legislation imposing interest rate ceilings on national banks regardless of State law, which will preempt the otherwise applicable State law. This authority might be based on the Commerce Clause or the closely related money power, in addition to the Federal instrumentality doctrine.[1/]

In 1864, when the National Currency Act was being rewritten as the National Bank Act, the House of Representatives accepted the recommendation of Mr. McCulloch, the first Comptroller of the Currency, and passed a bill which would have imposed a 7 percent ceiling on interest rates for all national banks regardless of State law (H.R. 395, 37th Congress, passed by the House April 18, 1864). This was amended by the Senate so as to permit national banks to charge the interest rate generally allowed by the appropriate State, except that if a different rate is provided for State banks, national banks may charge the State bank rate.[2/]

[1/] 1 Stat. 191, February 25, 1791, Section X; first Bank of the United States. 3 Stat. 266, April 10, 1816, Section Eleven, Paragraph Ninth; second Bank of the United States. See Schuyler National Bank v. Gadsden, 191 U.S. 451 (1903).

[2/] It was held in Tiffany v. National Bank of Missouri, 85 U.S. 409 (1874), that where the general rate was higher than the bank rate, national banks might charge the higher general rate and were not limited to the lower State bank rate, on the ground that the National Bank Act is an enabling Act, not a restricting Act, and that each of the three provisions then in Section 30 was an enabling provision not a limitation. In Northway Lanes v. Hackley Union National Bank and Trust Co., 464 F.2d 855 (6th Cir., 1972), it was held that national banks might also impose fees and charges permitted for special types of loans and lenders on loans at the maximum interest rates permitted, even though State banks could not do so. See also, Commissioner of Small Loans v. First National Bank of Maryland, 300 A2d 690 (Md. 1973).

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In addition, the section explicitly provided that interest may be taken in advance, whether or not the State's law permits it, [3] which may increase the effective interest rate or yield substantially. Furthermore, 12 U. S. C. §85 specifically authorizes discounting out-of-town bills of exchange at not more than the current rate of exchange for sight drafts, also regardless of the applicable State law.

In 1933 the provisions relating to interest computed by reference to Federal reserve bank discount rates were added by section 25 of the Banking Act of 1933 (48 Stat. 191).

The suggestion to permit national banks to charge interest based on the local Federal reserve bank discount rate appears to have been made first in S. 4723, 71st Congress, 2nd Session (the "Banking Act of 1930"), introduced by Senator Glass on June 17, 1930. Section 5 of this bill would have added a provision similar to the provision inserted in 12 U. S. C. §85 by the 1933 Act.

At the hearings held by a Subcommittee of the Senate Banking Committee on February 23, 1931, the following comments on S. 4723 by Senator Glass, the Subcommittee Chairman, and Professor Marcus Nadler appear:

> Professor Nadler...
>
> Then Section 5 of the Glass bill provides a maximum rate of interest to be charged -- I imagine to apply primarily to brokers' loans.
>
> The Chairman. It was not intended primarily to cover brokers' loans. What I had in view was the interior banks -- member banks. For example, the laws of the different States, you know, vary in the different States as to the rate of interest chargeable. For example, in my State banks are not permitted to charge over 6 per cent interest. When, if ever, the discount rate of the fifth district goes to 6 per cent, why, that is an estoppel of rediscount by member banks. It ought not to be, but it is practically an estoppel because they can not borrow money from the Federal reserve bank at any less rate than they charge for the discount, and this was intended that when that should happen the bank rate should be such as to insure a safe transaction or desirable transaction to the member bank.

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[3] This authority was specifically upheld in Evans v. National Bank of Savannah, 251 U.S. 108 (1919), and in Northway Lanes v. Hackley Union National Bank & Trust Co., supra.

Professor Nadler. That makes it much clearer, Mr. Chairman, but the experience with fixing a rate of interest -- the usury laws of New York fixed the maximum rate of 6 per cent -- the experience is that it results in bonuses, surcharges, commissions, and so forth --

The Chairman. We have the same think in my State.

Professor Nadler. So that if anyone wants to sell a second mortgage he can seldom get it done at less than 12 per cent.

The Chairman. The real purpose was as I have indicated. For example, a customer will come into a member bank, when the rediscount rate of the Federal reserve bank is high, and seek to renew a loan or contract a new loan, and he is told by the banker that he can not do it because the rate of the Federal reserve bank is so high they can not rediscount, and when the rate goes as high as 6 per cent -- it never has in the fifth district, but it has in other districts -- it amounts to an estoppel of rediscounting by member banks with the Federal reserve bank, and, of course, when there is no rediscounting it curtails the commercial transactions of the member banks. That was the purpose of that section.

Professor Nadler. Of course, I did not understand that.

The Chairman. It might apply on the stock market, but if so, I should regret it. 4/

4/ Hearings on "Operations of the National and Federal Reserve Banking Systems"; Subcommittee of the Senate Banking and Currency Committee, pursuant to Senate. Res. 71, P. 507-508, February 23, 1931.

The Historical Chart Book of the Federal Reserve Board, 1972, shows at pages 26 and 27 the changes in the Federal Reserve Bank of New York discount rate from 1919 to 1972. For a period during 1920 and 1921, this rate was at 7 percent, preceded by a brief period at 6 percent and followed by brief later periods at 6 1/2 and 6 percent. For a brief period in 1929, the rate was 6 percent. The chart does not show the discount rates of Federal reserve banks other than the New York bank, but it would appear that a number of other banks had discount rates at or approaching the usury rates in some States within the District.

The possibility that national banks might be able to charge more than State banks by reason of the Tiffany rule was not discussed, presumably because both Professor Nadler and Senator Glass assumed that in virtually all cases national banks and State banks charge the same interest rates.

The Senate and House Banking and Currency Committee reports on this provision demonstrate that, while not highly controversial, the provision was clearly intended to permit national banks to charge 1 percent more than the applicable discount rate, as an alternative to whatever rate State banks might be charging.

> Limits the interest that may be charged by a national bank to that which may be charged by local banks in the State where the national bank is located, or to a rate 1 per cent higher than the discount rate on 90-day commercial paper in effect at the Federal reserve bank in the district where the national bank is located, whichever is greater. If no rate is fixed by State law, the maximum rate the national bank may charge is limited to 7 per cent, or 1 percent in excess of such discount rate, whichever is greater.5/

The House Banking and Currency Committee included this interest rate ceiling provision in its bill, and in the Conference Report the provisions now in the section with respect to charging interest at 1 percent above the applicable discount rate were included as section 25 of the Banking Act of 1933.6/

5/From Senate Report No. 584, 72nd Congress, 1st Session, April 22, 1932, to accompany S. 4412 (House Banking and Currency Committee Print, Federal Reserve Act, etc., February 10, 1958). Identical descriptions of the provision were contained in Senate Report No. 77, 73rd Congress, 1st Session, May 15, 1933, to accompany S. 1631 and in House Report No. 150, 73rd Congress, 1st Session, May 19, 1933, to accompany H.R. 5661 (House Banking and Currency Committee Print, Federal Reserve Act. etc., February 10, 1958).

6/House Report No. 254, 73rd Congress, 1st Session, June 12, 1933, to accompany H.R. 5661 (House Banking and Currency Committee Print, Federal Reserve Act, etc., February 10, 1958).

The only change in 12 U.S.C. §85 since 1933 was the insertion of the third sentence by the Banking Act of 1935, relating to interest charges by branches located outside the States of the United States and the District of Columbia. Such foreign branches would, of course, not be in any Federal reserve district and consequently the 1 percent provision would be meaningless; in any event, international comity would obviously make it improper for branches of U.S. banks to charge more than local banks were permitted to charge.

While no Federal court cases have construed the 1933 Glass amendment to 12 U.S.C. §85, I have been informed of an unreported opinion rendered last year in the Court of Common Pleas of York County, Pennsylvania: National Central Bank v. Heindel (Civ. Actions Nos. 2064, 2065, 2066 and 2067, May Term 1970). The Pennsylvania usury statute contained a 6 percent ceiling for mortgages. The national bank involved charged 7 percent interest at a time when the discount rate in effect at the Federal Reserve Bank of Philadelphia was 6 percent. The Court held that 12 U.S.C. §85 permitted a national bank to charge 7 percent under these circumstances.

Accordingly, it is my opinion that 12 U.S.C. §85 can and should be interpreted to permit national banks to charge interest rates 1 percent in excess of the discount rate on 90-day commercial paper in effect at Federal reserve banks in the Federal reserve district where the bank is located, even though this may exceed the interest rate generally allowed by the laws of the applicable State, or the rate limited for State banks or 7 percent when no rate is fixed by the laws of the applicable State.

The Comptroller of the Currency expressed the same opinion as that expressed above in Banking Circular No. 1, dated April 29, 1968. In a letter of September 13, 1973 to me, Mr. Robert Bloom, the Chief Counsel of the Comptroller of the Currency, advised me that Banking Circular No. 1 is still in full force and effect.

Matthew Hale

Matthew Hale
General Counsel

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Banking Circular No. 1

THE ADMINISTRATOR OF NATIONAL BANKS
WASHINGTON

April 29, 1968

THE FOLLOWING LETTER WAS SENT TO A NATIONAL BANK:

This is in reply to your letter of April 22, 1968, requesting an interpretation by this Office of Title 12 U.S.C., Section 85, which deals with the question of the maximum rates of interest permitted to be charged on loans by national banks.

You state that present maximum rate of interest allowed under the laws of the State of Tennessee is 6% per annum. You request confirmation of your understanding that since the recent rise in the discount rate to 5½%, that pursuant to the applicable provisions of Federal law (12 U.S.C. 85), a national bank located in Tennessee may charge up to 6½% on loans or other extensions of credit.

Please be advised that in the opinion of our Law Department your interpretation is correct. National banks, located in states wherein the maximum rate allowed by state law is lower than 6½%, are permitted to charge up to 6½% by virtue of the applicable provisions of Federal law. See Tiffany v. National Bank 85 U.S. 409.

You are advised to consult with your own counsel as to the provisions of state law which are to be considered in conjunction with the above ruling.

Sincerely,

William B. Camp
Comptroller of the Currency

United States Treasury

THE ADMINISTRATOR OF NATIONAL BANKS

WASHINGTON, D.C. 20220

Office of the
Comptroller of the Currency

September 13, 1973

Mr. Matthew Hale
General Counsel
American Bankers Association
1120 Connecticut Avenue, NW
Washington, D. C.

Dear Mr. Hale:

This is to advise that Banking Circular No. 1, dated April 29, 1968, heretofore issued by this office, dealing with the question of maximum rates of interest on loans permitted to be charged by national banks is still in full force and effect.

Sincerely yours,

Robert Bloom
Chief Counsel

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THE ADMINISTRATOR OF NATIONAL BANKS

WASHINGTON, D.C. 20220

Office of the
Comptroller of the Currency

September 17, 1973

Robert I. Hart, Esquire
Michigan National Bank
124 W. Allegan Street
Lansing, Michigan 48904

Dear Mr. Hart:

We have your letter of August 27, 1973, in which you inquire whether Michigan National bank may charge interest at a rate 1% in excess of the discount rate quoted by the Federal Reserve Bank of Chicago for discounts of eligible paper under sections 13 and 13A of the Federal Reserve Act.

The rate of interest which may be charged by a national bank is governed by 12 U.S.C. 85. That statute reads, in pertinent part:

> Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter.

The original version of 12 U.S.C. 85, as enacted in the National Bank Act of 1864, intended to place national banks in a position at least as advantageous as that held by any lender within the state in which the national bank was located. Thus, prior to the 1933 amendment ("or at a rate of 1 per centum ... may be the greater"), national banks were permitted to charge the maximum rate permitted by state law for lenders generally, but if state law made special exceptions for state banks, thereby authorizing them to charge a higher rate than that permitted to other lenders, national banks could also levy the higher rate. Tiffany v. National Bank of Missouri, 85 U.S. (18 Wall.) 409, 411-412, 21 L. Ed. 862(1873); Northway Lanes v. Hackley Union National Bank & Trust Co., 334 F. Supp. 723, 726-727 (W.D. Mich. 1971), aff'd 464 F. 2d 855 (6 Cir. 1972); Partain v. First National Bank of Montgomery, 336 F. Supp. 65 (M.D. Ala. 1971), rev'd on other grounds, 467 F. 2d 167 (5 Cir. 1972); Comm'r. of Small Loans v. First National Bank of Maryland, 300 A2d 690 (Md. 1973).

In 1933, Congress amended 12 U.S.C. 85 to permit national banks to charge interest at a rate 1% in excess of the discount rate on ninety-day commercial paper in effect at the district Federal Reserve Bank. The amendment is phrased in the disjunctive, giving national banks the privilege of charging "whichever may be the greater" between the state usury limit, on the one hand, and a rate of 1% in excess of the ninety-day commercial paper rate, on the other.

That Congress intended to read the amended statute in the alternative is clearly indicated by the description furnished in the committee reports on the legislation known as the "Banking Act of 1933." Both the Senate Report (S. Rep. No. 77, 73d Cong., 1st Sess. 17) and the House Report (H.R. Rep. No. 150, 73d Cong., 1st Sess. 4) describe the amendment in identical language, using the disjunctive "or." According to the committee reports, the amendment

> Limits the interest that may be charged by a national bank to that which may be charged by local banks in the state where the national bank is located, or to a rate 1% higher than the discount rate on 90-day commercial paper in effect at the Federal Reserve bank .... If no rate is fixed by state law, the maximum rate the national bank may charge is limited to 7 percent, or 1% in excess of such discount rate, whichever is greater. (Emphasis added.)

Thus, since the enactment of the 1933 amendment, national banks have had a choice:

1. They can charge interest at the highest rate allowed by state law to lenders generally, but if state banks are permitted still a higher rate, national banks are authorized to charge that rate; or

2. They can charge interest at 1% above the discount rate on ninety-day commercial paper in effect at the district Federal Reserve Bank.

The only case to our knowledge which has construed the 1933 amendment is an unreported opinion rendered last year in the Court of Common Pleas of York County, Pennsylvania. In National Central Bank v. Heindel (Civ. Actions Nos. 2064, 2065, 2066 and 2067, May Term 1970), defendant homeowners petitioned to re-open judgments entered against them by confession in 1970. The grounds for the petition was that National Central Bank had charged interest at 7% in violation of Pennsylvania's 6% usury limit. The court held that, regardless of state law, the bank's status as a national bank permitted it to charge interest at a rate of 1% above the discount rate on ninety-day commercial paper. Since the discount rate in effect at the Federal Reserve Bank of Philadelphia was 6% at the time, the bank was permitted to charge 7%.

The statute, as it now stands, is not a model of clarity. Without a knowledge of its original purpose, the Supreme Court's holding in Tiffany and the exact wording of the 1933 amendment, one will find the syntax baffling. Not surprisingly, then, some erroneous notions have arisen concerning its interpretation. The principal misconception is that the statute is intended to assure that national banks and state banks are on an equal footing when charging interest. This idea was disposed of in Tiffany, where the Supreme Court, taking note of the critical importance that Congress placed upon the establishment of a strong national banking system to provide a uniform currency for the country, declared

> [The statute] speaks of allowances to National banks and limitations upon State banks, but it does not declare that the rate limited to state banks shall be the maximum rate allowed to National banks ... National banks have been National favorites. They were established for the purpose in part, of providing a currency for the whole country, and in part to create a market for the loans of the General government. It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the States, or to ruinous competition with State banks. On the contrary, much has been done to insure their taking the place of State banks. The latter have been substantially taxed out of existence. A duty has been imposed upon their issues so large as to manifest a purpose to

> compel a withdrawal of all such issues from circulation. In harmony with this policy is the construction we think should be given to the thirtieth section of the act of Congress we have been considering. It gives advantages to National banks over their State competitors. It allows such banks to charge such interest as State banks may charge, and more, if by the laws of the State more may be charged by natural persons. (Emphasis added.)

In light of the above, we hereby confirm the advice furnished to you by Mr. Barrett on the telephone that, regardless of Michigan's usury law, Michigan National Bank may charge interest on all loans at 1% in excess of the discount rate on ninety-day commercial paper in effect at the Federal Rank of Chicago. Since the discount rate is presently 7 1/2%, Michigan National may charge 8 1/2%.

For your information, we enclose a legal opinion from the law firm of Warner, Norcross & Judd, of Grand Rapids, Michigan, in which views similar to ours are expressed.

If we can be of further assistance, please call upon us.

Very truly yours,

Thomas G. DeShazo

Thomas G. DeShazo
Deputy Comptroller of the Currency

Enclosure

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USURY LAWS

Most interest rates have risen to historically high levels in recent months. For example, the rate on prime commercial paper (4- to 6-month maturities) averaged 12 percent in July as compared with averages of 8.15 percent in 1973 and 4.69 percent in 1972. Yet despite these developments, usury restrictions on the payment of interest have remained unchanged, with few exceptions. In Missouri, for example, the maximum legal interest rate on a loan to an individual or unincorporated business remains at 8 percent -- a rate established in 1891. Table I shows legal maximum rates for each state.

When market interest rates rise above legal maximums, problems develop in credit markets. Borrowers, who are willing to pay the competitive rate for funds, often find that they are legally unable to obtain financing. As a result, they find themselves faced with the choice of either circumventing the law to obtain the desired funds or else losing out to other borrowers who may not be willing to bid as much, but who are legally able to contract because of the nonuniformity of usury laws.

Despite the credit market distortions caused by ceilings on interest rates, usury laws have been retained in most jurisdictions. It is the intent of this article to provide some insight and perspective on the value of such restrictions by reviewing briefly the history and justification of such laws, the role of interest rates, and some of the effects of interest rate restrictions.[1/]

History of Usury Laws

Usury laws have been traced back to the dawn of recorded history. Both legal and religious restrictions on interest charges were imposed in ancient times.2/ The early Babylonians permitted credit but limited the rate of interest. One of the earliest writings of the Bible (Deuteronomy 23:19-20) stated, "Thou shalt not lend upon usury to thy brother, ... Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury ...." In the New Testament (Luke 6:35) the admonition was broadened" ... lend freely, hoping nothing thereby."

In Greece, Aristotle considered that money was sterile, and hence that the breeding of money from money was unnatural and justly hated. During the period of the Roman Republic, interest charges

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1/ A previous discussion of interest rate controls by this Bank was given by Clifton B. Luttrell, "Interest Rate Controls -- Perspective, Purpose, and Problems," this Review (September 1968), pp. 6-14; see also Charlotte E. Ruebling, "The Administration of Regulation Q," this Review (February 1970), pp. 29-40.

2/ See Sidney Homer, A History of Interest Rates (New Brunswick, New Jersey: Rutgers University Press, 1963).

were forbidden, but they were permitted during the time of the Roman Empire.

During the early Middle Ages religious leaders treated the subject more thoroughly, but from a moral viewpoint. The exploitation of the proverty-stricken by rich and powerful creditors appeared sinful to the Christians of that period, whose religion stressed meekness and charity as among the greatest virtues and played down the value of earthly goods. Secular legislation responded to the Church's influence and in general, interest and usury were regarded as synonymous.[3/]

The increase in economic activity and expansion of personal freedom that came with the Renaissance forced modifications in the prevailing views concerning interest rates. Recognizing that man was imperfect, Luther and other 15th century reformers began to concede that creditors could not be prevented from charging interest. Calvin, in the 16th century, rejected the scriptural basis for interest prohibition on grounds of conflicting interpretations and changed circumstances, but still advocated some control. Turgot, an eighteenth century French economist, noted that money is the equivalent of land, and hence the owner will not be inclined to loan

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3/ Eugene von Bohm-Bawerk, Capital and Interest Volume 1, 4th Edition, 1921, translated by George Huncke and Hans Sennholz (South Holland, Illinois: Libertatian Press, 1959), pp. 13-24.

his money unless he can expect a return as great as he would obtain through the purchase of land.[4/]

Legal restrictions on payment of interest were generally relaxed in the 18th century, but the belief continued that people who needed to borrow funds should be protected against overly high charges. Consequently, most nations maintained legal maximum usury rates at "reasonable" levels. Usury laws in the United States were inherited, in large part, from the British in colonial days. But, while these laws generally remain in force in the U.S., in Great Britain they, along with other restrictions on commerce and trade, came under intense pressure in the 19th century and were finally repealed in 1854.[5/]

One factor complicating attempts to maintain interest rate ceilings arose from the fact that risks and administrative expenses in making very small loans were so great that legitimate dealers could not handle such advances with rate ceilings. This situation fostered illegitimate loan "sharks" with exorbitant interest charges. As a result, it was eventually recognized that higher rates

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4/ Ibid, pp. 25-60.

5/ Homer, p. 187.

should be permitted on small loans than on large loans, and the small loan laws emerged.

Arguments for Usury Laws

As noted, ethical and religious arguments have been relied on to a great extent to justify either the prohibition or limitation of interest payments. Another factor which has been instrumental in sustaining support for usury laws has been public opinion which generally viewed the small borrower as an underdog at the mercy of large well-financed institutions from which he borrows. As a consequence of this public attitude, legislators have been reluctant to raise interest rate ceilings.

Several economic arguments also have been used to justify usury laws, and these considerations tend to bolster the moral and political reluctance to raise rate ceilings. The first of these economic arguments asserts that whereas most lenders are knowledgeable about conditions in the particular credit market in which they operate, it is readily observable that a sizable number of borrowers are unsophisticated and naive. It is contended that these borrowers are concerned only with obtaining credit and do not even know what rate of interest they are paying. Further that relatively few make a serious effort to study conditions or to shop around for better terms or better timing. Finally it is argued that contracts made with such unknowing borrowers at rates above those existing in the market for similar types of loans represent a distortion of competitive forces and provide a windfall to lenders.

A similar argument for the regulation of interest rates is related to the comparative market power of borrowers and lenders. Since lenders are usually fewer in number and larger in resources than borrowers, it is contended that they can exert market power in order to command artificially high rates. Hence, usury laws are necessary to restore competitive balance between the two groups.

Another economic argument for interest rate regulation is concerned with the economy in general. It has been contended that low interest rates are desirable to encourage more investment and consumption and promote faster economic growth.

Functions of Interest Rates

Interest rates play a strategic role in the economy. Interest rates are prices, and, as is true of all prices, they serve a rationing function. Rates are the prices that allocate available funds, and hence command over resources, among competing uses. Normally, the term "interest rate" is used in reference to return on marketable securities or a loan of funds. However, the concept of "interest rate" can be applied to all goods. The rate of interest reflects the price of the convenience of earlier availability, the preference for more certain rather than less certain consumption rights, and the economy's ability to use resources to increase output.

To the borrower, interest rates represent a cost, and as such, influence investment and consumption decisions. To the saver, they represent a return and affect decisions regarding amount to be saved. To wealth holders and managers of funds, interest rates or yields are a common denominator for evaluating alternative forms of holding wealth and alternative avenues for placing funds.

At any time, some individuals or businesses find that with their incomes, tastes, and investment prospects it is not desirable to pay the going rate for funds. They are "priced out of the market," just as there are those who find that at current prices it is not expedient to hire a servant, eat steak, or purchase a luxury automobile. Any movement in interest rates (as with other prices) will cause a reevaluation of projects which require borrowed funds.

General Arguments Against Usury Laws

Those who oppose interest rate restrictions view credit markets as relatively efficient when left alone to operate freely. According to this position free competitive markets lead to an optimum allocation of resources and maximum individual satisfaction. Consequently, interferences with normal credit flows, by use of imposed ceilings on lending or deposit rates, can only create inefficiencies in financial markets which hamper production and have an adverse impact on the distribution of goods and services.

It has been charged that maximum loan rates are necessary because credit applicants are gullible and would enter into oppressive contracts without such protection. But, are not individuals just as likely to be gullible in their dealings in other markets? Why then is the credit market singled out as an area to promulgate legal restrictions against such oppressive contracts? More importantly, has this special attention had its intended effects? That is, can and do these laws protect the uninformed from exploitation, and can the benefits of affording this protection be justified in view of the attendent social costs? Existing imperfections in credit markets could probably be reduced to a greater extent and with less cost by fostering greater competition among lenders. Also, education and counseling of borrowers may be a more efficient method to improve their performance than imposing rigid ceilings.

In most credit markets competition is very keen. Major lenders include commercial banks, savings and loan associations, insurance companies, mutual savings banks, mortgage companies, sales finance companies, personal finance companies, credit unions, real estate investment trusts, farm credit agencies, retailers, and individuals. It is relatively easy to establish a business for lending funds, except for restrictions imposed by the Government. Hence, in most cases where competition is lacking in a given market, it has resulted from legal limitations on entry or activities. In practice, most interest rates have been effectively controlled below usury ceilings most of the past forty years by competitive forces.

For a brief period, artificially holding interest rates below the equilibrium level probably does stimulate investment and contribute to economic expansion. However, maintaining arbitrarily low rates by imposing ceilings discourages saving at the same time it stimulates investment, placing further upward pressure on interest rates. As a result, rates can only be maintained at the lower level by some form of nonprice rationing (which tends to reduce efficiency and to offset the sought after investment increases) or by the creation of money and credit at progressively faster rates (which contributes to accelerating inflation).

General Impact of Usury Laws

Throughout much of the period since the nineteen-twenties usury laws did not have much effect, because the interest ceilings were at levels above prevailing market rates. However, with the rise in interest rates since the mid-Sixties relative to the rigid ceilings in most jurisdictions, usury laws have had a significant impact on many credit markets. Their effects have been quite arbitrary and have weighed heaviest on the weakest credit risks.

Professor Miller contends that usury legislation often adversely affects the ones it is designed to protect. 6/ He illustrates this conclusion by citing the Washington state experience, where consumer loans from credit

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6/ Roger L. Miller, Economics Today, (San Francisco California: Canfield Press, 1973), pp. 244-250.

card companies were generally at an annual rate of 18 percent. Consumer advocates felt that this rate was much too high, and that poor people could not afford the high charge. In 1968, the maximum rate was lowered to 12 percent. However, at the lower rate the amount of credit demanded exceeded the amount supplied, and the people with the weakest credit worthiness were the ones denied credit at 12 percent. Welfare mothers, people with records of unstable employment, students, and the elderly fell into this category. Gainers from the reduced rates were the ones who had the most wealth, best jobs, and the highest probability of being able to repay the loan.

Sometimes those higher risk borrowers, who are refused credit from legitimate lenders because of usury laws, seek funds from loan sharks who ignore the legislated ceilings. Costs of operating outside the law are relatively high, and competition among such unscrupulous lenders is severely limited, and, hence, interest rates may be several times the level that would have existed in the absence of ceilings.7/

As market rates approach usury ceilings, venture or developmental credit, which of course contains a higher than average degree of risk, becomes limited. Such credit can only be extended by savers at a higher rate of interest to compensate for the additional risk involved, and these loans are among the first to be affected as market rates rise relative to usury ceilings. Without such venture capital, the entrepreneur is frustrated, and economic progress and growth is hampered.8/

By contrast, the volume of credit flowing to wealthy individuals and sound established businesses may be as great or greater under severe usury restrictions than under free market conditions. 9/Since low usury

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7/ John M. Seidl, "Let's Compete with Loan Sharks," Harvard Business Review, May-June 1970, pp. 69-77.

8/ Studies show that in those states permitting higher rates lenders tend to expand credit opportunities. Lenders appear more willing to accept higher risk of losses if the rate is sufficient to compensate for bad debt, investigation and collection expenses. Maurice B. Goudzwaard, "Price Ceilings and Credit Rationing," Journal of Finance, March 1968, pp. 183-184.

9/ This may not always be the case, because the total volume of loanable funds is likely to be smaller under severe interest rate ceilings since saving is discouraged relative to consumption and since funds tend to flow out of the jurisdiction.

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maximums prevent other individuals and firms from effectively competing for funds, a greater share of the available funds tends to flow to lower risk applicants. The anticompetitive effects of these laws are thus spread from credit to product markets.

Usury Laws in the Eighth District

In general, usury laws tend to be more restrictive in the central section of the country than in states on or near either coast. In several Eighth District states usury laws have been a major obstacle in credit markets. In Illinois and Missouri the current general usury ceiling is a very low 8 percent, and in Kentucky the ceiling is 8-1/2 percent. In each of these states, however, corporations are able to legally pay higher rates and there are some other exemptions, but nevertheless many credit flows have been interrupted because of the ceilings, particularly away from potential individual borrowers.

Arkansas, Mississippi, and Tennessee have somewhat higher usury ceilings -- 10 percent in each case. However, because of the lack of legal exemptions from the maximums in Arkansas and Tennessee, the ceilings have been causing substantial disruptions to borrowers, lenders, and the general economy of these states, especially since April when the prime rate on business loans nationally has been above 10 percent.

During May and June of this year, commercial and industrial loans declined 9.3 percent at weekly reporting banks in Memphis and Little Rock, while they were rising 2.8 percent at all weekly reporting banks in the nation. In the corresponding period last year, when market rates were below the ceilings, these loans changed little in Memphis and Little Rock and rose 2.7 percent nationally.

In Mississippi the ceiling was raised to 10 percent from the extremely restrictive 8 percent level, effective July 1, 1974, in an effort to alleviate hardship. Among Eighth District states, only Indiana has had credit markets relatively free from usury restrictions.

Quantitative measures of the volume of potential loans affected by the rate restrictions are not available, but comments from market participants indicate that it is sizable. The following sketchy, indirect evidence also indicates that the impact has been great.

In the first four months of this year, the average interest rate on FHA 30-year mortgages was 8.78 percent whereas in the corresponding period last year the rate was 7.62 percent. Two District states had usury laws applicable to home mortgages that were between these rates -- Mississippi and Missouri at 8 percent. In these two states residential construction contracts fell 34 percent from the first four months last year to the comparable period this year, according to F.W. Dodge data. In the other five District states, Arkansas, Indiana, and Tennessee which had 10 percent or higher usury ceilings and Kentucky and Illinois which exempted certain residences from the ceilings, residential contracts declined 16 percent. The national average decrease was 21 percent over the same period.

By contrast, contracts for nonresidential construction, which are frequently exempted from usury ceilings, rose 8 percent in Mississippi and Missouri from the first four months last year to the first four months this year. This was about the same as the 9 percent gain in Arkansas, Illinois, Indiana, Tennessee and Kentucky and greater than the 2 percent nationally in the same period.

Insured savings and loan associations in Missouri received a 7.7 percent smaller increase in savings "deposits" in April and May this year than they did in the corresponding months last year. Nevertheless, these associations purchased 10.6 percent more mortgages (the bulk of which came from out of state) in the two months this year when the market rate on mortgages was above the state's usury ceiling than in the like period last year when the market rate was below the ceiling. As a result, the amount of new mortgage loans made on local properties declined markedly.

A number of District commercial banks and savings and loan associations have found that it has been more expedient to lend more of their available funds in the unrestricted Federal funds market than to lend locally under oppressive ceilings. For example, member banks in the Eighth District (outside eight large money market institutions) on the April 24, 1974 call date (the most current information available), when the effective Federal funds rate was 10.3 percent, lent a net of $368 million Federal funds. A year earlier, on the March 28, 1973 call date, when the Federal funds rate was 7.3 percent, these same banks advanced $283 million in this market.

Available data also indicate that those who are free from usury restrictions are able to attract a larger share of the funds available when market interest rates rise relative to rate ceilings imposed on others. Eight large money market banks in the District advance credit to a great extent in national money markets where lending rates are largely unregulated. Average Wednesday Federal funds "purchases" by these banks in the second quarter of 1974, when the prime rate on business loans ranged from 9-1/4 to 11-3/4 percent, was $1,625 million. By comparison, in the second quarter last year, when the prime rate ranged from 6-1/2 to 7-3/4 percent, Federal funds purchases of these banks averaged $1,080 million. Also, during the second quarter this year, total deposits of the eight large District banks, bolstered by large CD purchasers, rose at a 24.4 percent annual rate while deposits at other member banks in the district increased at a 9.6 percent rate.

Avoidance of Usury Law Impact

The impact of usury laws on credit markets has been made somewhat more tolerable by legal exceptions and other methods devised to avoid the harsh impact of the legislation. Without such means of avoidance, credit flows would virtually come to a halt in states like Illinois and Missouri, with 8 percent usury ceilings, when the rate nationally on business loans with prime credit risk is in the 8 to 12 percent range.

In a number of jurisdictions small loan laws have been enacted which permit higher rates on certain small extensions of credit where operating costs are high and risk is frequently large. Many other legal exceptions have been granted for a variety of reasons. Retail credit charges, time-sales contracts, and loans to out-of-town residents are subject to higher ceilings in some states.

In Missouri, as in a number of other states, corporate businesses that are supposedly capable of protecting their interests in dealing with lenders are free to pay any rate that they desire. As might be expected, these corporations find that they have a tremendous advantage in attracting funds over unincorporated firms and individuals that are "protected" by the state.

In addition, many credit market arrangements have been devised for circumventing the effect of usury laws and permitting credit flows which otherwise would be halted. Some of these activities may be an outright disobeyance of the law, such as simply ignoring the ceiling, or by calling the payment something other than interest. However, violation of usury laws frequently carries high financial penalties, such as loss of all interest or even principal, and so lenders are generally reluctant to knowingly violate the statutes.

Other arrangements, which may or may not be technically legal, but which certainly conflict with the spirit of the law, have been adopted in order that a loan made at the legal rate might be effectively adjusted to the market rate. One method is to lend to those who in some other way help you. Examples include the practice by lenders of favoring customers who maintain compensating deposit balances or whose firm does.

Another approach is to "adjust" the legal rate in some manner. The effective rate on mortgages has traditionally been adjusted upward through the use of "points" charged either to the buyer or to the seller or both. At times, loans have been granted, by third parties at the legal rate, after which the real lender then purchases the loan at a discount. Other loans have been "closed" in a more liberal location, such as across a state line. Such techniques, although permitting credit to flow, run risks of legality, are inefficient, and probably cause effective rates to be slightly higher to the borrower and lower to the saver than they would be in a free market.

Lenders in states with low usury ceilings also have an option of moving funds into a state with more liberal laws. Informed opinion indicates that the interstate movements of funds because of usury laws is sizable. Investment funds leave the state to finance mortgages in other states and to buy notes and bonds. Also, banks and savings and loan associations "sell" net sizable amounts of day-to-day Federal funds in the national money markets. This alternative of lending in another state protects large lenders to some extent and makes funds more readily available in states with liberal usury ceilings. However, such movements contribute to inefficiency. Also, in the low ceiling state borrowers find credit still more difficult to obtain, lenders with small amounts are forced to accept lower yields, and economic activity suffers.

Conclusions

Ceilings on interest rates are relics of ancient and medieval thought, and have survived to the present largely because of a lack of confidence in market forces or as presumed benefit to weaker credit risks. Actually, supply and demand for funds, rather than rate controls, have been the chief forces holding interest rates at existing levels.

Ceilings on rates may, at times, be of some benefit to borrowers easily deceived by unscrupulous lenders. However, usury laws cause a loss of individual freedom, and in modern economies they are very disruptive, especially during periods of inflation when interest rates, like other prices, rise. Usury laws are based on false premises, operate perversely, and are economically inefficient. The cheap money you cannot obtain does you little good.

Effective usury ceilings, which alter the flow of funds, retard economic growth. The low maximums tend to prevent credit from flowing to higher risk individuals and businesses. Funds available are channelled into well-established, low risk functions. As a result, innovation is discouraged, economic progress is slowed, and competition is reduced. It is the recognition that usury laws are extremely burdensome and inequitable, and that they cause funds to move out of the jurisdiction, that has led some states to relax the law.

Controls also adversely affect the saver, since they deny him the right to a competitive return on his funds. This is especially true of smaller savers that practically must rely on interest paid by thrift institutions. Those with large amounts of savings can more easily by-pass the controlled market by investing in uncontrolled central money and capital markets. Not only is the saver of moderate means injured, but the economy also loses as he becomes discouraged.

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STATEMENT OF NELSON ANDREWS, PRESIDENT, MCCLURE'S DEPARTMENT STORES

I am Nelson Andrews, President of McClure's Department Stores. McClure's is a family owned corporation operating five stores in Nashville and Middle Tennessee. These range from ladies specialty stores doing a volume of $150,000 a year to small department stores in the slightly over $1,000,000 category. Our competition consists of other stores similar to our own but principally comes from national chains including Sears-Roebuck, J. C. Penney, Allied and Mercantile.

You have undoubtedly heard much of the plight of the lenders to this type of business, but let me today speak principally to the problems of the small business borrower in Tennessee.

We are, of course, tied to the general business climate which is now suffering and will continue to suffer under conditions that exist in regard to interest rates in Tennessee. We share, along with other businesses, the bad effects of a poor business climate, but let me first speak to the more immediate and specific problem that faces us. I would like to put several facts before you to give you a frame of reference of this problem.

First of all, we require two kinds of money to operate our business—somewhat longer term capital and short term seasonal borrowings. The longer term capital finances our expansion—in our case we have within the year completed our newest and largest store and we plan that this borrowing will be repaid over a longer period of time out of contemplated profits. Our reasonal borrowings are on a short term basis and are used to finance the peaking of inventory and accounts receivables, principally in the fall and Christmas seasons. Our profits come principally in the fall and Christmas seasons, so obviously the aforesaid borrowings are essential to our profit picture.

The source of our borrowings is entirely from our banking connection in Nashville, Tennessee. We are neither large enough nor financially strong enough to float bonds or sell commercial paper. Being a closely held corporation, we do not have the opportunity of selling additional stock to raise new capital. Unlike national corporations, we cannot go to the New York or other money center banks for loans, because their loan demand is also high and they are in no position to make what they would consider small loans to distant borrowers who have not previously been customers of their banks. If such arrangements could be made, they would naturally and properly insist that we move our bank accounts out of our Tennessee banks to their institutions. This, of course, would compound the problems of the availability of credit to other smaller Tennessee borrowers. The necessity of some of Tennessee's larger borrowers having to do this has undoubtedly affected our ability to receive our full credit needs from our Tennessee bank. In any event, we are totally dependent on the aforementioned bank for the source of our borrowings.

Now to the specific problem we face. If credit is to be refused by the bank in Tennessee, and at this point this seems logically to be the only solution they have (certainly we must expect a rationing of available funds), and if in turn that means we would not be able to obtain seasonal borrowings, the fact is that we simply could not compete with those competitors who have access to borrowings outside of Tennessee. In even simpler terms, if Allied or Sears-Roebuck or Mercantile could and would bring in the proper inventories for the Christmas season and we could not and did not, we would be in an extremely critical and serious position as to profits and, in fact, survival. In this regard we are like all other retail businesses in Tennessee who are dependent upon sources within Tennessee for their seasonal borrowings. Because of the money supply situation, we have, of course, completely stopped any expansion plans that we had entertained and have curtailed other promotional efforts that would have required additional capital.

The conflict between Tennessee's usury laws and the cost of funds imported in Tennessee by banks and other financial institutions is well known by the business community in Tennessee. Business men know that Tennessee banks are rationing credit by refusing many loans that would ordinarily be made by insisting that those loans that must be made for essential business operations be reduced to minimal amounts.

In June of this year we adopted the Master Charge and Bankamericard programs to lessen the need for accounts rceivable borrowing. This is but one illustration that we are doing what we can to continue to operate our business in the restrictive environment created by our outmoded usury laws.

While we appreciate and understand the problems of lenders in Tennessee, we feel that the ultimate problem is one from the borrowers' standpoint. No business wants to pay more interest, but we must compete and we certainly are willing to pay for money on a fair and competitive basis. Obviously, lending institutions can and will pull in theih horns, so to speak, and lend money on a restrictive basis keeping within the bounds of a profitable money source—money loan situation. As we would not be able to for long sell our merchandise for less than it costs us, the lenders cannot lend money for less than it costs them. And we are keenly aware of the dangers of inflation. We see its effects every day in the prices we pay for inventory and the prices we must charge our customers. We support the efforts to control inflation, but the national monetary policy to combat inflation squeezes harder in Tennessee because of our usury laws. It hurts us when construction jobs or new manufacturing payrolls are lost because potential sales of dresses, suits, and home furnishings are lost.

We do not ask for an unfair advantage over any other sector of our economy. Instead, we ask for accessibility to capital and short term borrowings to the same extent that our national competitors have. We ask for the right to compete.

STATEMENT OF J. GARRETT BURDETT, PRESIDENT, TENNESCO, INC.

My name is J. Garrett Burdett. I am President of Tennesco, Inc., a savings and loan service corporation owned by 12 federal savings and loan associations ranging from Bristol, Tennesssee to Union City, Tennessee. I appear before you today as a representative of the Tennessee Savings and Loan League whose Board of Directors has adopted a resolution of support for this proposed legislation on behalf of all seventy-five Federal Savings and Loan Associations in Tennessee.

My statement is as follows:

"Mr. Chairman, Ladies and Gentlemen of the Committee, I find myself rather filled with awe in your presence and the responsibility of presenting to you the problems of the savings and loan industry in Tennessee which has become my assignment.

The responsibility for providing the funds for housing the citizenry of our state has been, in large measure, assigned to our industry throughout the years. The funds obtained by our industry are deposited for much shorter periods than the periods required by our citizenry to feasibly plan to repay loans of a size required to purchase homes. This has continuously caused the savings and loan industry to find itself with loans comprising its portfolio which carry interest rates lower than their current rates paid on deposits. This, of course, forces the industry to obtain rates from new borrowers or other types of investments which will offset the below cost loans in their portfolios. The housing needs of this nation must be met. More and more, we have seen the growth of multi-family housing as the most economical method of housing our average citizen. This type of housing is produced by the knowledgeable, sophisticated developer, who must carefully study his market versus current material and money costs, and then decide whether to borrow now or wait. His decision is one made by a man who knows the costs, knows the marketplace, and after careful consideration, makes his final decision on his ability to produce this housing at interest rates currently available in the market place. His decision is then carefully analyzed by the lender with whom he negotiates, and he, too, must be fully satisfied that the rate to be charged can be supported by the project under consideration. Thus, we see a transaction negotiated between parties fully knowledgeable, cognizant of their business responsibilities, and desirous of filling the need for housing the people in the community.

Present capital requirements of this nation coupled with the inflationary trend with which we are all familiar, have forced the Federal Reserve to restrict the money supply. The price the banking industry must pay for daily funds has been running between 12 and 13½ percent. Should the savings and loan industry, in view, of their cost squeeze, make loans on real estate when prohibited from getting maximum returns, or should they invest in outside higher yielding investments? Are we to expect our banks to make us loans for loan warehousing and other short term needs at 10 percent, when they are paying 12 percent for overnight funds?

It appears to me that the only answer to the problem of equalization of the flow of funds throughout the economy in times requiring such remedies as we now face is the ability to lend and borrow on equal terms area by area.

The sophisticated borrowed, able to negotiate at arms length, must be able to obtain funds or face the collapse of his business. For these reasons, we dutifully request your support of this legislation. Thank you, Mr. Chairman and members of the committee for your kind attention.

THE AMERICAN BANKERS ASSOCIATION,
Washington, D.C., July 29, 1974.

Hon. THOMAS J. MCINTYRE,
Chairman, Subcommittee on Financial Institutions, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The American Bankers Association would like to express its support for S. 3817, an emergency bill which would enable corporations to obtain loans from insured banks and insured savings and loan associations at rates up to 5% above the Federal reserve discount rate, even though these rates might exceed the applicable State usury law.

This Association is a firm supporter of the dual banking system. This consists of two strong, competing groups of banks in each State—one consisting of State-chartered banks, the other consisting of national banks with Federal charters. These groups are interrelated through correspondent relationships and the Federal Reserve Systm to form what we consider to be the most highly competitive and most effective banking system in the world, providing the world's best banking services to industry and commerce, to consumers and the public generally, and to local, State, and national governments.

One of the elements of the dual banking system is the general principle that national and State banks are to be governed in most basic aspects of their structure and operations by the applicable State law. Among such State laws which apply to national banks are State laws regulating interest rates, which, by 12 U.S.C. §85, are generally applicable to national banks.

There are exceptions to this general rule. For example, the National Bank Act, since 1933, has permitted national banks to charge 1% in excess of the discount rate on 90-day commercial paper in effect at the local Federal Reserve Bank. This provision was proposed by Senator Glass in order to enable business firms to borrow the funds necessary to carry on their operations, even though this might involve an interest rate higher than the State usury rate.

With the current discount rate at 8%, and with prime rates generally around 12% and Federal funds rates around 13–14%, Senator Glass' exception provides no help for corporate borrowers in States where the interest ceiling applicable to corporations is 10%, as in Tennessee and Arkansas under their Constitutions or in Montana under its usury statute.

S. 3817 would provide a 3-year exception to the general rule, permitting corporations to borrow money at as much as 5% over the applicable Federal reserve bank discount rate from insured banks and insured savings and loan associations. In our view, this proposal would result in substantial benefits to corporate borrowers in Tennessee, Arkanas, and Montana and to their employees and customers. It would also benefit banks and savings and loan associations in those States, by permitting them to take care of their customers' needs, avoiding either the loss of production and employment which would result in their communities if these needs were not met, or causing the customers, if they are large enough, to go to financial sources in some other State for their funds.

We are advised that bank customers in Tennessee, Arkansas, and Montana are finding it increasingly difficult to satisfy their financial requirements from their ordinary sources, because of the low interest rates in those States. And when the agricultural crops are harvested in the latter part of the summer and the fall, the need for funds to finance the harvest, storage and ultimate sale of these crops will place a tremendously increased burden on the banking systems of those States, with further disruption of other customers of the banks.

Such a failure of the banking system to carry out its responsibility for the financial needs of business and agriculture would have serious effects on the economic health of those communities and would, of course, constitute a most unfortunate failure to carry out the purposes and functions of the banking system.

It is our view that S. 3817 would provide temporary relief for this situation, giving Tennessee, Arkansas, and Montana, and any other States which might be affected, time to bring their constitutional and statutory interest rate provisions in line with current economic conditions. The 3-year period provided by the bill would appear adequate for this purpose.

Accordingly, the American Bankers Association recommends prompt approval and enactment of S. 3817. We request that this letter be included in the hearings on S. 3817.

Respectfully,

REX J. MORTHLAND.

WORTHEN BANK & TRUST COMPANY, N. A.,
Little Rock, Ark., August 6, 1974.

Senator BILL BROCK,
Subcommittee on Financial Institutions,
Committee on Banking, Housing and Urban Affairs,
Washington, D.C.

DEAR SENATOR BROCK: In accordance with my testimony during the hearings of the Committee concerning your bill, S3817, the following materials are submitted as examples of the effects of a high public awareness of the restrictions of the Arkansas usury provision.

If I can be of any further assistance in the pursuit of a solution to Arkansas' current artificial credit crunch problems, please feel free to make any suggestions.

Yours very truly,

EDWARD M. PENICK,
Chairman and Chief Executive Officer.

RESOLUTION ADOPTED BY THE EXECUTIVE COUNCIL OF THE ARKANSAS BANKERS ASSOCIATION; AUGUST 5, 1974

Whereas, in order to preserve the liquidity of all the federally insured financial institutions of the State of Arkansas, and to provide those same financial institutions the opportunity to compete fairly and equitably in regional and national money markets; and

Whereas, in order to permit corporation and business borrowers to secure funds necessary to the continued conduct of their business, and to prevent the loss of jobs and tax revenues to the State of Arkansas; and

Whereas, in order to avoid a reversal of favorable long term economic growth trends and to prevent serious economic dislocation in the State of Arkansas Be It

Resolved, That the Arkansas Bankers Association acknowledges their full support of S3817, which is Senator Brock's bill amending section 5197 of the Revised Statutes, as amended (12 U.S.C. 85), and urges that all its members contact their Congressional representatives to solicit their full support of this bill.

[From the Arkansas Gazette, July 30, 1974.]

TUCKER SAYS UNITED STATES CAN OVERRIDE STATE USURY LIMIT

Attorney General Jim Guy Tucker said Monday Congress could override Arkansas's constitutional 10 per cent interest limit if a bill on which a United States Senate subcommittee has scheduled a hearing Wednesday becomes law.

In an opinion to state Bank Commission Harvel C. Adams, Tucker said the power of Congress "to pre-empt the Arkansas Constitution is not open to question" and that the bill proposed by United States Senator William E. Brock (Rep., Tenn.) would be legal in this respect.

The bill would apply only to corporate or business loans, not consumer loans.

Also not open to question, Tucker continued, is whether national and state banks are involved in interstate commerce. They are, he said, and "once Congress determines an activity is in interstate commerce, its power to regulate is extremely broad."

In addition to the power to regulate interstate commerce, Congress is constitutionally charged with regulating the country's monetary system of which banks are a part, Tucker said.

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Because Arkansas is one of the few states that would be affected by Brock's bill, a copy of the original draft was sent to Adams and he was asked to comment.

Brock's bill would allow natlional banks, federally insured state banks and federally insured savings and loan associations to charge up to 5 per cent more than the discount rate set by the Federal Reserve Board, regardless of the limit established by state laws or constitutions.

BURNS SUGGESTS RATE BE TIED TO INTEREST

Dr. Arthur F. Burns, chairman of the Federal Reserve Board, then suggested the rate for banks should be tied to the interest rate on Treasury bills because this rate reflects market conditions and the discount rate does not. This change in the bill apparently is being contemplated.

Adams received a letter Monday from Senator Thomas J. McIntyre (Dem., N.H.) inviting him to testify at the hearing before the Senate Banking Committee's Subcommittee on Financial Institutions Wdnesday. Adams is not going.

He does not support the bill because the Arkansas banking community is divided on it, Adams said Monday.

In spite of Tucker's opinion, Adams said some state banks would be reluctant to make loans on the strength of Brock's bill, if it becomes law, for fear that interest above 10 per cent would be held usurious by some court, and they would have to forfeit both the principal and interest.

BILL REGARDED AS THREAT TO VOTE

Some state banks see Brock's bill as a threat to the passage of Amendment 57 on the November 5 general election ballot in Arkansas. That amendment would allow the General Assembly to establish interest rates in Arkansas.

"I think something ought to be done in Arkansas," Adams said, explaining that he supports Amendment 57. "It seems to me that if you're going to send those people [state legislators] up there, they could change the rates—raise them or lower them—to fit economic conditions."

Leaders of the Arkansas Credit Requirements Committee, the organization advocating adoption of Amendment 57, say that because it would apply only to corporate loans and not to all lending, Brock's bill would "fragment" Arkansas's economy.

Tennessee's Constitution has a 10 per cent limit on certain types of loans, and Brock's administrative assistant, Pat Abshire, said Brock drew up the bill at the request of Tennessee bankers who said they could not afford to "buy" money at 12 per cent and loan it at 10 per cent interest.

Tucker declined to comment on specific provisions of the bill until he could see an amended copy of Brock's bill.

TUCKER CITES APPEALS COURT RULING

The question of the federal government's power to regulate federally insured state banks worried Adams the most. Tucker pointed out that the United States Seventh Circuit Court of Appeals upheld the constitutionality of the Federal Deposit Insurance Corporation Act of 1937, saying, "It's obvious intent was, by insuring deposits to prevent runs on banks by depositors, to preserve solvency of insured banks, and thus to keep open the channels of trade and commercial exchange." The Supreme Court refused to review the lower court's finding.

Tucker interpreted this language to be a "strong indication that this court is sanctioning the regulation of banking, at the federal level, due to its important, if not vital, influence on interstate commerce."

The federal courts also have found that "to the extent of its participation in the federal [FDIC] legislation, each bank became an instrumentality of the federal government, enjoying its remedial legislation and bound by its legal limitations and responsibilities," Tucker said.

Given the broad power to regulate commerce, Tucker concluded, "It appears that the United States Congress has the authority to establish interest rates which FDIC insured state chartered banks may collect. This power would also include the authority to establish penalties for collecting usurious interest."

APPENDIX I

EXODUS OF CAPITAL FROM ARKANSAS

'Why can't you stay at home with me?'

Source: Kennedy, Jon, Arkansas Democrat, February 20, 1974.

[From Business Week, September 29, 1973.]

Arkansas: A Usury Law Dries Up Loan Funds

TODAY'S INTEREST RATES EXCEED THE TEN PERCENT LIMIT, MANY LENDERS HAVE FLED THE STATE

Unlike many of its neighbors, Arkansas has never been noted for its Southern down-home hospitality, at least as far as the financial world is concerned. For years, beginning in 1846, banks actually were banned from the state. And some citizens still talk about the carpetbagger banks and finance companies that made loans at 60% interest after the Civil War.

As a result, Arkansas retains a special clause in its strongly anti-Reconstruction state constitution of 1874 that prohibits any lender from charging more than 10% simple interest a year. That usury law has long been the bane of finance companies and merchants who rely heavily on credit sales. Now, with the prime rate itself up to 10%, the state's biggest financial institutions are feeling panicky.

Unless the law is changed or interest rates take a rapid dive, Arkansas will experience a full-scale credit crunch and recession, contends Edward M. Penick, president of First Arkansas Bankstock Corp., the state's only bank holding company. "There will be no growth in the state, and that will hurt construction and employment," Penick predicts. "The average working man looking for a car, mobile home, or boat won't be able to find a loan. The Arkansas usury law, which is supposed to protect the small borrower, is going to be his downfall."

No exceptions. All 50 states have usury laws of one sort or another, and more than half have statutes or constitutional provisions that fix general maximum interest rates below the 10% in Arkansas. But in practice, the ceilings apply mostly to home mortgages. Special exemptions usually are made for small loans, various business and bank loans, and retail credit.

But not in Arkansas. That state's supreme court has taken the firm position that a loan carries one basic charge—interest. It has not allowed lenders to get around the 10% ceiling by adding finance charges, service or commitment fees, points, or other extras.

Any lender found guilty of usury in Arkansas stands to lose the full value of his loan. In one case, an auto dealer who sold a car under an installment loan that was later declared usurious was unable to recover interest, principle, or the car itself.

'At least we're protected against excessive rates'

Thus, all kinds of loans—big and small, long-term and short—are desperately hard to find in Arkansas when they are available at all. Every type of lender is feeling the pinch:

Worthen Bank & Trust Co., part of the First Arkansas Bankstock group and the biggest bank in the state, with assets of $350–million, has set up a special loan allocation department to ration credit. Customers for auto or personal loans of less than $500 are almost certainly wasting their time in applying to Worthen. "We're just trying to take care of our good customers," says Donald Eugene Fortson, the bank's marketing vice-president.

First Federal Savings & Loan Assn. in Little Rock, the state's biggest S&L, with $175–million in assets, has stopped making loans on older houses. Its construction loans are only to contractors who are established customers—and even their loan volume has been cut in half.

Two multimillion-dollar projects for the Little Rock area recently were scuttled—a Ramada Inn and a 150–acre shopping center. Fortson at Worthen Bank acted as broker between the shopping center's developer and an out-of-state bank, lining up a tentative $3.5–million in interim financing at 13% interest. But the bank's outside legal counsel took a close look at the Arkansas usury law, and the deal was canceled.

Manhattan Credit, the only finance company with branches around the state, has cut its loan volume from $15–million several years ago to less than $7–million today. And it has eliminated its auto loan, mobile home, and factoring departments.

Crown Mobile Homes, the state's largest mobile home dealer, with annual sales of $3–million and offices in 11 Arkansas cities, reports that four banks that had been supplying financing have cut it off in recent weeks.

Since they cannot charge more than 10% on loans, Arkansas banks and S&Ls cannot afford to pay more than that for deposits. Worthen Bank reports that it has lost about $5–million, nearly 2% of its total deposits, since July, largely as a result of a flight of big certificates of deposit to banks in neighboring states, particularly to banks in Memphis.

"A friend called me to ask what I could get him on a big CD," says Fabco's Penick. "I said 8½%, and he said a Memphis bank told him he could get nearly 11½%. Now, if it's a quarter of a percent differential, you can probably sell a person on loyalty and all that. But if it's three full points—that's a pretty good sales job."

No new problem. The interest ceiling has plagued some lenders for years. Finance companies began to be squeezed in the 1960s, and few have survived. The big national chains, which used to have many offices in the state, are almost all gone today. "We used to buy money at 8% and lend it out at 10%," laments Raymond Rebsamen, co-owner of Manhattan Credit. "We could make a fair profit then, but that was some time ago."

During the 1950s and most of the 1960s, the finance companies got no help from the rest of the financial community in pleading for repeal of the harsh usury law. The banks saw the situation as a way to expand their consumer loan activities.

But that quickly changed during the 1969–70 credit crunch, when banks found themselves obliged to pay 10% and more when they borrowed federal funds (short-term borrowings from other banks). Now the banks are as much against the usury law as the finance companies are. And both camps have an ally in the merchants who rely heavily on credit sales. Many have either had to raise their list prices or move to cities just outside the Arkansas border. A 1968 study, for example, showed that prices for major appliances in Little Rock, located in the center of the state, were 4% to 7% higher than in seven comparable out-of-state cities.

And that disparity is expected to grow if the cost of money keeps going up as it did through last summer. "In effect, the cash customers are subsidizing the credit customers," says H. R. Lively, director of public affairs for the general credit office of Sears, Roebuck & Co., the state's biggest volume retailer.

In a split city. The contrast is most noticeable on the border-straddling cities of Texarkana, where 21,700 Arkansans and 30,500 Texans live hunched together separated only by a street. There are 11 new car dealers on the Texas side, where usury laws are more lenient, but none on the Arkansas side. The Texas city boasts 23 used car dealers to Arkansas' three. There are 21 furniture and appliance dealers on the Texas side, while the Arkansas city has only six.

Two of the national department store chains in Texarkana, Ark., have solved the credit problem another way:

They simply have dropped major appliances that are normally sold on credit, such as TV sets, washing machines, and dryers, from their inventories. And there are no finance companies on the Arkansas side of the city, but more than 25 on the Texas side. That is more finance companies than exist in the whole state of Arkansas.

Fifty banks joined in a futile bid three years ago to get a constitutional convention to wipe out the usury clause. But century-old fears of collusion between bankers and politicians were resurrected at the convention, killing any chance of immediate repeal of the usury law. And organized labor is expetced to continue to oppose any change the law. "It's one of the finest laws we've ever had," asserts J. Bill Becker, president of the Arkansas State AFL-CIO. "They ought to quit raising the interest rates in Washington and copy it. It's the one break we've had."

In the crunch, business and financial leaders are half-dreading and half-hoping for the worst. "There haven't been enough people hurt enough yet," says Charles E. Venus, economic consultant to Worthen Bank. "Wait until Dad is out of a job and wants $300 for 90 days and finds out there's no way in the world a bank is going to lend him the money."

[From Mid-Continent Banker.]

USURY LAWS NEED CHANGING

Most bankers agree that interest rate ceilings must be raised. But how can this best be done, considering formidable opposition from various areas—notably trade unions and consumer groups? MID-CONTINENT BANKER editors asked three prominent bankers to explain their approaches to this important topic.

JOHN P. WRIGHT,[1] PRESIDENT, AMERICAN NATIONAL, CHATTANOOGA

The interest rate ceilings in Tennessee are 6% as a legal rate and 10% as a contract rate for both individuals and corporations. Just a few years ago, bankers in Tennessee thought these ceilings were adequate, but today the view has been so drastically altered that it is obvious that change is necessary. Interest rate ceilings in Tennessee must be raised. Why the change and why the mandate? Basically, the reason is inflation, the upward spiraling of so many costs that we have experienced in recent years. What is needed is a viable means of dealing with economic change so that the financial growth and prosperity of the state can continue. Let me deal with these two issues separately—the problem and the solution.

Certainly, inflation is not a problem just in this state, it is worldwide in scope. Still, Tennesseans live and work under state law, and the Tennessee economy must operate under those same statutes. When costs rise to the degree that the rate ceilings hamper economic progress, it is regrettable and hopefully short-lived, but when the costs rise so as to impede or stifle economic well being, change is required. This is particularly true when inflation which causes the increases is so pervasive and underlying that no significant downturns are in sight. This is precisely where Tennessee bankers find themselves today. Their cost of funds has risen to such a degree that the granting of credit on a profitable basis has become restricted and resulted in reductions in the availability of funds so necessary to growth and prosperity.

Let me cite examples of this. At the end of September, 1973, the 10 largest banks in the state reported some interesting statistics: Their net Fed funds position was in excess of $383 million, with funds selling at a rate of 10% or more; their large ($100 thousand and up) CD holdings were over $1.7 billion, up over $810 million from the same date a year earlier. This latter position is particularly revealing because the costs of these certificates increased during the period from 5% and 5½% to 10%. Both the Fed funds and certificate rates match the loan rate ceiling, leaving no margin for operating cost or profit. Another notable statistic recently was the announced cost of living increase of 8½%. In this kind of atmosphere, savers will not long be satisfied with the rate of returns on their savings not matching the cost-of-living increase plus an in-

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[1] Mr. Wright is also president of the Tennessee Bankers Association.

terest margin for the use of their money. The result of all of this is a profit squeeze and a potential flight of funds from the state, thus further worsening the local economics.

Now, in regard to a recommended solution, let me say I understand why ceilings are sought. Consumers deserve and should have protection from unethical lenders. What is needed is a workable system which allows both protection and flexibility to deal with changing economic conditions on a continuing basis. Tennessee is one of the few states in which the rate ceilings are set as constitutional maximums. What I propose is for a constitutional convention to place the responsibility for setting the ceilings into the trusted hands of the state legislature. In that way, these representatives of the people can deal with the situaion of economic supply and demand as it develops. The very people for whom the ceilings were designed, the voters who supply and consume funds, can in fact be helped in this way. The legislators can discharge their proper duties to their constituents, and the economy of the state will have the opportunity to respond progressively to change. The alternative is little or no relief for a developing dilemma and, in the absence of reduced inflation, the threat of economic regression in Tennessee.

EDWARD M. PENICK, PRESIDENT, WORTHEN BANK, LITTLE ROCK

The Arkansas interest rate ceiling is unique in that it is a provision of the Arkansas Constitution of 1874. This provision limits the maximum rate of interest to 10%. Through the years, this ceiling has been interpreted by the State Supreme Court to mean 10% simple-interest ceiling. In other words, the maximum interest rate that one can earn on any type of installment paper, conditional sales contract or accounts receivable is a 10% simple-interest rate. This has been further enforced by a provision in the Arkansas Constitution that makes any usurious contract complete void and which requires the forfeiture of not only the interest but also the principal.

Prior to the early 1950s, the Arkansas Supreme Court had been more lenient in its interpretation of this provision and had accepted the time-price-differential theory which would allow an interest ceiling of higher than 10%. In the early 1950s the Court went back to a restrictive interpretation of 10% simple interest. It was at this time that the major finance companies started to withdraw their business from Arkansas. Today few major finance companies and none of the major personal finance companies are engaged in business in Arkansas. The only finance companies operating in the state are those that are related to the automobile industry.

This ancient and unusually severe restrictive interest rate has had a bad effect on the general economy of Arkansas. Arkansas, like many of the other southern states, is a capital-poor state. It has had to import the capital necessary for its economic development. This has been accomplished through industrial revenue-type bonds that have the advantage of a tax-free status. Without these, industrial development in Arkansas would be at a standstill.

The most serious consequence of the Arkansas restrictive interest rate was felt last fall when the prime interest rate reached 10%, a rate equal to the maximum interest rate that could be charged in Arkansas. With bumper crops in cotton, rice and soybeans, those out-of-state financial organizations that had been financing the processing and storage of Arkansas crops refused to come into Arkansas at a 10% interest rate when their funds were earning much higher rates in competitive markets. This became a serious matter and could have had a devastating effect on the Arkansas economy. The reason it did not have a worse effect was that the price of agricultural crops was good, and the crops did not stay in process long but moved into the market so that the funds accelerated through the economy at a rapid pace.

The general consumer in Arkansas also suffers from this restrictive interest rate. Studies conducted by research teams of the University of Arkansas have conclusively proved that the cost of major appliances in Arkansas is anywhere from 8% to 12% higher than in adjoining states. This is due entirely to the fact that the credit seller makes up the difference in his cost of credit by raising the basic price of the product.

Probably the most serious consequence has been in the Arkansas banking industry. As the rates on the large CDs have moved upward in excess of 10%, it has been difficult, if not impossible, for Arkansas banks to pay rates competitive with those of surrounding states. Last fall Arkansas bankers had aggressive competition from banks in surrounding states offering larger depositors 11% and 12% on short-term CDs. This has resulted in a major outflow of this type of investment funds from the state when it is badly needed.

There is currently a group which has filed a petition with the attorney general asking for a referendum election on the interest rate provision of the Arkansas Constitution. If this petition is successful, it will put the interest rate ceiling into the hands of the legislature, so that it can be reviewed on a periodic basis. The problem now is that we are trying to operate in a 1974 economic environment with an 1874 interest-rate ceiling. Until this is changed, or until a degree of flexibility is permitted, Arkansas will continue to be a state that has difficulty in attracting outside capital and Arkansas banks will continue to have difficulty in serving the consumer banking market with the type of services that consumers in other states have come to enjoy.

JAMES E. CLINE,[2] PRESIDENT, CITIZENS STATE BANK, MARYVILLE, MO.

For more than a decade financial leaders, business leaders, and the whole citizenry, for that matter, have witnessed a constant flow of money out of Missouri. I want to emphasize the fact that the flow has been continuous, maybe at not too alarming a rate at times, but at other times money departed from our state at a rapid rate.

Economic history will record the past 10 years as being very damaging to the economic growth of Missouri. Time will prove that it will take years to recover from this period of disintermediation.

Looking back, it is difficult to reconcile the fact that our financial leaders, our business community, our labor leaders and our elected government officials have failed to develop the necessary thrust to change the state's usury laws so as to provide us with equalization which would permit the state's financial institutions to compete with the federal government and the financial institutions of other states on a competitive basis. Far too many people in and out of government did not even recognize such problems existed. We all talk about the law of supply and demand and freedom in the marketplace, but changing the laws so that supply and demand can function has never been accomplished.

We have now reached the point where such basic industries as housing, agricultural and many others are suffering because capital and credit are no longer available. Productivity has been seriously hampered. A city can make a great effort to secure a new plant with a national reputation only to find that adequate housing is not available for the new employees, so the plant goes to another state.

Missouri agriculture is facing the best prospects for growth since World War II, but we find the shortage of capital for operating funds curtailing growth. People fail to recognize that a man working in a factory or a farmer on a tractor provides employment for an additional 10 to 12 people in other related industries, such as marketing, transportation, finance, construction, chemicals, petroleum and health, just to mention a few.

We are each day experiencing a slowdown in Missouri's economic growth. Those dollars that have left our state the past 10 years for a higher rate of return will be difficult to recover. Investment of funds classified as more or less permanent funds move around slowly. Consequently, those funds lost from Missouri banks and other savings institutions will be slow to return. Many dollars will never return.

Many Missouri communities have unknowingly let these savings leave their communities without demanding that at least part be reinvested in their home communities. Some financial institutions have taken funds from communities for more than a year without financing a single new house. Many savings that formerly were used to finance new homes now finance commercial enterprises in the Southwest because of much better earnings there.

Changes in policy are in order. Funds now must be invested in out-of-state to enhance profit. We must restrict lending in our state until our interest rate is equalized with other states, thereby giving our banks an opportunity and an environment which will insure profits. Those banks fortunate enough to have state funds are forced to invest with out-of-state corporations in order to receive a return to make these public funds profitable. How does this condition help Missouri citizens and Missouri taxpayers?

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[2] Mr. Cline is also president of the Missouri Bankers Association.

GOALS FOR CENTRAL ARKANSAS,
Little Rock, Ark., February 25, 1974.

MR. JAMES O. POWELL, *Editorial Director,*
Arkansas Gazette Co.,
112 West Third Street,
Little Rock, Ark.

DEAR MR. POWELL: The *Gazette* seems to be allowing its continued animosity toward the Arkansas Legislature, and its suspicion of the business community in general, to determine its editorial policy on the usury issue. The usury problem is complicated and very critical to the future welfare of Arkansans. It smacks of our old self-sufficiency argument about building a fence around the State. The *Gazette* is generally much more rational and forward thinking in its policies.

Surely the editors and Mr. DuVall have studied the problem. The recent article "Arkansas: A usury law dries up loan funds," *Business Week*, September 29, 1973, is publicity we need like a hole in the head. Mr. James E. Mitchell's "Usury in Arkansas" *Arkansas Law Review*, Fall 1972; Dr. Gene C. Lynch's "Consumer Credit at Ten Per Cent Simple: The Arkansas Case," and other works clearly illustrate the effects that the constitutional usury provision has in Arkansas. Some of the effects include:

1. Cash prices in Arkansas are abnormally inflated (cash buyers must pay more because ten percent simple will not cover all the costs of credit buyers).

2. The low limit eliminates risk capital and risk takers. Ambitious people cannot get financing without capital holders "buying in," so their propensity is to go elsewhere.

3. Arkansas border cities suffer from lack of growth compared to their border counterparts. Texarkana is a more than obvious example.

4. Arkansas merchants limit credit sales, and those who do give credit demand faster payment than merchants in other states—12 to 18 months compared to 24 to 36 months.

5. Credit standards for Arkansas consumers are abnormally high, meaning a smaller proportion of our people can buy on credit.

There are other effects, but as Mr. Mitchell put it, "Arkansas buyers, who have less income than those of any other state save Mississippi, pay more for similar items than do out of state buyers when they pay cash. And they pay cash more often because they have a harder time getting credit."

All of this has been going on for some time. More recently, as national capital shortages and the inflationary bias is built into interest rates, we have experienced more drains from the State. The worst periods were in the 1969–70 crunch and the late 73–early 74 high rate period. Bordering state banks were delighted to steal major CD customers by paying higher rates than other institutions could match.

Fortunately or unfortunately for the usury "issue," we may breathe a little easier this year, since interest rates should back down some—until fall. Projections for 1975 call for another upswing in the economy, however, with the prime interest rate reaching between 11 and 12 percent. I know of no one who will be happy to see that happen, but Arkansas will be in a terrible straight jacket if it does.

The money market is probably the most fluid market in the United States. Political boundaries make little difference; money as a commodity seeks its highest return, wherever that return is. Arkansas cannot stand apart from the national market without paying the price. And the price is a severe shortage of funds now and for the foreseeable future. So we must get to a more flexible position—the sooner the better.

Although the *Gazette* might have done more to educate the Arkansas people about these effects, its editorials do suggest some sympathy for a change *if* the change satisfies certain criteria. These criteria would appear to include keeping any change procedure out of the hands of the Arkansas Legislature and maintaining some "lid," preferably the "DuVall Plan" tying the rate to the Federal Reserve Discount Rate.

With regard to the *Gazette's* position:

1. We have the usury issue because it was stuck in the 1874 Constitution along with so many other specific controls, all of which we admit should not be constitutional items. To the best of my knowledge the *Gazette* has agreed that the specificness of the Constitution has served as an albatross around the collective

Arkansas neck. The Governor's salary, county government structure, the usury limit nor any other specific social limiting item should be constitutionally controlled.

2. If not a constitutional limit, what? As an economist who believes that competition works, especially in the most liquid of markets, I would remove the limit entirely, and free the Arkansas economy to let rates find their own level. Yes, they would go higher, and short term installment buyers might pay 1–1½% a month—like they do everywhere else, but the cash buyers wouldn't be subsidizing the credit buyers, and credit would be easier to get. But nobody seems to trust competition any more, so we must build in some sort of protection.

3. How about the "DuVall Plan" (our maximum rate would be double the Federal Reserve Discount Rate)? We would be moving from maximum control as a constitutional provision to absolutely no Arkansas control at all. The Federal Reserve Discount Rate is set within the Federal Reserve system to help control the money supply. Sometimes the FED adjusts it as interest rates move; sometimes it doesn't. It was changed six times in 1971, as rates were going down, none in 1972 as rates were creeping up, and seven times in 1973. The discount rate is a policy tool of the Federal Reserve System and has zero relationship to the supply of and demand for money in Arkansas. The same arguments apply to any "national" standard, and besides, it would probably be an unconstitutional delegation of powers.

4. So we have a proposition to let the Arkansas Legislature set the maximum rate. The *Gazette* seems to hold that the Legislature would succumb to pressure groups and raise the rate too high. Yet on highly visible public issues, the legislators fear the voter more than the interest groups, and seldom act until they have a clear public mandate (as the *Gazette* has often pointed out concerning taxes and other issues). So my concern would be that the Legislature would not allow us to be sufficiently flexible to compete in the national money market. Nevertheless, we do elect the Legislature to represent us, and compared to a provision in the constitution, can react in fairly short order to whatever they create.

Most important of all is to understand that we will have only one opportunity to change the usury provision this year. While we might like to have a multiple-choice type amendment, at least one viable option may be presented. A change needs to be made as soon as possible. Both the *Gazette* and the Governor would do well to study the evidence and reconsider the current option. Any better solution would be most welcome.

Sincerely,

CHARLES E. VENUS.

[From Tapestry, Vol. III, No. 7, February 19, 1974.]

USURY LAW NEEDS CHANGING

Most bankers agree that interest rate ceilings must be raised. But how can this best be done, considering the formidable opposition from various areas—notably trade unions and consumer groups? Mid-Continent Banker editors published in their February 1974 issue statements from three prominent bankers explaining their approval to this important topic. The following article was written by Edward M. Penick, president and chief executive officer of Worthen Bank.—Ed.

The Arkansas interest rate ceiling is unique in that it is a provision of the Arkansas Constitution of 1874. This provision limits the maximum rate of interest to 10 per cent. Through the years this ceiling has been intrpreted by the State Supreme Court to mean 10 per cent simple interest ceiling. In other words, the maximum interest rate that one can earn on any type of installment paper, conditional sales contract or accounts receivable is a 10 percent simple interest rate. This has been further enforced by a provision in the Arkansas Constitution that makes any usurious contract completely void and which requires the forfeiture of not only the interest but also the principal.

Prior to the early 1950's the Arkansas Supreme Court had been more lenient in its interpretation of this provision and had accepted the time price differential theory which would allow an interest ceiling higher than 10 per cent.

In the early 1950's the Court went back to very restrictive interpretation of 10 per cent simple interest. It was at this time that the major finance companies sarted to withdraw their business from Arkansas. Today a very few major finance companies and none of the major personal finance companies are engaged in business in Arkansas. The only finance companies operating in the State are those that are related to the automobile industry.

This ancient and unusually severe restrictive interest rate has had a very bad effect on the general economy of Arkansas. Arkansas like many of the other southern states is a capital poor state. It has had to import the capital necessary for its economic development. This has been accomplished through industrial revenue type bonds that have the advantage of a tax-free status. Without these, industrial development in Arkansas would be at a standstill.

The most serious consequence of the Arkansas restrictive interest rate was felt this last fall when the prime interest rate reached 10 per cent, a rate which was equal to the maximum interest rate that could be charged in Arkansas. With bumper crops in cotton, rice and soybeans, those out-of-state financial organizations that had been financing the processing and storage of the Arkansas crops refused to come into Arkansas at a 10 per cent interest rate when their funds were earning much higher rates in competitive markets. This became a very serious matter and could have had a very devastating effect on the Arkansas economy. The reason it did not have worse effects was that the price of the agricultural crops was good, and the crops did not stay in process very long but moved into the market so that the funds accelerated through the economy at a very rapid pace.

The general consumer in Arkansas also suffers from this restrictive interest rate. Studies conducted by research teams of the University of Arkansas have conclusively proved that the cost of major appliances in Arkansas is anywhere from 8 per cent to 12 per cent higher than the same article in stores in adjoining states. This is due entirely to the fact that the credit seller makes up the difference in his cost of credit by raising the basic price of the product. Dr. Gene Lynch of the University of Arkansas College of Business Administration has published an extensive study of this which has brought home to the Arkansas consumer the fact that he is being penalized by the unusually restrictive 10 per cent simple interest rate.

Another important area that has been affected by this rate is the building industry. Interim construction loans at the 10 per cent rate are not attractive to larger investors. Consequently, Arkansas has been bypassed. Some of the major local developers have circumvented the Arkansas law by the organization of out-of-state subsidiary corporations which acquire their funds from out-of-state lenders, using their Arkansas lands and land contracts as security for their loans. The Arkansas Supreme Court has interpreted this to be a non-Arkansas contract governed by the laws of the state in which the subsidiary is located. The consequence of this is that it forces legitimate, profitable business to leave the State of Arkansas and be domiciled in other states because of the restrictive interest provisions.

Probably the most serious consequence has been in the Arkansas banking industry. As the rates on the large certificates of deposit have moved upward in excess of 10 per cent, it has been very difficult, if not impossible, for Arkansas banks to pay rates competitive with those of surrounding states. During this last fall Arkansas bankers had very aggressive competition from banks in surrounding states offering larger depositors 11 per cent and 12 per cent on short-term certificates of deposit. This has resulted in a major outflow of this type of investment funds from the state when it is badly needed.

There is currently a group which has filed a petition with the Attorney General asking for a referendum election on the interest rate provision of the Arkansas Constitution. If this petition is successful, it will put the interest rate ceiling into the hands of the legislature, so that it can be reviewed on a periodic basis. The problem now is that we are trying to operate in a 1974 economic environment with a 1874 interest rate ceiling. Until this is changed, or until a degree of flexibility is permitted, Arkansas will continue to be a state that has difficulty in attracting outside capital and Arkansas banks will continue to have difficulty in serving the consumer banking market with the type of services that consumers in other states have come to enjoy.

[From Tapestry, Vol. III, No. 11, March 18, 1974.]

A Checklist of Usury Effects

(By Dr. Charles S. Venus, Worthen Bank's Consulting Economist)

Since we have started discussing the possible change in the Arkansas Constitutional usury provision, a good many of our employees have asked me just what the effects of the usury provision are, and what we should tell our customers about it. A good bit of research has been done on this, and more is being done at this time. Through the years this research has pointed out the following effects of our 10% simple interest limit:

1. CASH prices are higher in Arkansas than in surrounding states, because the cash price must include the credit costs not covered because of the usury limit. As far back as 1968 a study found the difference to be from 3% to 7%. So we pay the higher credit costs anyway, except that in Arkansas the CASH buyer pays more to subsidize the credit buyer.
2. Arkansas border cities suffer from lack of growth compared to their border counterparts. Texarkana and West Memphis are good examples, where most businesses are located on the non-Arkansas side of the border. A 1972 study points out that Texarkana, Arkansas, has one automobile dealer, while Texarkana, Texas, has 16, although their populations aren't that different (about 22,000 in Arkansas, 31,000 in Texas).
3. The low limit eliminates risk capital and risk takers. Ambitious people cannot get financing without capital holders "buying in," so they are inclined to create their business elsewhere, where there is more opportunity to fully own and control their business.
4. Arkansas merchants limit credit sales, and those who do give credit demand faster payment than merchants in other states—12 to 18 months compared to 24 to 36 months. This is just logical good business practice since the limited credit charge does not cover the full costs of extending credit.
5. Credit standards for Arkansas consumers are abnormally high, meaning a smaller proportion of our people can buy on credit. If credit charges do not cover costs and risks of losses, business must be more selective about lending.

There are other effects, but as Mr. James Mitchell stated in his study USURY in ARKANSAS, in 1972: "Arkansas buyers, who have less income than those of any other state save Mississippi, pay more for similar items than do out of state buyers when they pay cash. And they pay cash more often because they have a harder time getting credit."

[From Tapestry, Vol. III, No. 12, March 25, 1974.]

Usury and Retail Prices in Arkansas

(By Dr. Charles E. Venus)

One of the effects of the 10% simple interest usury limit in Arkansas' Constitution is that cash prices in Arkansas are higher than are prices in states where credit charges can pay the full costs of credit. Our cash prices must be high enough to make up the difference. The effect is that cash customers subsidize credit customers.

More research is being done on this effect now, but an earlier study by Dr. Gene Lynch of the University of Arkansas detailed the difference, and was partly included in the Report of the National Commission on Consumer Finance, *Consumer Credit in the United States*, in 1972. Forming an index with a base price set at $100 for Little Rock, comparable prices in the neighbor-state cities were found to be as shown in the Table.

Both competition and transportation costs will make some difference in prices among cities, but notice that *all* the areas are lower than Little Rock; the difference ranging from $2.49 to $4.85. The normal credit charge in other areas is 1.5% a month, compared to our .541%. The difference, on $100 borrowed for one year, on a monthly payment basis, comes to $4.54!

The cost of extending credit must be paid somehow, by somebody. The Arkansas usury ceiling causes the difference to be included in the cash price. So if we buy for cash, either because we can't get or don't need credit, we pay more than we would if credit users carried their own costs.

COMPARABLE CASH PRICES

	Color TV	Washer and dryer	Refrigerator	Range
Little Rock	$100.00	$100.00	$100.00	$100.00
Texarkana, Tex	94.26	95.94	96.83	99.34
Monroe, La	96.47	98.15	95.99	99.48
Greenville, Miss	97.18	96.30	97.35	93.64
Springfield, Mo	96.95	99.64	97.07	93.14
4-city average	96.21	97.51	96.81	95.15
Average difference	3.79	2.49	3.19	4.85

APPENDIX 5

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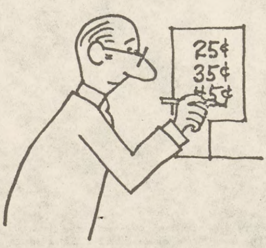
It's happening in Arkansas right now.

Credit harder to get

Adverse retail climate



Prices climbing faster


Loan sharks step in

Don't let it happen in Iowa.

Source: Iowa Retail Federation, Inc., Des Moines, Iowa.

All this resulted since Arkansas applied its maximum interest rate to consumer retail credit.

And today, some people want to establish Iowa's retail credit rate at 12%.

Statements concerning the credit situation in Arkansas are documented throughout this booklet with source notations. More extensive materials concerning the Arkansas situation can be obtained by writing the sponsors of this brochure . . . The Iowa Retail Federation, Inc. 324 Fleming Building, 218 Sixth Avenue, Des Moines, Iowa 50309.

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It's happening in Arkansas right now.

Don't let it happen in Iowa.

Don't let

...cash customers be forced to pay higher prices

...responsible citizens be denied credit in Iowa

...loan sharks get started

...restrictive rates deter merchant's expansion in Iowa

...border residents go out-of-state to shop

Don't let 12% become law in Iowa.

Act now. Contact your legislator.

[From the Arkansas Gazette, Saturday, June 29, 1974.]

208,457 Signers Back Increase in Interest Rate

(By Carol Griffee, of the Gazette staff)

Petitions bearing 208,457 signatures of persons asking for a vote in the November general election on whether the General Assembly should receive the power to change Arkansas's 10 per cent interest limit were submitted Friday to Secretary of State Kelly Bryant.

Bryant and William J. Smith of Little Rock, attorney for the Arkansas Credit Requirements Committee, said it was the largest number of signatures ever submitted asking for a vote on an issue.

The previous record number, also submitted by Smith, was about 200,000 in 1972, on petition, seeking a vote to repeal the 1907 state law requiring full crews on railroads.

Bryant said it would take his staff about 10 days of the 15 days allowed by law to verify that at least 64,807 of the signatures were those of qualified voters, the minimum required before he can place the amendment on the ballot. To initiate a constitutional amendment requires the signatures of 10 per cent of the 648,069 voters who participated in the 1972 gubernatorial election. In addition, Amendment 7 to the Constitution requires that the petitions must contain the signatures of at least 5 percent of the qualified voters in 15 of the 75 counties.

The petitions were brought into Bryant's office in five cartons, four of which were transported on a dolly.

Smith's principal argument for the amendment was that "we have a democratic form of government. For 100 years, the legislature and the governor have been able to deal with every subject except one—the cost of money." The governor's power to veto bills and the people's right to a referendum on any law passd when 6 per cent of the voters demand it are adequate safeguards, he said.

The 10 per cent ceiling on interest rates would not be repealed automatically if the amendment were approved because it would take affirmative action by the General Assembly to change it, Smith stressed. He and Wilson said they hoped the Legislative Council would begin an immediate study of the problem if the amendment were approved, concentrating on what neighboring states have done. Many have sliding scales of interest on different types of loans, he said.

Arkansas, Smith continued, is the only state that has a constitutional limit on interest rates. The national prime interest rate (the rate banks charge their best customers) is 11¾ per cent. This means that capital that should remain in Arkansas to furnish loans is leaving because it can draw more interest elsewhere, Smith said.

To meet existing contractual obligations, some Arkansas banks are having to "buy" money at 12 per cent which they can then loan only at 10 per cent, Wilson and Smith said. This is why Arkansas banks will not take on any new financing contracts, especially on interim construction, they said.

Arkansas Consumer Research noted the Committee's contention than the 10 per cent limit "is responsible for tight credit conditions in Arkansas" and called this a "false argument that should be rejected outright."

Credit conditions are tight in Arkansas "because they are tight nationally," ACR said. "The backers have not offered one iota of proof to indicate that the Arkansas limit is preventing people from getting credit." Money also is tight "because of a national inflation rate of more than 10 per cent," ACR said. "Changing the Arkansas Constitution is not going to prevent inflation. In fact, higher interest rates add to inflation."

When asked by reporters for verification that the interest ceiling hurts low income persons, Smith introduced Burl C. Rotenberry of Fort Smith, a lawyer now in private practice who was director of the Legal Aid Bureau in Pulaski County from 1965 to 1968. Rotenberry said usury laws "do more harm than good" because the "people who need credit the most and who most need to deal with legitimate and reputable" lenders are driven to illegitimate and disreputable sources because they often are looked on as being "high risk" consumers.

Smith said that various surveys were being conducted to determine how much capital Arkansas had lost because of the ceiling and how many consumers had not been able to obtain loans. Pressed to name who was conducting the surveys, Smith said the Federal Deposit Insurance Corporation was one and that the Arkansas Bar Association was financing a research project.

He also said that the federal Consumer Credit Commission filed a report last year in which it recommended that states be given four years in which to lift interest rate limits. If the states did not act, the Commission said, the federal government should step in.

ACR's statement said the organization was "not surprised" at the record number of signatures submitted because the Committee had enlisted "everyone from college fraternity members to high school band students to people hired through the want ads in newspapers" to gather them.

[From the Arkansas Gazette, Little Rock, July 12, 1974.]

Vote on Interest Rate Set November 5

(By Carol Griffee, of the Gazette staff)

Arkansans will vote in November on whether they want to give the General Assembly the power to change the constitutional limit of 10 per cent on interest rates.

Secretary of State Kelly Bryant said Thursday that his staff had verified 78,783 names of qualified voters on 5,000 petitions submitted June 28 by the Arkansas Credit Requirements Committee. Only 64,807 names were needed to get the amendment on the November 5 general election ballot. The question's official title is Proposed Constitutional Amendment No. 57.

At a news conference after the certification, Kenneth Pat Wilson of Jacksonville, the Committee chairman, said in response to questions that Governor Bumpers had not dropped his opposition to the proposed amendment.

Asked if the governor would speak out against its passage, Wilson said, "I don't think anyone in his right mind would talk against it * * *. Anyone who is smart enough to sit in the governor's chair is smart enough to know" that the interest rate ceiling is hurting Arkansas's economy.

With the national prime interest rate at 12 percent and New York financial institutions paying 12.25 per cent on large certificates of deposit, capital is being drained from Arkansas because it can earn more elsewhere, Wilson and William J. Smith of Little Rock, the Committee's legal counsel, asserted. They said published statements of bank conditions show some Arkansas institutions are experiencing a slowing of the growth of their deposits.

Mr. Bumpers responded later that he would re-evaluate his opposition "if somebody can prove to me there is a flight of capital from this state and bank deposits in this state are, in fact, decreasing or flying to other states and that banking in this state is jeopardized by this.

"It is very difficult to ask me or anybody else to raise interest rates on what I know are going to be the people who have the toughest time making ends meet. They're the ones that will be hit with the highest rates if this amendment passes. That one thing deeply concerns me." He added that a study of the state Commerce Department showed that bank deposits in Arkansas were increasing at a rate similar to those of surrounding states.

SENATOR'S BILL ALSO CRITICIZED

Wilson and Smith also frowned Thursday on a bill proposed by United States Senator William Brock III (Rep., Tenn.) that would allow financial institutions to charge more interest on commercial loans and loans of $100,000 or more, regardless of a state's constitutional or statutory limitations.

Wilson, a Jacksonville banker, said Brock's bill would "selectively accommodate certain groups" rather than benefit the public. Smith said the bill, if passed, would "fragment Arkansas's economy" by allowing only certain loans to qualify for an interest rate of up to 5 per cent more than the federal discount rate, which currently is 8 per cent.

Wilson was asked that if a bank could earn more on commercial loans would this not dry up funds for other types of loans that could not draw equal interest. "You draw your own conclusions," he said, indicating that this would be true.

Smith noted that Tennessee's constitution had a 10 per cent interest ceiling on certain types of loans, whereas Arkansas's was an across-the-board limit, applying even to department store charge accounts. "Tennessee has a curable case; we've got a terminal case," he quipped.

Pressed by reporters to cite specific instance where banks had lost deposits to out-of-state institutions, Smith repeatedly referred them to statements of conditions published quarterly in newspapers, which he said would show a decline in the rate of growth of deposits during the last six months. He conceded that there had been no actual reduction in the total amount of deposits.

(The state's largest bank is Worthen Bank and Trust Company. Its deposits from December 31, 1972, to December 31, 1973, grew by $24,869,072. From June 30, 1973, to June 30, 1974, it registered a $28,586,743 increase in deposits).

HALT IN INVESTMENTS BY STATE CITED

In mid-May, the state stopped investing its surplus funds in certificates of deposit because an attorney general's opinion said they were securities and state law limited the amount of state investments in securities. The state was over that limit. Smith was asked if this could have caused the alleged growth slowdown and he said it "could have contributed to it."

Smith cited two instances that he said showed the money market was growing more critical in Arkansas. Commercial Credit Corporation, one of the nation's largest, has notified its borrowers that it is pulling out of Arkansas, he recalled.

He said also that St. Francis County Community College at Forrest City was unable to attract any bidders on 6 per cent tax-exempt construction bonds and was having to apply to the state Board of Higher Education for permission to offer bonds at a higher interest rate.

The Committee submitted 11,715 petitions containing more than 208,000 signatures to Bryant. The secretary of State said his staff stopped counting when it was satisfied that the petitions contained more valid names than were needed.

In addition to requiring that at least 10 per cent of those who voted in the 1972 gubernatorial election sign constitutional amendment petitions, the state Constitution says he signatures must include 5 per cent of the qualified voters in a minimum of 15 counties. Bryant said the Committee's petitions contained at least 5 per cent of the voters in 64 of Arkansas's 75 counties.

[From the Arkansas Democrat, Thursday, July 11, 1974.]

PETITIONS VALID; USURY MEASURE GETS BALLOT SPOT

Secretary of State Kelly Bryant certified as sufficient today petitions from an organization that wants to change the state's constitutionally set 10 per cent interest limit.

Bryant said the question of changing the law to allow the legislature to set maximum interest rates would be designated Amendment 57 on the Nov. 5 general election ballot.

Bryant said the Arkansas Credit Requirements Committee, the group pushing for the change in the usury law, had submitted 11,715 pages of petitions. He said 5,099 petitions were checked and some 78,783 names were found to be acceptable.

Bryant said that was 21.44 per cent more than the required amount of names.

The committee needed 10 per cent of the total number of votes cast for governor in the last general election. The committee also had to have signatures of 5 per cent of the total number of votes cast for governor in the last election in 15 counties.

Bryant said the committee had enough signatures to meet both requirements.

Kenneth Pat Wilson of Jacksonville, committee chairman, predicted the usury change would be approved. "I feel the people will want Arkansas to join America," he said.

Asked if Gov. Dale Bumpers, who has expressed opposition to the change in its present form, would continue his opposition, Wilson said, "I don't think anybody in his right mind will talk against it."

Attorney William J. Smith of Little Rock, the committee's legal counsel, said Arkansans cannot compete on the national or regional money market because of the limit. He said badly needed capital is leaving the state daily.

Wilson said the national prime interest rate continues to climb and that Arkansas banks now are competing for federal money at 13.1 per cent interest. He said that two weeks ago, Arbansas banks were competing for funds at 11.7 per cent interest.

On another subject, Bryant told reporters today that he had sent letters to Atty. Gen. Jim Guy Tucker from two persons who want to be write-in candidates in the general election.

Editor Joseph Weston of Cave City wants to run for governor and Jim E. Lendall of Little Rock wants to run for House District 1, Position 3.

Bryant turned down a request from both, saying they had not qualified under state law. He asked Tucker for his opinion.

FEDERAL RESERVE BANK OF ST. LOUIS,
LITTLE ROCK BRANCH,
Little Rock, Ark., October 2, 1973.

MR. EDWARD M. PENICK,
President and Chief Executive Officer,
Worthen Bank and Trust Co., N. A.,
Little Rock, Ark.

DEAR ED: The request for credit submitted in your letter of September 14 has been reviewed by our Discount Committee.

The Committee is sympathetic to the credit needs of your bank, and is mindful of the fact that you are not able to serve your community in a manner you deem adequate. However, in view of the increase in both loans and deposits over 1972 levels, the Committee feels that your bank does not now qualify for emergency credit as defined under Section 201.2(e) of Regulation A. The problem created by the restrictive usury laws in Arkansas is not, in the Committee's opinion, unique to Worthen Bank, but arises from a state constitutional provision that affects the entire Arkansas banking community, and is particularly troublesome for the more progressive banks.

The Committee noted that your bank does have access to the national money markets, and that you have been able to cope with the situation thus far. The Committee also noted that your bank still has adjustment credit available under our guidelines. While no one knows when interest rates will turn down, there is at least the hope of some relief in the not too distant future. In the meantime, the Committee expressed its desire to keep abreast of your situation, and to evaluate any new information that might have a bearing on your eligibility for emergency credit.

Sincerely,

JOHN F. BREEN.

WORTHEN BANK & TRUST COMPANY, N. A.,
Little Rock, Ark., September 14, 1973.

MR. JOHN BREEN, *Vice President,*
Federal Reserve Bank of St. Louis,
Little Rock Branch
Little Rock, Ark.

DEAR JOHN: An emergency now confronts Worthen Bank due to a severe unavailability of funds necessary to meet minimum legitimate loan and commercial bank servicing requirements of the community served by Worthen Bank. The principal cause of this emergency is the unduly restrictive 10% Arkansas usury law.

Under the provisions of Section 201.2(e), Regulation A, Extension of Credit by the Federal Reserve Bank (April 19, 1973), Worthen Bank & Trust Company, N. A., of Little Rock, Arkansas, requests extension of emergency credit. The bank requests additionally that, if considered favorably, the disbursement of funds take place at the earliest feasible time and that the credit be made available for a period of time sufficient to allow a significant easing of the conditions which have brought about the current emergency.

The management of Worthen Bank believes that the Bank has taken timely and prudent steps both to increase the deposits available to the bank and to reduce loan commitments. On March 6, 1973, a Funds Allocation Committee was formed. Since that time the committee has declined loans of $26,631,000 based solely on the unavailability of funds and without regard to the merit of the loan. Other credit tightening measures initiated by the bank have kept undeterminable additional millions of dollars in loan requests from ever reaching the bank's funds allocation and discount committees. Commercial lines of credit, which on March 15, 1973, stood at $112,340,000, have been reduced by 15.2% to $95,290,000 as of August 15, 1973. Similarly, utilization of these commitments during the same period has been reduced by 10.5% from $38,810,000 to $34,734,000. Since early 1973 Worthen Bank has as a rule not made speculative loans, overline loans, or loans to non-customers or existing customers with marginal banking relationships. Borrowers with alternative sources of funds have been requested and in many cases compelled to seek other credit sources or rest their lines with Worthen Bank.

On the deposit gathering side, Worthen Bank is paying the highest interest rates allowed by law for savings instruments of under four years maturity and is paying as high a rate of interest in the over four year category as any other major Arkansas bank. However, bank deposits of several types that would normally flow to Worthen have been diverted to out-of-state financial institutions due to our inability to competitively bid for these funds as caused by Arkansas's unusually restrictive usury law.

An addendum is attached that quantitatively summarizes the funds shortages traceable to the adverse effects of the usury law in Arkansas.

The factors which created the present emergency are still at work and the deficiency of funds needed to meet minimum basic requirements of the community may even increase before normal money conditions return.

In light of the current situation, Worthen Bank cannot continue to meet its community responsibilities without emergency assistance in the amount of a requested $20,000,000 credit extension. Failing this assistance, the bank will have no alternative but to make banking decisions based on an abnormal and largely artificial generated deficiency in funds which will result in severe harm to the community it is chartered to serve.

Sincerely,

EDWARD M. PENICK,
President and Chief Executive Officer.

Addendum

Funds shortages at Worthen Bank as of Sept. 12, 1973 believed to be traceable to the effects of Arkansas' 10 percent usury limit:

Estimated loss of demand deposits of individuals, partnerships, and corporations which have left Worthen for banks in other States able to pay over 10 percent for large time deposits	$5, 000, 000
Estimated loss of time deposits for the above reason, which would also otherwise be in Worthen	7, 000, 000
Estimated loss of time deposits from public agencies that have been placed in noninstitutional investments at higher rates than can be paid by Arkansas banks	2, 000, 000
Loans brought to Worthen by large borrowers with access to national markets at higher rates than our allowable 10 percent. Despite our attempts to eliminate the practice, we estimate a minimum figure of	2, 000, 000
Loan participations which are unsaleable because of the 10 percent maximum rate. Worthen's gross commercial loans of $128,081,000 on Mar. 15, 1973 were reduced to $120,682,000 as of Sept. 12, 1973, as a result of strong restrictive credit measures. This effort was offset, however, by a 24.3 percent (or $8,000,131) reduction in participations sold to other banks. We estimate that at least one-half of that reduction in participations sold was attributable to the difficulties of selling loans with maximum yields of 10 percent. In addition, we are vulnerable to the further eventual loss of a major portion of the $24,867,160 participations currently sold	4, 000, 000
Total	20, 000, 000

FEDERAL RESERVE BANK OF ST. LOUIS,
St. Louis, Mo., July 26, 1974.

Mr. EDWARD M. PENICK,
Chairman and Chief Executive Officer,
Worthen Bank & Trust Company, N.A.,
Worthen Bank Building,
Little Rock, Ark.

DEAR ED: This is a terribly belated response to your letter of July 1, but I still want to tell you how much we enjoyed having you here. Also, all of us appreciated receiving the article from the Arkansas Democrat of June 26. We are well aware of your problem and continue to hope that the situation in general will improve at an early date.

With kindest regards,

Sincerely,

DARRYL R. FRANCIS.

WORTHEN BANK & TRUST CO.,
Little Rock, Ark., June 10, 1974.

Mr. JOHN F. BREEN,
Vice resident and Manager,
Little Rock Branch Federal Reserve Bank of St. Louis,
P. O. Box 1261,
Little Rock, Ark.

DEAR JOHN: This letter is to request of the Federal Reserve Bank a stand-by line of credit in the amount of $10 million to be available over the next six months period under Regulation A as its various provisions apply to Worthen Bank & Trust Company, National Association.

You will remember that in September, 1973, we made an emergency request for a Federal Reserve Bank loan in the amount of $20 million under Section 201.2E of Regulation A. This request was declined, but in declining, you expressed your desire to be kept abreast of our needs. We now feel that current economic developments in our market area have expanded our need for funds to the point where emergency credit is justified.

Worthen Bank has been operating under severely restricted credit policies since March, 1973, and it only has been due to these policies that we have been able to maintain our funds position as well as we have. We are currently experiencing a rapid decline in our deposit base, however, and we are unable to find support from correspondent banks (either big city or country banks) to assist us in handling the very basic credit requirements of this market area.

The situation in Arkansas is unique among the states due to our Constitutional maximum interest rate of 10% simple interest. This effectively holds our maximum chargeable rate 1½% under the prime rate now existing elsewhere. The usury law also makes it impossible for us to pay a competitive rate for certificates of deposit. This is resulting in a substantial outflow of funds from Arkansas to adjoining states where rates are currently above 10% on certificates of deposit. Coupled with the reduction in correspondent bank balances due to the country banker utilizing his funds in out of state participations and in the Fed funds market at 11% and 11½%, this has caused a critical situation among the major banks of Arkansas. Without relief from the Federal Reserve we will be forced to rely on dangerously high levels of Fed funds purchased or a complete shutdown in the lending activities throughout our market area. (See Enclosure II.)

We hoped to avoid the necessity of applying for this credit by severely restricting lending activities and we have been reasonably successful in this effort until the last several weeks. Our success has been due to several factors:

1. Stricter rationing of credit through the operation of a Funds Allocation Committee. This has been particularly effective in curtailing commercial loans. We were able to reduce gross commercial loans from $128.1 million on March 15, 1973, to a level of $123.0 million on May 1, 1974—the approximate duration of the operation of our Funds Allocation Committee.
2. Strong requests to our national lines of credit that they "rest" their borrowings at Worthen.
3. Near cessation of real estate lending except to honor existing commitments.
4. Accelerated efforts to sell loan participations.

5. Reduction of line of credit commitments. Since March 15, 1973, we have reduced our commercial line of credit commitments from $112,340,000.00 to $100,580,000.00 on May 1, 1974. This represents a reduction of 10.05% in the face of expanding needs by our customers.

6. Stricter credit requirements. We have established stricter credit requirements in the consumer lending area and eliminated dealers in the FHA home repair loan, small appliance loan and automobile loan categories.

During the past several weeks certain indicators point toward the probability of a more rapidly deteriorating liquidity position for Worthen Bank. (See Enclosure 2.) First, we are having considerable difficulty in obtaining new certificates of deposit of $100,000 or more, and we are finding it virtually impossible to renew maturing ones. Although we are paying the maximum rate we can reasonably pay in Arkansas, we are not competitive with the major money center banks who are paying well over 10% for such certificates. As a result Worthen Bank had a net outflow of $3 million in these funds during May. Similar experiences are occurring throughout the state.

Second, "Due to Banks" and "Participations Sold" are decreasing at a rapid rate due to normal seasonal factors as funds from downstream correspondent banks are diverted to agricultural uses. However, the magnitude of this reduction is being abnormally exaggerated due to attractive earnings rates available to correspondents wishing to (1) enter the Federal funds market, (2) purchase participations from non-Arkansas banks at rates in excess of the 10% permitted by our state law. (See Enclosure 3.)

We are reluctant to extrapolate the current adverse trends except to anticipate a more difficult position through September, 1974. (See Enclosures 4 and 5 for historical and current deposit trends.) The period of June, July, and August is historically the lowest deposit period due to the seasonal factors relative to our agricultural market. The recent devastating tornadoes and floods in Arkansas will require additional outlays of funds to assist those damaged communities in rebuilding.

The only other possible relief would be a change in the 10% simple interest usury provision of the Arkansas Constitution. The earliest time this could be accomplished is the legislative session of January, 1975, assuming that the current effort to amend the Constitution is successful in the November, 1974, general election. If successful, this action will come too late to avoid serious economic consequences in our community. (See Enclosure 6.)

Our request for Federal Reserve credit is not intended in any way to avoid the normal difficulties to be encountered by any aggressive bank in dealing with the effects of current Federal Reserve monetary policies. Rather it is an expression of our concern that (1) the community we serve will experience serious economic difficulty if we restrict the credit activities of this bank even further, and (2) the best way to prevent the economic collapse of our market is for the major banks to be able to continue to supply the credits essential for the basic business needs of our market.

Yours very truly,

EDWARD M. PENICK,
Chairman and Chief Executive Officer.

ENCLOSURE 1

TABLE I.—NET FEDERAL FUNDS PURCHASED[1]

[Dollar amounts in thousands—Weekly Averages for Weeks Ending as Indicated]

	Net Federal funds purchased	Loan/deposit ratio (percent)
Feb. 6, 1974	$2,089	73.6
Feb. 13, 1974	3,896	74.5
Feb. 20, 1974	1,024	74.6
Feb. 27, 1974	535	74.5
Mar. 6, 1974	5,057	74.7
Mar. 13, 1974	5,548	74.8
Mar. 20, 1974	8,912	73.8
Mar. 27, 1974	6,549	75.2
Apr. 3, 1974	11,215	73.8
Apr. 10, 1974	15,109	74.4
Apr. 17, 1974	4,916	71.2
Apr. 24, 1974	4,145	72.1
May 1, 1974	9,217	73.2
May 8, 1974	20,714	73.5
May 15, 1974	7,327	73.1
May 22, 1974	8,339	74.1
May 29, 1974	18,172	78.1

[1] Includes direct borrowings from the Federal Reserve Bank—a broader definition than commonly made.

ENCLOSURE 2

TABLE II.—DEPOSITS

[In thousands of dollars—weekly averages for weeks ending as indicated]

	Savings and other time deposits	Certificates of deposit, $100,000 or more	Demand deposits	Total deposits
Feb. 6, 1974	$89,465	$51,635	$138,495	$279,595
Feb. 13, 1974	89,497	53,174	133,902	276,573
Feb. 20, 1974	89,829	54,332	133,797	277,958
Feb. 27, 1974	90,235	55,517	131,717	277,469
Mar. 6, 1974	90,543	55,565	136,053	282,161
Mar. 13, 1974	90,273	54,779	132,064	277,116
Mar. 20, 1974	90,229	55,855	134,986	281,070
Mar. 27, 1974	91,357	55,395	137,243	283,995
Apr. 3, 1974	92,332	54,682	140,256	287,270
Apr. 10, 1974	92,717	54,951	139,304	286,972
Apr. 17, 1974	92,461	54,288	148,672	295,421
Apr. 24, 1974	92,017	54,844	147,196	294,057
May 1, 1974	91,857	55,093	143,107	290,151
May 8, 1974	92,434	54,622	141,784	288,840
May 15, 1974	92,473	54,318	143,102	289,893
May 22, 1974	92,421	53,818	141,322	287,561
May 29, 1974	92,280	52,229	134,483	278,992

ENCLOSURE 3

TABLE III.—DUE TO BANKS AND PARTICIPATIONS SOLD

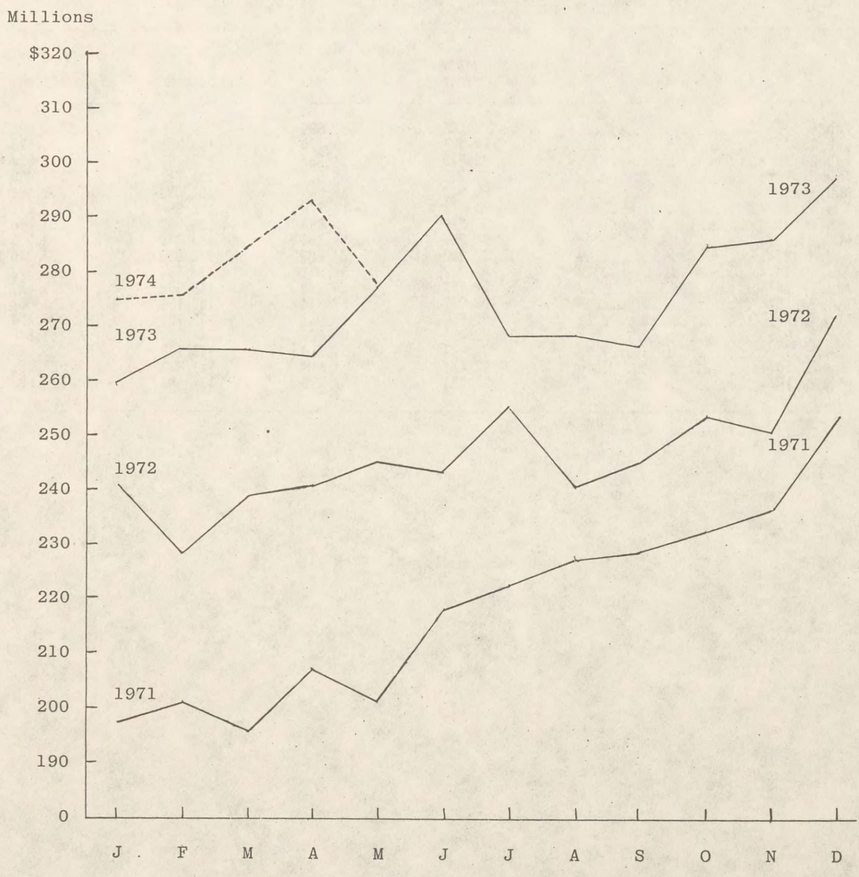
[In thousands of dollars—weekly averages for weeks ending as indicated]

	Due to banks[1]	Participations sold
Feb. 6, 1974	$34,030	$42,323
Feb. 13, 1974	31,630	42,332
Feb. 20, 1974	28,665	42,375
Feb. 27, 1974	28,207	41,992
Mar. 6, 1974	31,798	42,035
Mar. 13, 1974	32,523	42,011
Mar. 20, 1974	28,781	40,802
Mar. 27, 1974	30,273	40,423
Apr 3, 1974	32,771	40,160
Apr. 10, 1974	31,584	42,665
Apr. 17, 1974	30,831	44,082
Apr 24, 1974	30,959	44,116
May 1, 1974	28,331	44,126
May 8, 1974	29,672	42,936
May 15, 1974	27,716	41,591
May 22, 1974	28,842	40,211
May 29, 1974	25,267	39,296

[1] Average for week ending 2 days after the indicated dates.

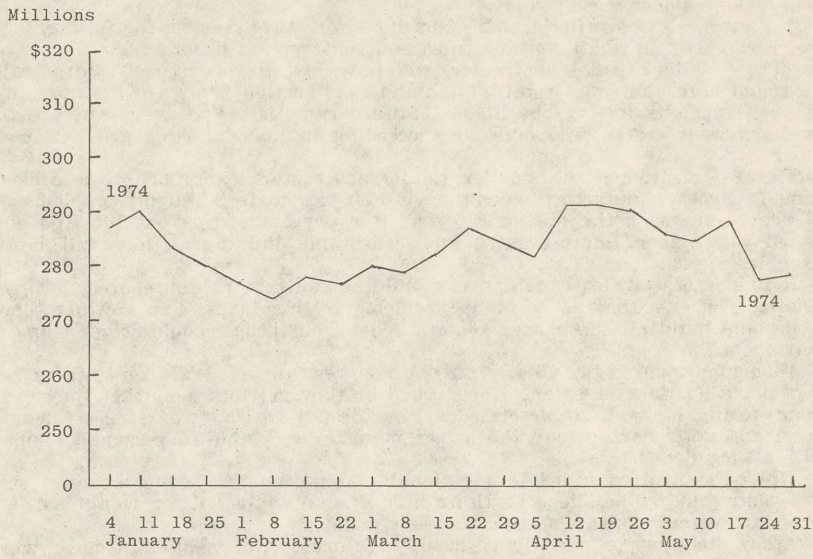
Enclosure 4
Worthen Bank & Trust Company, N.A.

CHART I
1971-1974 TOTAL DEPOSITS
AT END OF MONTH



Enclosure 5
Worthen Bank & Trust Company, N.A.

CHART II
1974 TOTAL DEPOSITS



ENCLOSURE 6

[From the Arkansas Democrat, Sunday, June 9, 1974.]

Insolvency Hitting Larger Businesses, 14 in State Failed in First 4 Months of 1974

Historically, commercial and industrial failures are more common among smaller concerns.

The past 12 to 18 months have begun to emphasis that larger businesses are experiencing the sting of insolvency and liquidation. This trend is showing up in Arkansas and the United States as a whole.

However, regionally, Arkansas consistently since 1969 has had a lower failure rate per 10,000 firms listed with Dun & Bradstreet than Texas, Oklahoma, Louisiana and Mississippi. In 1972 Texas had 58.0 failures per thousand, the highest of any of the five states, and Arkansas had 13.0 per thousand, the lowest.

Bill Waldron, credit reporting manager of Dun & Bradstreet's Little Rock office, said:

"This year, as far as total numbers (of business failures) compared to last year are concerned, it's down a little. But, we've had some larger ones. The whole state is doing well (in terms of industrial growth).

"Of course, there are always rumors that there are supposed to be more. There are some companies getting on shaky ground, but I don't see any increase (in failures) for this year."

The first four months of 1974 have seen 14 business failures in Arkansas. This is an average of .875 per week, though not enough time has passed for this to be an indication of the final year-end weekly average.

The average liability of failed businesses in Arkansas has been $213,200 so far. In 1973, with a weekly average of .769 failures, there was a $460,000 average liability figure. During the last two months of 1973, two major concerns liquidated, pushing up that average.

A recent Dun & Bradstreet report indicated that, nationally, businesses failing with liabilities of $100,000 or more have increased during the first quarter of 1974, compared to the first quarter of 1973. The number of national failures was reported down.

"The first three months of last year were really bad," Waldron said. "Everybody kept saying retail sales were up and a bunch of people opened little shops. The business just wasn't there."

Enterprises discovering a lack of business, or other reasons for failing, have been primarily in retail clothing sales and construction firms.

"There's a lot of small contractors who have just disappeared," Waldron said. "Around here, the small retail stores and construction firms are the ones that have been going lately. The highest failure rate that I've ever seen are the western wear stores. The odds of succeeding in that business are extremely low."

He also mentioned the smaller retail carpet stores approaching a difficult time if carpet manufacturers don't solve their raw material supply problems.

"There are so many businesses, that if everything turns out like it's supposed to (higher interest rates and continuing inflation), they will be in trouble," he said.

Rising interest rates caught many building contractors unprepared, he said, adding: "They're having so many problems getting loans. For a while there, you could build all the houses you wanted to, but people couldn't get loans to buy them."

Mismanagement is the villain in most business failures, Waldron believes.

"People let themselves get over-stocked or they get into a market they can't compete in," he said. He described a Pine Bluff firm that was successful on a local and state basis where the owner manager was able to personally supervise all the details.

When the firm extended into regional and national markets, however, the one man couldn't handle everything himself and could not, or would not, get adequate managerial assistance. He went under.

"They just got in over their head," Waldron said. "That's usually what happens to most of them—they get more than they can handle."

Judge Arnold M. Adams, who presides over the federal bankruptcy court in Little Rock, said: "This year, until June 1, we had more big bankruptcies than in the last three of four years. There's not any substantial increase in the numbers. It's the size."

Judge Adams considers the larger bankruptcy filings to be $300,000 and up.

For the first four months of this year, as compared to 1973, Judge Adams said the only difference in Arkansas has been a large increase in large business filings: "I think in the past they would have held on, or tried to. But hold on and get into what?" he asks?

Judge Adams believes the economic situation—with high interest and inflation, the effort to keep a business afloat and to borrow the necessary capital to keep going—makes people much less inclined to ride out hard times.

Claud Rankin, sales manager for Daniel Construction Co. of Arkansas, said inflation is "tearing us up" adding:

"Inflation and shortages both. Steel items have doubled in prices. Prices are climbing every day. It's getting tough. We normally work with industrial clients and construction right now is booming."

No major construction firms have failed in Arkansas, according to Dun & Bradstreet. It's the smaller firms that are dropping out in that particular business. Manufacturers have been hardest hit in Arkansas. Nationally, failures among manufacturers are up.

Transportation has been pointed out as one industry experiencing difficulty. In Arkansas, Maurice L. Britt, regional administrator of the Small Business Administration in Little Rock, said SBA here has had "some difficulty in the trucking industry—in the loans we've made to truckers. My guess is that they're over the hump now—if they don't encounter any more gasoline or fuel shortages," he said.

Britt explained that since the SBA was dealing with "marginal type loans, naturally our figures are higher than others," concerning business failure. The SBA helps finance businesses that have difficulty getting capital loans from commercial institutions.

"Right now, right after this energy crisis, and tight money in Arkansas, our delinquencies have increased somewhat," Britt said. "The figure is right now running 6.4 per cent. It's higher than it was last year. Next month it may be down a little bit or up a little bit, its hard to say."

The causes of the increased delinquencies with the State are "hard to put your finger on," Britt said but attributed it to the general business condition. The energy crisis has really hit service stations, camp grouns and other small businesses, he said.

"The other thing, I would think," he said, would be the higher interest rates. If the interest rate stays up it will dry up lending in Arkansas." The reliance of Arkansas businesses on out-of-state loans is putting them in a bind. It's really going to curtail business if it continues for any length of time."

Britt, a former lieutenant-governor, would not single out a line of business that's failing more than others.

"The Arkansas business activity doesn't act like the nation, usually," he pointed out. "We react a little slower than in the east and west."

Statement of Andrew J. Biemiller, Director, Department of Legislation American Federation of Labor and Congress of Industrial Organizations

The American Federation of Labor and Congress of Industrial Organizations has grave concerns with regard to S. 3817, which is under consideration by your Committee and wishes to make known its position on this bill.

The legislation proposed in S. 3817 would allow national chartered banks, savings and loan associations and state banks whose accounts are insured by Federal agencies to charge interest rates of up to 5% more than the Federal Reserve's discount rate on commercial loans and on loans of $100,000 or more. Such Federal legislation would supersede state usury laws which frequently establish statutory interest rate ceilings for loans of these types which are below the maximum rate that would be allowed pursuant to the proposed legislation. At this time, for example, with a Federal Reserve discount rate of 8%, the ceiing pursuant to S. 3817 would be 13%. That is 3% above the 10% usury limit in Arkansas, for example, and also above the applicable usury limit in many other states.

There would be several probable effects of this legislation.

(1) Interest rates on commercial loans, or on loans of $100,000 or more for other purposes, that are made by local and regional financial institutions during tight money periods would probably be higher than currently. When loanable funds are in short supply, usury laws tend to hold down the interest rates that are charged. If banks were permitted to operate under a 13% limit instead of, as in Arkansas, under a 10% limit, the rates at a time such as the present would probably be closer to 13% than 10%. Many moderate and large size businesses that might borrow for inventory or plant expansion would have to pay higher interest rates. Such higher interest rates become part of the cost of the production of goods and services, and would be passed on to consumers in the prices that they are charged. The higher interest rates would thus have an inflationary impact.

(2) Money for residential mortgage loans and small businesses would become even scarcer than it has been in tight money periods. The provisions of S. 3817 would not be applicable directly to home mortgage loans or business loans of under $100,000. Indirectly, however, the bill would contribute to the scarcity of such loan funds as lending institutions could obtain interest rates up to 13% on large business loans. The limited supply of available funds would flow to large borrowers who could pay the higher interest rates. This process would dry up to the supply of funds for home mortgage loans and small business.

The excess of the ceiling interest rate permitted under the bill over effective yields on FHA-insured home mortgage loans is shown in the attached table for prior years and recent months. In earlier years, the ceiling rate permitted under the bill generally would have been two to three percentage points above the yield on FHA-insured mortgage loans, and currently it would be three to four percentage points higher.

(3) Since lending institutions could charge higher interest rates they would tend to make high risk loans on which the borrowers agreed to pay the higher rates.

The Franklin National Bank and a number of other banks, in their eagerness to obtain high yields, have made speculative investments which placed them in a dangerously weak position. Consequently, there has been a notable shakiness in the financial structure of the country. It is undesirable to create a statutory framework that would encourage depository institutions to engage in highly speculative ventures with other people's money.

In addition to the foregoing undesirable effects that could flow from the provisions of the proposed bill, there is a question of how much profit lending institutions have to make in their operations. The banking business has been highly profitable with current interest rates. In the second quarter of this year, major banks had year-to-year increases of 16 to 32% in profits after taxes. To permit them to charge 5% more than the interest rates that they have to pay to borrow from the Federal Reserve Banks would assure them of an extraordinarily high rate of profit.

Furthermore, the 5 point spread between the 8% discount rate and the 13% rate that could be charged would be an enticing opportunity for many banks. It would encourage credit expansion to support questionable enterprises, increasing inflationary pressures in the process.

The Federally chartered or insured savings and loan associations are paying savers between 5% and 7½% on their deposits. To allow them to charge 1% interest rates on the loans that they make would permit them to obtain a spread of between 5½ and 8 percentage points above their cost of money. Savings and loan associations can operate adequately on a spread of 1½ to 2 percentage points between the cost of money to them and the interest rate charged on loans.

For the foregoing reasons, the AFL–CIO strongly opposes the enactment of S. 3817.

COMPARISON OF FEDERAL RESERVE DISCOUNT RATE PLUS 5 PERCENT AND FHA HOME MORTGAGE YIELD

Year or month	Federal Reserve discount rate	Federal Reserve discount rate plus 5 percent	FHA new home mortgage yields	Difference between discount rate plus 5 percent and FHA mortgage yield
1950	1.59	6.59	4.17	+2.42
1951	1.75	6.75	4.21	+2.54
1952	1.75	6.75	4.29	+2.46
1953	1.99	6.99	4.61	+2.38
1954	1.60	6.60	4.62	+1.98
1955	1.89	6.89	4.64	+2.25
1956	2.77	7.77	4.79	+2.98
1957	3.12	8.12	5.42	+2.70
1958	2.15	7.15	5.49	+1.66
1959	3.36	8.36	5.71	+2.65
1960	3.53	8.53	6.18	+2.35
1961	3.00	8.00	5.80	+2.20
1962	3.00	8.00	5.61	+2.39
1963	3.23	8.23	5.47	+2.76
1964	3.55	8.55	5.45	+3.10
1965	4.04	9.04	5.46	+3.58
1966	4.50	9.50	6.29	+3.21
1967	4.19	9.19	6.55	+2.64
1968	5.17	10.17	7.13	+3.04
1969	5.87	10.87	8.19	+2.68
1970	5.95	10.95	9.05	+1.90
1971	4.88	9.88	7.78	+2.10
1972	4.50	9.50	7.53	+1.97
1973	6.44	11.44	8.08	+3.36
1974:				
January	7.5	12.5	(1)	----------------
February	7.5	12.5	8.54	+3.96
March	7.5	12.5	8.66	+3.84
April	7.5	12.5	9.17	+3.33
May	8.0	13.0	9.46	+3.54
June	8.0	13.0	9.46	+3.54

1 Not available.

Sources:
(1) 1950–73 data from "Economic Report of the President" (Feb. 1974), Table C–58, p. 317.
(2) 1974 FHA new home mortgage yield: "Federal Reserve Bulletin" (July 1974).
(3) 1974 Federal Reserve discount rate data: "Federal Reserve Bulletin" (July 1974), chart entitled "Current Rates on Loans to Member Banks."

THE ROBERT MORRIS ASSOCIATES,
PHILADELPHIA NATIONAL BANK BUILDING,
Philadelphia, Pa., August 9, 1974.

Hon. THOMAS J. MCINTYRE,
Chairman, Subcommittee on Financial Institutions,
U.S. Senate, Washington, D.C.

DEAR SENATOR MCINTYRE: I am writing you as president of the Robert Morris Associates, the National Association of Bank Loan and Credit Officers, to voice our support for S. 3817, the bill introduced by Senator Brock and others to amend the National Bank Act, the Federal Deposit Insurance Act, the National Housing Act, and for other purposes.

We believe that it is vital to both the economies of the states directly affected by this legislation and business borrowers within these states that this legislation be enacted by the Congress at this time. While we share the feeling of the sponsors of this bill that ideally the states should determine their own legal framework within which business as well as other lending and borrowing transpire, the urgency for relieving the adverse situation facing business borrowers in these states, calls for action, in this case, at the Federal level.

We understand that S. 3817 has been amended in Committee to make its provisions apply to all business borrowings of $25,000 and over. We support these modifications and are pleased that the Banking Committee has acted favorably on this legislation. We would now urge the Senate to pass the bill and do all in its power to speed its passage through the Congress to avoid the further penalizing of business borrowers in states where usury limits now preclude borrowing in the current economic environment.

We appreciate your considering these views and would also appreciate their inclusion in the public record. Thank you very much.

Sincerely,

NORMAN J. COLLINS.

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